

## Foreign Investment in China has entered into the Fast Track – Interpretation of the New Implementing Regulations of the Foreign Investment Law of the People’s Republic of China (“PRC”)

On December 31, 2019, the *Implementing Regulations of the Foreign Investment Law of the People’s Republic of China* (the “**Regulation**”), an important administrative regulation facilitating the implementation of the *Foreign Investment Law of the People’s Republic of China* (“Foreign Investment Law”), was officially published. It came into force on January 1, 2020, together with the *Foreign Investment Law*. This article provides an interpretation of the main contents of the Regulation, the major changes made from the *Implementing Regulations of the Foreign Investment Law (Draft)* (the “**Draft**”)<sup>1</sup> published by the Ministry of Justice on November 1, 2019, and legal issues related to the Regulation. It will then end with a discussion regarding the practical issues that may need further clarification and resolution from the legislature or other supervisory authorities.

### I. Interpretation of the Regulation’s Main Contents

Consistent with the *Foreign Investment Law*<sup>2</sup>, the Regulation comprises 6 chapters (**General**

**Provisions, Investment Promotion, Investment Protection, Investment Administration, Legal Liability and Supplementary Provisions**) and 49 articles in total. Many amendments were made as compared to the Draft which comprised of 5 chapters and 45 articles, in which nearly all of the articles in the Draft were involved.

We believe that attention should be paid on the following issues mentioned in the Regulations:

- Abolishing of the approval or filing requirements for the establishment or change of foreign-invested enterprises
- Compulsory publication for the governmental rules governing foreign investment
- Enhanced protection of intellectual property (“IP”) and trade secrets of foreign-invested enterprises
- Requirements for government commitments
- Compensation and remedies for the expropriation of foreign investment
- Chinese natural persons as qualified investors of foreign-invested enterprises or new construction projects
- Limitation on the establishment of

<sup>1</sup> Please refer to the below website of the Ministry of Justice for the full text of the *Implementing Regulations of the Foreign Investment Law (Draft)*:

[http://www.moj.gov.cn/news/content/2019-11/01/zlk\\_3235065.html](http://www.moj.gov.cn/news/content/2019-11/01/zlk_3235065.html)

<sup>2</sup> For the introduction of the main content and the highlights of the Foreign Investment Law, and the impact on the existing foreign-invested enterprises, please refer to JunHe Legal Commentary dated March 15, 2019: “Grand Unification” Era of China’s Administration on Foreign Investment – A Brief Commentary on the New Foreign Investment Law (Yu ZHENG).

foreign-invested partnerships in areas included in the negative list

- Obligation of information reporting and penalties for violations
- Transition period for existing foreign-invested enterprises
- “Penetrating Administration” for the domestic reinvestment of foreign-invested enterprises
- Allowed application by reference for investment from Hong Kong, Macau, Taiwan, and Overseas Chinese
- Resolution of conflicts between the *Foreign Investment Law* and the Regulation with other regulations on foreign investment
- No exception for the administration of “round-trip” investment
- Ambiguity on the administration of Variable Interest Entities (“VIE”)

### 1. Abolishing of the Approval or Filing Requirements for the Establishment or Change of Foreign-Invested Enterprises

Since *the Law on Sino-Foreign Equity Joint Ventures* came into force in 1979, the **approval system** has been the standard used in Chinese foreign investment procedures. This was governed successively by the Commission of Foreign Investment Management, the Ministry of Foreign Economics and Trade, the Ministry of Foreign Trade and Economic Cooperation, and the Ministry of Commerce. This system was later changed to an **approval and filing system** governed by the Ministry of Commerce, that is, the establishment and change of foreign-invested enterprises in the area included in the negative

list shall be subject to approval, while the filing system would apply to the establishment and change of foreign-invested enterprises in the area beyond the negative list. However, with the implementation of *the Foreign Investment Law* and the Regulation from January 1, 2020, and the simultaneous repeal of *the Law on Sino-Foreign Equity Joint Ventures*, *the Law on Sino-Foreign Cooperative Joint Ventures* and *the Law on Wholly Foreign Owned Enterprises* (collectively, the “**FIE Laws**”), **the approval system and the filing system** regarding the establishment and change of the foreign-invested enterprises **steps down simultaneously from the historical stage**.

According to the Regulation, the registration of foreign-invested enterprises shall now be governed by the **market regulation authority** in the State Council or authorized counterparts in local governments (Article 37). The Regulation prohibits competent authorities from approving registrations, accepting registrations or proceeding with other related matters in case the foreign investment within the negative list is not in compliance with the requirements specified in the negative list (Article 34). Thus, the market regulation authority is required also to review whether the business scope of the applying foreign-invested enterprise is included in the negative list and whether the relevant requirements are satisfied.

This can be seen as a simplification of the procedure for the establishment and change of foreign-invested enterprises that had been implemented for a long time as it combines the approval/filing stage in the commerce authority and the registration in the market regulation authority (the former administration for industry and commerce). The Regulation has thus created a “**One-stop**” **approval/registration process** in

the market regulation authority, which significantly shortens the procedures for the establishment and change of foreign-invested enterprises, increases the efficiency of administrative procedures, and reduces the burden of the investors and enterprises. Such simplification is a significantly positive change after forty years of managing foreign-invested enterprises in China and represents a crucial measure for the development of foreign investment in China.

## 2. Compulsory Publication for the Governmental Rules Governing Foreign Investment

In terms of the management of foreign investment, it should be noted that there are also plenty of **governmental regulatory documents** promulgated by the government in addition to the laws, administrative regulations, department rules, local regulations, and local government rules. The Regulation clarifies that **governmental regulatory documents that are not published in accordance with the relevant laws** shall not be used as the basis of public administration. Moreover, **the period between the publishing and implementation of the regulatory documents** that are closely related to the production and operation activities of foreign-invested enterprises **shall be determined reasonably** based on the reality (Article 7). Such provisions are important to improve the transparency and practicality of foreign investment management.

In accordance with the regulations of the State Council, the Regulation also requires a **legality review**<sup>3</sup> to be conducted for the regulatory

<sup>3</sup> Existing regulations regarding the legality review of the governmental regulatory documents include *the Notice of the General Office of the State Council on Strengthening the Development and Supervisory Administration of Administrative Regulatory Documents* (No. Guo Ban Fa (2018) 37) published by

documents related to foreign investment promulgated by local governments and their relevant departments (Article 26).

## 3. Enhanced Protection of IP and Trade Secrets of Foreign-invested Enterprises

### ● IP

According to Article 22 of *the Foreign Investment Law*, the State has a duty to protect the IP rights of foreign investors and foreign-invested enterprises, the lawful rights and interests of IP right holders and relevant right holders thereof, and strictly hold those who infringe upon the IP rights of others legally accountable. The Regulation clearly requires that the State **reinforces punishment for the infringement of IP rights and constantly strengthens the protection of IP rights** (Article 23).

The punitive damages system was introduced in China when *the Trademark Law* was revised in 2013. Under this system, punitive damages of up to 3 times the actual damages (the minimum being the actual damages received) may be granted in case of gross violations. However, this maximum was later revised to up to 5 times the actual damages when *The Trademark Law* was amended in November 2019. Similarly, in the draft amendment of *the Patent Law* that was published in February 2019, the statutory limitation of the damages in the current *Patent Law* was increased to CNY5,000,000 from the previous limitation of CNY1,000,000.<sup>4</sup> This issue

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the General Office of the State Council on May 2018 and *the Guiding Opinions of the General Office of the State Council on Comprehensively Implementing of the Legality Review Mechanism for Administrative Regulatory Documents* ( No. Guo Ban Fa (2018) 115) published by the General Office of the State Council on December 2018, which provide, from a national level, comprehensive and systematic provisions regarding the subject, scope, process, duties, responsibilities, etc. of the legality review for Administrative Regulatory Documents.

<sup>4</sup> Certain parts are excerpted from *the Letter of Reply regarding the No. 0345 (No. 21 in the category of politics and laws) Resolution in*

of punitive damages will also be a key concern in the *Copyright Law* which has been listed in the legislative plan of the Standing Committee of the thirteenth session of National People's Congress and currently has its draft amendment being studied by the relevant parties.

- **Trade Secrets**

The Regulation requires that state administrations take the following specific measures to **protect trade secrets of foreign investors and foreign-invested enterprises**: (1) strictly limit the scope of materials and information related to trade secrets that are required by administrative agencies; (2) prohibit those that are not involved to access such materials and information that are related to trade secrets; (3) where information is shared with other administrative agencies, confidential treatment should be given for trade secrets to prevent leakage of such information (Article 25).

We understand that the aforementioned provisions regarding the responsibilities of state administrations to protect trade secrets of foreign investors and foreign-invested enterprises are consistent with the last section of Article 9 of the new *Anti-Unfair Competition Law* that was amended on April 23, 2019. Particularly, this is in regard to the prohibition of infringement of trade secrets by the business operator as well as **other natural persons, legal persons, and unincorporated organizations** other than a business operator.<sup>5</sup>

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*the Second Session of the 13th CPPCC National Committee* published by the State Intellectual Property Office dated August 2, 2019.

<sup>5</sup> Article 9 of the *Anti-Unfair Competition Law*: "A business operator shall not commit the following acts of infringement on trade secrets: (1) acquiring a trade secret from the obligee by theft, bribery, fraud, coercion, electronic intrusion, or any other illicit means; (2) disclosing, using, or allowing another person to use the trade secret acquired from the obligee by any means as specified in the

#### 4. Requirements for Government Commitments

- **The Form of the Government Commitments**

According to Article 25 of the *Foreign Investment Law*, *local governments at all levels and their relevant departments shall honor their **policy commitments** (made in accordance with the law) to foreign investors and foreign-invested enterprises and perform the contracts entered into therewith in accordance with the law.*

The Regulation further clarifies the definition of the aforementioned "*policy commitments*", that is, "*the **written commitments** made by local governments at all levels and their relevant departments within their **statutory authority** concerning the **supportive policies, preferential treatment, and facilitating conditions** that apply to foreign investors and foreign-invested enterprises who invest in the local area. The content of such commitments shall comply with law and regulations*" (Article 27).

- **The Validity and Enforceability of Government Commitments**

In the past, foreign investors and foreign-invested enterprises have in practice signed investment agreements involving preferential investment treatment with local governments in China. The validity and enforceability of government commitments within these agreements have

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preceding subparagraph; (3) disclosing, using, or allowing another person to use a trade secret in its possession, in violation of its confidentiality obligation or the requirements of the obligee for keeping the trade secret confidential; (4) abetting a person, tempting, or aiding a person into or in acquiring, disclosing, using, or allowing another person to use the trade secret of the obligee in violation of his or her non-disclosure obligation or the requirements of the obligee for keeping the trade secret confidential. An illegal act as set forth in the preceding paragraph committed by a natural person, legal person or unincorporated organization other than a business operator shall be treated as an infringement of the trade secret."

always been a controversial issue. Today, the aforementioned provisions in the Regulation provide foreign investors and foreign-invested enterprises with more comfort as there will no longer be any concern regarding the validity of government commitments that comply with the laws and regulations in said investment agreements.

In addition, *the Provisions of the Supreme People's Court on Several Issues Concerning the Trial of Administrative Agreement Cases* that came into force on January 1, 2020, further clarifies the enforceability of the investment agreements which are administrative agreements. According to this judicial interpretation, the court should support the claim if the investor(s) argues that the government agency has failed to fulfill its responsibilities and thus is required to compensate for the losses, or pay liquidated damages or the deposit according to the investment agreement.<sup>6</sup> However, it should also be noted that according to this judicial interpretation, arbitration clauses that are included in the administrative agreement are deemed to be invalid, unless otherwise provided by laws, administrative regulations, or the international treaties concluded or acceded to by China. Thus, foreign investors or foreign-invested enterprises are advised to avoid using arbitration as a form of dispute resolution for the investment agreement executed with governments regarding

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<sup>6</sup> Article 19 of *the Provisions of the Supreme People's Court on Several Issues Concerning the Trial of Administrative Agreement Cases*: Where a defendant fails to perform the administrative agreement in accordance with the law or as agreed, the people's court may, in accordance with Article 78 of the Administrative Litigation Law, in light of the claims of plaintiff, adjudge the defendant to continue performance and specify the specific content of the continued performance; if performance by the defendant is impossible, or continuing performance is without practical significance, the people's court may adjudge the defendant to take corresponding remedial measures; and if loss is caused to the plaintiff, the defendant shall be adjudged to pay compensation. If the plaintiff requests compensation in accordance with the agreed liquidated damages clause or deposit clause, the people's court shall support the claim.

preferential treatment measures.<sup>7</sup>

## 5. Compensation and Remedies for the Expropriation of Foreign Investment

Article 20 of *the Foreign Investment Law* establishes the principle that fair and reasonable compensation should be provided in a timely manner for the expropriation of foreign investors' investment if it is conducted for the public interest. The Regulation further clarifies that compensation shall be provided based on **market value**. Moreover, remedies available to foreign investors who disagree with the expropriation decision are also provided in the Regulation, i.e. **applying for administrative reconsideration** or **launching administrative litigation** (Article 21).

## 6. Chinese Natural Persons as Qualified Investors of Foreign-Invested Enterprises or New Construction Projects

The Regulation clarifies that the investors of **foreign-invested enterprises** or **foreign-invested new construction projects** may include **Chinese natural persons** (Article 3). This resolves the controversy that has been around since the promulgation of the *Foreign Investment Law* of whether a Chinese natural person can be the shareholder of a new Sino-Foreign Equity Joint Venture or the partner of the new Sino-foreign partnership.

## 7. Limitation on the Establishment of Foreign-invested Partnership in Areas Included in the Negative List

The Draft used to require that the proportion of

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<sup>7</sup> Article 26, *The Provisions of the Supreme People's Court on Several Issues Concerning the Trial of Administrative Agreement Cases*: Where an administrative agreement contains an arbitration clause, the people's court shall confirm the nullity of the clause, except as otherwise provided by the laws, administrative regulations, or international treaties concluded and acceded to by China.

voting rights held by foreign investors as agreed in the partnership agreement shall be in compliance with the restrictions on the shareholding percentage as prescribed by the *Foreign Investment Access Negative List*. However, this provision was deleted in the final version of the Regulation. This could mean that the regulations in the current *Foreign Investment Access Negative List* (including the negative lists applicable in and outside the Pilot Free Trade Zones) **prohibiting the establishment of foreign-invested partnerships** in areas with the **restrictions on the shareholding percentage** will continue to apply.

## 8. Obligation of Information Reporting and Penalties for Violations

Pursuant to the Regulation, (1) foreign investors or foreign-invested enterprises are required to report their investment information to the commerce authority through the **Enterprises Registration System** and the **Enterprises Credit Information Publicity System** (Article 38); (2) **content, scope, frequency** and **detailed procedures** of the information reporting for foreign investments shall be determined and published by the commerce authority of the State Council together with the market regulation authority of the State Council and other competent authorities based on the principle of **necessity, efficiency** and **convenience** (Article 39); (3) investment information reported by foreign investors or foreign-invested enterprises are required to be **true, accurate** and **complete** (Article 39).

On December 31, 2019, the Ministry of Commerce and the State Administration for Market Regulation jointly published the *Measures for the Reporting of Foreign Investment Information* (Ministry of Commerce and State

Administration for Market Regulation 2019 Decree No. 2) (the “**Measures of Information Reporting**”). According to this measures, information reports shall include the following types: **Initial Reports, Change Reports, Dissolution Reports** and **Annual Reports**<sup>8</sup>, among which:

- **Initial Reports** should include **basic information of the enterprise, information of investors and actual controllers, information of investment transactions** amongst other information;
- **Annual Reports** should include **basic information of the enterprise, information of investors and actual controllers, information of the enterprise’s operation, assets and debts of the enterprise,** and information relating to **relevant industrial licenses** (if included in the negative list).

In addition, it is also worth noting that the Measures of Information Reporting explicitly mention that foreign investors investing in financial industries such as **banking, securities** and **insurance** in China are also required to report information to the commerce authority.

Pursuant to the Measures of Information Reporting, in the case of a violation of the information reporting obligation, the commerce authority shall order the obligor to **rectify the issue within 20 business days; if rectification is not made in time, a penalty of between CNY100,000 and CNY300,000 shall be imposed;** if rectification is not made in time and

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<sup>8</sup> The format and content of such information reports can be referred to in Attachment 1 (Foreign Investment Initial and Amendment Report) and Attachment 2 (Foreign Investment Annual Report) of the *Announcement on Certain Matters related to the Reporting of Foreign Investment Information* (Ministry of Commerce 2019 Decree No. 62) issued by the Ministry of Commerce on December 31, 2019.

the obligor carries out the following serious violations: evasion of reporting obligations, concealment of the truth, provision of misleading or false information, provision of wrong information related to the negative list, the investor(s) or the actual controller(s), or carries out a second violation within two years after the last penalty, etc., **a penalty of between CNY300,000 and CNY500,000 shall be imposed**. The above penalties are a further refinement of the administrative penalties for violations of information reporting obligations under Article 37 of the *Foreign Investment Law*.

#### **9. Transition Period for Existing Foreign-Invested Enterprises**

Existing foreign-invested enterprises (formed before January 1, 2020) can adjust their **organizational structure and organs** and apply for registration of change pursuant to the *Company Law*, *Partnership Law* or other laws **within 5 years** after the *Foreign Investment Law* comes into effect. As of **January 1, 2025**, the market regulation authority **will not handle other registrations for the existing foreign-invested enterprises** and will publicize such enterprises if they have not made the required changes to the organizational structure and organs and apply for registration of change.

It should be noted that **the agreements such as the transfer of the shares or equity interests, the distribution of income and residual assets** that the existing joint-venture partners have agreed in the contracts can still be applied after the organizational structures and organs of the existing foreign-invested enterprises have been adjusted (Article 46). This provision can better resolve the effectiveness of such contractual arrangements that are related to the core business interests of the partners but are also in

conflict with the provisions of the *Company Law* in the equity or cooperative joint venture contracts concluded under the FIE Laws. Such arrangements can include that the transfer of shares in an equity joint-venture enterprise shall be subject to the unanimous consent of all other investors, or that the foreign investor can recover its investment in advance in a Sino-foreign cooperative joint venture enterprise. This would effectively avoid possible disputes when reopening the negotiation of core business interests of investors to meet the transition period adjustment requirements, thus maintaining the stability of the transaction.

#### **10. “Penetrating Administration” for the Domestic Reinvestment of Foreign-Invested Enterprises**

Pursuant to the Regulation, the **domestic investment** of foreign-invested enterprises shall be governed by the relevant provisions in the *Foreign Investment Law* and the Regulation (Article 47).

This makes it clear that China implements a system of **“penetrating administration”** on foreign investment, meaning that no matter how many layers of companies that a foreign investor has set up in China, the direct and indirect investment of this foreign investor shall always be administrated as a foreign investment. This approach is consistent with the definition of “foreign investment” in Article 2 of the *Foreign Investment Law*, which refers to “any investment activity **directly** or **indirectly** carried out by foreign natural persons, enterprises or other organizations (“foreign investors”) within the territory of China”.

Under the framework of the FIE Laws, with the exception of those falling under the scope of

prohibited or restricted industries in *the Catalogue of Industries for Guiding Foreign Investment* or the negative list, reinvested enterprises by foreign-invested enterprises are normally regulated as domestic enterprises. Therefore, the “penetrating administration” system established by the *Foreign Investment Law* and the Regulation is definitely an important development for the administration of foreign investment in China.

#### **11. Allowed Application by Reference for Investment from Hong Kong, Macau, Taiwan and Overseas Chinese**

Pursuant to the Regulation, investments made in mainland China by investors from the Special Administrative Region of **Hong Kong and Macau** and by **Chinese citizens residing overseas** shall apply the *Foreign Investment Law* and the Regulation by reference. However, laws, administrative regulations or the State Council provisions that regulate otherwise shall prevail. Besides that, investments made in mainland China by investors from **Taiwan** shall be governed by the *Law on the Protection of Investment by Taiwanese Compatriots* and relevant implementing regulations. Where there is no applicable regulation for certain areas, the *Foreign Investment Law* and the Regulation shall apply by reference (Article 48).

Compared to the regulation that the FIE laws shall be applied by reference on the investment made in mainland China by investors from Hong Kong, Macau, Taiwan and by Chinese citizens living overseas, the Regulation contains the following notable change:

- **Chinese Citizens Residing Overseas**

Both of the *Implementation Regulations for the*

*Law on Sino-foreign Cooperative Joint Venture Enterprises and Implementation Regulations for the Law on Wholly Foreign Owned Enterprises* regulate that enterprises that have been invested in mainland China by Chinese citizens living overseas shall be governed by reference. However, “**Chinese citizens living overseas**” is not a defined legal concept and so this wording was changed in the Regulation to “**Chinese citizens residing overseas**”, specifying that investments made by such persons in mainland China shall also be governed by the *Foreign Investment Law* and Regulation by reference.

According to the *Regulation on Determination of the Identification of Overseas Chinese, Expatriate Chinese and Returned Overseas Chinese* (Guo Qiao Fa [2009] No. 5) issued by the Overseas Chinese Affairs Office of the State Council on April 24, 2009, the term **Overseas Chinese** refers to **Chinese citizens residing overseas**. Therefore we understand the term “Chinese citizens residing overseas” mentioned in the Regulation refer to “Overseas Chinese”, meaning that the definition of Overseas Chinese can be used to determine whether someone is a Chinese citizen residing overseas. The above regulation of the Overseas Chinese Affairs Office has set up the following criteria in determining whether someone is an Overseas Chinese:

( 1 ) “Residing” refers to a Chinese citizen who has obtained a long-term or permanent residency in his country of residence, and has been living in that country for two continuous years for a total of at least 18 months;

( 2 ) A Chinese citizen is considered an Overseas Chinese if, even without a long-term or permanent residency of his country of residence, he has obtained a lawful residency of his country

of residence for 5 or more continuous years, during which he has resided in such country for at least 30 months in total;

( 3 ) Chinese citizens who stay abroad for study (including government-funded and self-funded) or business (including dispatched personnel) shall not be regarded as Overseas Chinese during their study or business periods.

We understand that after the *Foreign Investment Law* and the Regulation come into effect, the approval of the establishment of wholly-owned enterprises or equity or cooperative joint-venture enterprises by Overseas Chinese in mainland China as set forth in the *Regulations on Encouragement of Investments from Overseas Chinese and Hong Kong and Macao Compatriots* (State Council Decree No. 64) that was issued by the State Council and came into force on August 19, 1990, shall no longer be enforced.

#### ● Investors from Taiwan

Both the *Detailed Rules for the Implementation of the Law on Chinese-Foreign Cooperative Joint Ventures* and *Detailed Rules for the Implementation of the Law on Wholly Foreign Owned Enterprises* require that such rules shall be applied to the establishment of enterprises in mainland China by Taiwan investors by reference. However, the Regulation requires investments made by Taiwan investors in mainland China to be governed by the *Law on the Protection of Investments by Taiwan Compatriots*<sup>9</sup> and its relevant implementing regulations. The *Foreign Investment Law* and the Regulation shall be applied should there be no applicable regulation

<sup>9</sup> *Law on the Protection of Investments by Taiwan Compatriots* came into force on March 5, 1994, and was amended respectively on September 3, 2016, and December 28, 2019. The most up-to-date *Law on the Protection of Investments by Taiwan Compatriots* came into force on January 1, 2020.

found in the above law and regulations.

To ensure that Taiwan compatriots also enjoy the benefits of the foreign investment system reform as well as to further encourage and promote the investment of Taiwan compatriots, and link the existing and new laws pursuant to the principle and spirits of the *Foreign Investment Law*, the fifteenth meeting of the Standing Committee of the thirteenth session of the National People's Congress approved the relevant amendment to the *Law on the Protection of Investments by Taiwan Compatriots* on December 28, 2019. The amended version of the *Law on the Protection of Investments by Taiwan Compatriots* comes into force on January 1, 2020.

The amendment mainly focuses on the following two aspects: (1) to delete provisions in Articles 8 and 14 which are related to the approval and filing of Taiwan invested enterprises, and to adjust the wording of Article 9 accordingly; and (2) to amend the investment type of Taiwan investors in section 1 of Article 7. In this article, the investment of Taiwan investors used to be divided into equity joint-venture enterprises, cooperative joint-venture enterprises, and enterprises wholly-owned by Taiwan investors. However, the newly revised section 1 reads "Taiwan investors may establish enterprises wholly or partly owned by Taiwan investors or invest in other forms that are permitted by laws, administrative regulations or the State Council"<sup>10</sup>.

#### 12. Resolution of Conflicts between the Foreign Investment Law and the Regulation with other Regulations on Foreign Investment

<sup>10</sup> Website of Central People's Government ([http://www.gov.cn/xinwen/2019-12/23/content\\_5463359.htm](http://www.gov.cn/xinwen/2019-12/23/content_5463359.htm)): "Draft of Amendment to the Law on the Protection of Investments by Taiwan Compatriots is submitted to the Standing Committee of the National People's Congress for Approval" (December 23, 2019)

The **consistent treatment principle on domestic and foreign investment** in areas outside the *Foreign Investment Access Negative List* as established by Article 28 of the *Foreign Investment Law* is seen as a major reform of China's foreign investment administration system. However, it also causes several conflicts with FIE Laws requiring special administration for foreign investment. To ensure the effective application of the *Foreign Investment Law*, the Regulation specifies that **in the case of any inconsistency between foreign investment regulations made before January 1, 2020, with the *Foreign Investments Law* and the Regulation, the *Foreign Investment Law* and the Regulation shall prevail** (Article 49). This is pursuant to the principle that “upper law shall prevail over lower law and newer law shall prevail over older law”.

Therefore, under the unified supervision of the State Council, Ministry of Commerce, Development and Reform Commission and Ministry of Justice are now organizing the local governments and authorities to promptly and comprehensively sort out the existing foreign investment-related regulations. Any regulations, rules or regulatory documents that are inconsistent with the *Foreign Investment Law* will be abolished or amended<sup>11</sup>.

### **13. No Exception for the Administration of “Round-trip” Investment**

In the Draft, a wholly-owned enterprise formed outside China by a Chinese natural person, legal person or any other organization (excluding

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<sup>11</sup> Information Source: “Press Conference Convened by Charging Person of the Ministry of Justice, Ministry of Commerce and Development and Reform Commission on the Regulation on the Implementation of the Foreign Investment Law of the People's Republic of China” published on the website of the Ministry of Justices (<http://www.moj.gov.cn/>) on December 31, 2019

foreign-invested enterprises) that makes an investment within China would not be subject to the restrictions of special access administrative measures as prescribed in the *Foreign Investment Access Negative List* upon examination by the competent department of the State Council and approval by the State Council. However, this clause was deleted in the final version of the Regulation. We understand that it indicates that **the “round-trip” investment made by wholly or partly owned or holding enterprises established by Chinese investors outside China shall still be regulated as a foreign investment by the negative list and other regulations under the framework of the *Foreign Investment Law*.**

### **14. Ambiguous Administration of Variable Interest Entities (“VIE”)**

The Regulation does not mention the regulation on VIE which remain a big concern for the industry and market practitioners. We understand that the legislature and supervisory authorities may choose not to clearly regulate VIE in the Regulation considering the historical and complex nature of the VIE issue as well as the possible impact on the market if any administrative principle or attitude towards VIE is clarified.

However it is still worth noting the definition of “foreign investment” in Article 2 of the *Foreign Investment Law*, i.e. “for the purpose of this law, Foreign Investment means any investment activity **directly or indirectly** carried out by foreign natural persons, enterprises or other organizations (“foreign investors”) within the territory of China, including...(ii) Foreign investors acquiring shares, equity interests, shares of property or **other similar interest** in enterprises in mainland China;...”. According to this definition, investments made by foreign investors through

VIE can theoretically be covered under the scope of “foreign investment”. Therefore, there might be a possibility that VIE may be clearly admitted into the scope of administration based on the definition of Foreign Investment in the *Foreign Investment Law*, and that the principles and methods regulating different types of VIE (such as VIE actually controlled by foreign investors or Chinese investors) will also be clarified when the legislature and the supervisory authorities see fit.

## II. Major Differences with the Draft

As stated above, the final version of the Regulation possesses quite a few changes as compared to the Draft, suggesting that the final version of the Regulation has been determined based on a variety of opinions from the public. As compared to the Draft, the Regulation has added the following new contents:

- Inquiries, doubts, and complaints concerning government procurement (Article 16);
- Compensation of state expropriation according to market value and possible administrative reconsideration or administrative lawsuit against an expropriation decision (Article 21);
- Possibility of using RMB or foreign currency for the registered capital of foreign-invested enterprises (Article 37);

- “Legal Liability” of the government or any of its staff members in violation of the Regulation (Articles 41, 42 and 43);
- Inclusion of reinvestment of foreign-invested enterprises within China under the jurisdiction of the *Foreign Investment Law* (Article 47);
- Resolution of conflicts between the *Foreign Investment Law* and the Regulation with other foreign investment regulations (Article 49).

Meanwhile, the final version of the Regulation also deleted the following contents from the Draft:

- Interpretation of “new construction projects” (former Article 4);
- Conditions to establish partnerships in certain fields of the negative list with restrictions on the shareholding ratio (former Article 34);
- Exemptions from the restrictions of the negative list for “round-trip” investment made by overseas enterprises wholly owned by Chinese investors upon approval by the State Council (former Article 35).

The following table provides in more detail the important changes that were made in the Regulation as compared to the Draft:

	The Draft	The Regulation	Comments
<b>General Provisions</b>	<p>[New Construction Projects]</p> <p>Article 4: <b>For the purpose of Article 2 (2) (3) of the Foreign Investment Law, investing in new construction projects in China shall mean that a foreign investor invests in the construction of a specific project in China without establishing any foreign-invested enterprise and without obtaining any share, equity, property share or any other similar rights and interests in an enterprise in China.</b></p>	N/A	The final version of the Regulation has completely deleted the interpretation of “new construction projects”. Thus, we understand that the definition of “new construction projects” may be subject to clarification made by the legislature in subsequent supportive regulations.
<b>Investments Promotion</b>	<p>[Regulatory Documents regarding the Administration of Foreign Investments]</p> <p>Article 10: When drafting laws, regulations, rules and regulatory documents related to foreign investments, the government and its relevant departments shall, as applicable, seek comments from foreign-invested enterprises and foreign chambers of commerce by inviting written comments, convening seminars and</p>	<p>[Regulatory Documents regarding the Administration of Foreign Investments]</p> <p>Article 7: When administrative regulations, rules and regulatory documents relating to foreign investment are developed, or when governments and their relevant departments draft laws and local regulations relating to foreign investment, they shall, according to actual circumstances,</p>	The final version of the Regulation has mainly added that the time period between the issuing and implementation of regulatory documents shall be determined reasonably.

	The Draft	The Regulation	Comments
	<p>demonstrating meetings. With regard to comments and recommendations that have been frequently offered or those on issues involving the material rights and obligations of foreign-invested enterprises, feedbacks on the adoption of such comments and recommendations shall be given by appropriate means.</p> <p>Regulatory documents concerning foreign investment shall be published in a timely manner in accordance with the law, and those that have not been published shall not be cited as the basis for administration.</p>	<p>solicit the comments and recommendations of foreign-invested enterprises and the relevant chambers of commerce, associations and other parties in multiples forms such as soliciting written opinions and holding symposiums, demonstration meetings and hearings. With regard to comments and recommendations that have been frequently offered or those on issues involving the material rights and obligations of foreign-funded enterprises, feedbacks on the adoption of such comments and recommendations shall be given by appropriate means.</p> <p>Regulatory documents concerning foreign investment shall be published in a timely manner in accordance with the law, and those that have not been published shall not be cited as the basis for administration. <b>For regulatory documents closely related to the production and</b></p>	

	The Draft	The Regulation	Comments
		<p><b>operation of foreign-invested enterprises, the time between the issuance and implementation thereof shall be rationally determined in light of the actual circumstances.</b></p>	
	<p>[Formulation of the Standards]</p> <p>Article 15: Foreign-invested enterprises can equally participate, in accordance with the law, in the formulation of State standards, industry standards, local standards, and group standards, and no entity or individual may illegally restrict such participation by foreign-invested enterprises.</p> <p>Foreign-invested enterprises may submit proposals for setting compulsory State standards to the standardization administration of the State Council and may offer comments and recommendations in the course of drafting of standards, technical review, giving feedback on the implementation of</p>	<p>[Formulation of the Standards]</p> <p>Article 13: Foreign-invested enterprises can equally participate, in accordance with the law, in setting and revising State standards, industry standards, local standards, and group standards with domestic enterprises.</p> <p><b>Foreign-invested enterprises may, based on their needs, make industry standards through their own initiative or jointly with other enterprises.</b></p> <p>A foreign-invested enterprise may <b>propose to</b> the administrative department in charge of standard-setting and the other relevant administrative departments <b>for setting a standard</b> and may</p>	<p>The final version of the Regulation has mainly added the following contents: (1) foreign-invested enterprises may formulate standards on its own or jointly with other enterprises; (2) the proposal raised by foreign-invested enterprises for standards-setting is not limited to compulsory State standards; (3) requirements of information disclosure regarding the standardization work conducted by administrative agencies have been added.</p>

	The Draft	The Regulation	Comments
	<p>standards, and may engage in relevant works according to relevant regulations.</p> <p>Foreign-invested enterprises may participate in the translation of standards into foreign languages.</p>	<p>offer comments and recommendations in the course of initiating the formulation of and drafting standards, technical review, giving feedback on the implementation of standards, and assessment, among others, and may undertake the work on the drafting of standards and technical review as well as the foreign language translation of standards according to the relevant provisions.</p> <p><b>The standardization administrative department and relevant administrative departments shall establish and improve the relevant working mechanism, make the formulation and revision of standards more transparent, and promote the whole-process information disclosure for the formulation and revision of standards.</b></p>	
	N/A	<p>[Questions and Complaints regarding Government Procurement]</p> <p>Article 16: <b>A</b></p>	<p>The final version of the Regulation has clarified the remedies that may be applicable to foreign-invested enterprises for illegal</p>

	The Draft	The Regulation	Comments
		<p><b>foreign-invested enterprise may, in accordance with the Government Procurement Law of the People’s Republic of China (the ‘Government Procurement Law’) and its implementation regulations, inquire into or question the purchaser or its agency regarding a government procurement matter and then lodge a complaint with the department supervising the government procurement. The purchaser, its agency, or the department supervising the government procurement shall provide a response or make a decision within the stated time period.</b></p>	<p>acts during the process of government procurement.</p>
	<p>[Investment Promotion and Facilitating Policies]</p> <p>Article 20: Local governments at and above the county level may, according to the actual conditions of their respective region and their respective needs, promote foreign investment,</p>	<p>[Investment Promotion and Facilitating Policies]</p> <p>Article 19: Local governments above the county level may, in accordance with the laws, administrative regulations, and local regulations and within their delegated authority,</p>	<p>The final version of the Regulation has elaborated on specific content regarding foreign investment promotion and facilitation policies, such as the <i>abatement of fees, the guarantee of land-use quotas, and</i></p>

	The Draft	The Regulation	Comments
	<p>formulate targeted policies regarding foreign investment promotion and facilitation within their respective statutory authority.</p> <p>The formulation of policies regarding foreign investment promotion and facilitation made by local governments at and above the county level shall be in compliance with the laws, administrative regulations and local regulations, and be oriented to promote high-quality development, and adhere to the principles of contributing to the improvement of economic, social and ecological benefits.</p>	<p>take policy measures to promote and facilitate foreign investment, such as the <b>abatement of fees, the guarantee of land-use quotas, and the provision of public services</b>.</p> <p>The policy measures purported to promote and facilitate foreign investment taken by the local people's governments above the county level shall be oriented to promote high quality development, shall be beneficial for improving economic, social, and ecological benefits, and for optimizing the foreign investment environment.</p>	<p><i>the provision of public services.</i></p>
<b>Investment Protection</b>	<p>[National Expropriation and Requisition]</p> <p>Article 22: The State shall not expropriate the investment of foreign investors. The special circumstances under which the investment made by foreign investors need to be expropriated or <b>requisitioned</b> for the public interest shall be clearly stipulated by law, and the investments of foreign investors shall not be expropriated or</p>	<p>[National Expropriation]</p> <p>Article 21: The State shall not expropriate the investment of foreign investors.</p> <p>Under special circumstances, the State may <b>expropriate</b> the investment made by foreign investors for the public interest in accordance with the laws, and such expropriation shall be conducted according to</p>	<p>The final version of the Regulation has deleted the circumstance of 'requisition' and adds certain critical principals for national expropriation: compliance of statutory procedures, non-discriminatory manner, and compensation based on market value. Besides, remedies available to foreign investors who disagree with the expropriation decision</p>

	The Draft	The Regulation	Comments
	<p>requisitioned according to any basis other than the law. Where the investment of a foreign investor is expropriated or requisitioned in accordance with the law, the foreign investor shall be given fair and reasonable compensation in a timely manner.</p>	<p><b>statutory procedures</b> and in a <b>non-discriminatory</b> manner. In addition, foreign investors shall be promptly compensated based on the <b>market value</b> of the expropriated investment.</p> <p><b>A foreign investor who has objections to a decision on expropriation may apply for administrative reconsideration or launch an administrative lawsuit pursuant to the laws.</b></p>	<p>are clarified, that is, applying administrative reconsideration or launching administrative litigation.</p>
	<p>[Subject of Obligations regarding the Prohibition of Forced Technology Transfer]</p> <p>Article 25: Administrative agencies and their staff members shall not, directly or indirectly, force foreign investors and foreign-invested enterprises to transfer technologies by virtue of conducting registration, approval, filing or administrative licensing of investment projects, implementing supervision and inspection, imposing administrative</p>	<p>[Subject of Obligations regarding the Prohibition of Forced Technology Transfer]</p> <p>Article 24: Administrative agencies (<b>including organizations that are authorized by laws and regulations to perform public affairs administration functions</b>, hereinafter the same) and their staff members shall not, directly or indirectly, force foreign investors and foreign-invested enterprises to transfer</p>	<p>The final version of the Regulation has expanded the subjects who are prohibited from directly or indirectly forcing foreign investors and foreign-invested enterprises to transfer technologies from administrative agencies to organizations that are authorized by laws and regulations, to perform public affairs administration functions.</p>

	The Draft	The Regulation	Comments
	<p>punishments, or taking administrative enforcement or other actions of performing administrative duties.</p>	<p>technologies by virtue of implementing administrative licensing, conducting administrative inspections, imposing administrative punishments, or undertaking administrative enforcement or other administrative actions.</p>	
	<p>[Prohibition on Violation of Government Commitments]</p> <p>Article 29: Local governments at all levels and their relevant departments shall fulfill the policy commitments made to, and perform the various types of contracts concluded with, foreign investors and foreign-invested enterprises pursuant to the law. They shall not unilaterally alter policy commitments or contractual agreements unless the national interests or public interests are at stake, nor shall they violate or breach any contract on the grounds of an administrative area adjustment, re-election, organizational or functional change or a</p>	<p>[Prohibition on Violation of Government Commitments]</p> <p>Article 28: Local governments at all levels and their relevant departments shall fulfill the policy commitments made to, and perform the various types of contracts concluded with, foreign investors and foreign-invested enterprises pursuant to the law. They shall not violate or breach any contract on the ground of administrative area adjustment, re-election, organizational or functional adjustments or a change of the head of a governing body.</p> <p><b>Where the commitment on policies or contracts needs to be changed as required for social</b></p>	<p>The final version of the Regulation has emphasized that the change of government commitments must be conducted based on statutory authority and legal procedures, and fair and reasonable compensation shall be provided to foreign investors and foreign-invested enterprises in a timely manner for any loss resulting from such a change.</p>

	The Draft	The Regulation	Comments
	change to the head of a governing body.	<b>public interests, it shall be done in accordance with the statutory authority and legal procedures, and the damage thus suffered by a foreign investor or a foreign-invested enterprise shall be fairly and reasonably compensated in a timely manner.</b>	
<b>Investment Administration</b>	<p>[Limitations in the Negative List]</p> <p>Article 34: Investments made by foreign investors in an area with restrictions in a <i>Foreign Investment Access Negative List</i> shall comply with the restrictive requirements regarding shareholding percentages, senior executives and other aspects prescribed in the negative list.</p> <p><b>In a case whereby foreign investors establish a partnership in an area with restrictions on shareholding percentages as prescribed in the <i>Foreign Investment Access Negative List</i>, the proportion of voting rights held by foreign investors as agreed in</b></p>	<p>[Limitations in the Negative List]</p> <p>Article 33:</p> <p>Foreign investors shall not invest in the prohibited area in the negative list. For those areas with restrictions as prescribed by the negative list, investments made by foreign investors shall comply with the requirements on shareholding percentages, senior executives, and other restrictive special administrative measures.</p>	The final version of the Regulation has deleted the requirements that need to be satisfied for the establishment of a foreign-invested partnership in the area with restrictions on the shareholding percentage in the negative list.

	The Draft	The Regulation	Comments
	<p><b>the partnership agreement shall be in compliance with the restrictions on shareholding percentages prescribed by the negative list.</b></p>		
	<p>[Exception of “Round-trip Investment</p> <p>Article 35: <b>Where a wholly-owned enterprise which are formed outside China by a Chinese national, legal person or any other organization makes an investment within China, upon examination by the competent department of the State Council and approval by the State Council, it will not be subject to restrictions by the special access administrative measures prescribed in the <i>Foreign Investment Access Negative List</i>. Legal persons or other organizations as</b></p>	<p>N/A</p>	<p>The final version of the Regulation has deleted the exception that the “round-trip” investment can be exempted from the special administrative measures in the negative list.</p>

	<p><b>mentioned in the preceding paragraph exclude foreign-invested enterprises.</b></p>		
	<p>[Registration of Foreign-invested enterprises]</p> <p>Article 38: At the time of registration of a foreign-invested enterprise in accordance with the law, the market regulatory department shall examine whether the foreign-invested enterprise complies with the restrictive requirements on the shareholding ratio, senior executives and other aspects prescribed in the <i>Foreign Investment Access Negative List</i>, if the relevant department has already conducted an examination of the foregoing during the relevant formalities in accordance with the law, the market regulatory</p>	<p>[Registration of Foreign-invested enterprises]</p> <p>Article 37: The registration of a foreign-invested enterprise shall be legally handled by the market regulatory department of the State Council or the authorized local market regulatory department. The market regulatory department of the State Council shall publish the list of market regulatory departments authorized by it.</p> <p><b>The registered capital of foreign-invested enterprises may be denominated in RMB, or in a freely convertible foreign currency.</b></p>	<p>The final version of the Regulation has mainly added the content that the registered capital of a foreign-invested enterprise can be denominated in RMB or a foreign currency.</p>

	department will not repeat the examination.		
<b>Legal Liability</b>	N/A	<p>[Legal liability of the government and its staff]</p> <p>Article 41: <b>The government, the relevant department or any of its staff members in any of the following circumstances shall be held liable in accordance with the laws and regulations:</b></p> <p><b>(1) making or implementing a policy which does not equally treat foreign-invested enterprises and domestic enterprises in compliance with the law;</b></p> <p><b>(2) illegally restricting foreign-invested enterprises from equally participating in standard setting and review, or imposing a technology requirement on foreign-invested</b></p>	<p>In the Draft, there is no legal liability imposed on the government and its staff in the case of a violation of the <i>Foreign Investment Law</i> or the Regulation, but those three articles were added in the final version of the Regulation, and this will help to supervise the government and its staff to strictly perform their obligations under the <i>Foreign Investment Law</i> or the Regulation.</p>

		<p>enterprises which is higher than the mandatory standard;</p> <p>(3) illegally restricting foreign investors from remitting funds inbound or outbound;</p> <p>(4) failure to honor a commitment on policies made in accordance with the law to a foreign investor or foreign-invested enterprise or failure to perform the various contracts legally entered into therewith, making a commitment on policies in exceeding its duly delegated authority, or making a commitment on policies, the content of which does not comply with the law or administrative regulations.</p> <p>Article 42: Any purchaser or procurement agency</p>	
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		<p>engaged in government procurement that treat any foreign-invested enterprise differently or discriminately with unreasonable terms shall be subject to legal liability in accordance with the provisions of the Government Procurement Law and the regulations on its implementation; if the bidding or trading result is affected or may be affected, the matter shall be handled in accordance with the provisions of the Government Procurement Law and the regulations on its implementation.</p> <p>Where the government procurement regulatory department fails to handle the complaint of any</p>	
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		<p>foreign-invested enterprise within the prescribed time limit, disciplinary action shall be taken against the directly responsible person in charge and other directly liable persons according to the law.</p> <p>Article 43: Where the administrative agency or any of its staff members force or otherwise compel any foreign investor or foreign-invested enterprise to transfer technology by administrative means, disciplinary action shall be taken against the directly responsible person in charge and other directly liable persons according to the law.</p>	
<b>Supplementary Provisions</b>	[Transition Period] Article 42: For a foreign-invested enterprise formed in	[Transition Period] Article 44: Foreign-invested enterprises formed in	The final version of the Regulation has deleted the provision that within the five year transition

	<p>accordance with the <i>Law of the People's Republic of China on Sino-foreign Equity Joint Ventures, the Law on Wholly Foreign Owned Enterprises</i> and the <i>Law of the People's Republic of China on Sino-foreign Cooperative Joint Ventures</i> before the <i>Foreign Investment Law</i> comes into force (hereinafter referred to as the 'existing foreign-invested enterprises'), if the organization form or organs, among others, fails to comply with the compulsory provisions of the <i>Company Law of the People's Republic of China, the Partnership Enterprise Law of the People's Republic of China, or any other law,</i></p> <p><b>the State encourages such enterprises to undergo a registration of change in accordance with the law within five</b></p>	<p>accordance with the <i>Law of the People's Republic of China on Sino-foreign Equity Joint Ventures, the Law on Wholly Foreign Owned Enterprises</i> and the <i>Law of the People's Republic of China on Sino-foreign Cooperative Joint Ventures</i> before the <i>Foreign Investment Law</i> comes into force (hereinafter referred to as the "existing foreign-invested enterprises") may, within five years after the <i>Foreign Investment Law</i> comes into force, adjust their organization form or organs, among others, in accordance with the provisions of the <i>Company Law of the People's Republic of China, the Partnership Enterprise Law of the People's Republic of China, or any other law,</i> and undergo registration</p>	<p>period 'the State encourages' such enterprises to undergo registration of change of their organization forms and organs and the additional six month grace period after the expiration of the five year transition period.</p>
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	<p><b>years after the <i>Foreign Investment Law</i> comes into force.</b></p> <p>Where the existing foreign-invested enterprise under any circumstance set out in the preceding paragraph, fails to undergo a registration of change in accordance with the law within five years after the <i>Foreign Investment Law</i> comes into force, <b>it shall legally undergo a registration of change within six months from January 1, 2025.</b> If the enterprise fails to legally undergo the registration of change within the prescribed time limit, the enterprise registration authority shall not process other registration matters of the enterprise, and may announce the relevant circumstances in the enterprise information publicity system.</p>	<p>of changes in accordance with the law, or may remain in their original organizational form or organ.</p> <p>Where any existing foreign-invested enterprise fails to adjust its organization form or organ, among others, and undergo registration of change in accordance with the law as of January 1, 2025, the market regulatory department shall not process other registration matters filed by the enterprise, and may announce the relevant circumstances.</p>	
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	<p>The specific measures for undergoing the registration of a change of organization form and organ, among others, by the existing foreign-invested enterprises, shall be developed by the market regulatory department of the State Council in conjunction with the relevant departments of the State Council. The market regulatory department of the State Council shall prepare and disclose to the public the guidelines for handling affairs, and specify the workflow for undergoing a registration of change.</p>		
	<p>[Exception Matters in the Transition Period] Article 43: After the <i>Foreign Investment Law</i> comes into force, the income distribution method, and the method for the distribution of residual assets, among</p>	<p>[Exception Matters in the Transition Period] Article 46: After the organization form or organ, among others, of an existing foreign-invested enterprise is adjusted in accordance with the law,</p>	<p>Besides an income distribution and residual asset distribution, the final version of the Regulation has also added the transfer of shares or other equity interests as one of the matters that can remain</p>

	<p>others, that are agreed in the contract by the equity or cooperative joint-venture parties to the existing foreign-invested enterprises, may continue to apply during the term of the joint venture.</p>	<p>the methods for the <b>transfer of shares or equity interest</b>, the income distribution methods, and the methods for the distribution of residual assets, among others, agreed upon in the contract by the original parties to the equity or cooperative joint venture, may continue to apply.</p>	<p>unchanged in an existing foreign-invested enterprise, during and after the transition period.</p>
	N/A	<p>[Reinvestment of foreign-invested enterprises within China] Article 47: <b>The relevant provisions of the <i>Foreign Investment Law</i> and this Regulation shall apply to investments made by foreign-invested enterprises within China.</b></p>	<p>The final version of the Regulation has specified the applicable law of the reinvestment of foreign-invested enterprises within China</p>
	<p>[Application on Investors from Hong Kong, Macau and Taiwan and Overseas Chinese by reference] Article 44: Unless it is</p>	<p>[Application on Investors from Hong Kong, Macau and Taiwan and Overseas Chinese by reference]</p>	<p>The final draft of the Regulation has changed 'Overseas Chinese' to 'Chinese citizens residing overseas'.</p>

	<p>otherwise provided for by any law, administrative regulation or the State Council, the provisions of the <i>Foreign Investment Law</i> and this Regulation shall apply by reference to investments in the mainland made by investors from the Hong Kong Special Administrative Region and the Macao Special Administrative Region.</p> <p>The <i>Law of the People's Republic of China on the Protection of Investments by Taiwan Compatriots</i> and the <i>Detailed Rules for the Implementation of the Law of the People's Republic of China on the Protection of Investments by Taiwan Compatriots</i> (hereinafter referred to as the 'Law on the Protection of Taiwan Compatriots and the Detailed Rules for the Implementation thereof') shall apply to</p>	<p>Article 48: The <i>Foreign Investment Law</i> and this Regulation shall apply by reference to investments in the mainland made by investors from the Hong Kong Special Administrative Region and the Macao Special Administrative Region; if it is otherwise provided for by any law, administrative regulations or the State Council, such provisions shall apply.</p> <p>The <i>Law of the People's Republic of China on the Protection of Investments by Taiwan Compatriots</i> (hereinafter referred to as the 'Law on the Protection of Taiwan Compatriots') and the detailed rules for the implementation thereof, shall apply to investments made in the mainland by investors from Taiwan. The</p>	<p>According to the <i>Regulation on the Determination of the Identification of Overseas Chinese, Expatriate Chinese and Returned Overseas Chinese</i> (Guo Qiao Fa [2009] No. 5), the two concepts shall have the same meaning. We understand that this change may originate from the concept of 'Chinese citizens residing overseas' used in the <i>Nationality Law</i> in order to maintain consistency of the laws.</p>
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	<p>investments made in mainland China by investors from Taiwan.</p> <p>The <i>Foreign Investment Law</i> and this Regulation shall apply by reference to matters not prescribed in the Law on the Protection of Taiwan Compatriots and the Detailed Rules for the Implementation thereof.</p> <p>The provisions of the <i>Foreign Investment Law</i> and this Regulation shall apply by reference to investments made by <b>Overseas Chinese</b> within China.</p>	<p><i>Foreign Investment Law</i> and this Regulation shall apply by reference to matters not prescribed in the Law on the Protection of Taiwan Compatriots and the detailed rules for the implementation thereof.</p> <p>The provisions of the <i>Foreign Investment Law</i> and this Regulation shall apply by reference to investments made within China by <b>Chinese citizens residing overseas. If it is otherwise provided for by any law, administrative regulation or the State Council, such provisions shall apply.</b></p>	
	<p>[Effectiveness]</p> <p>Article 45: This Regulation shall come into force on January 1, 2020, upon which the <i>Regulation on the Implementation of the Law of the People's</i></p>	<p>[Effectiveness and Settlement of Conflict of Laws]</p> <p>Article 49: This Regulation shall come into effect on January 1, 2020, upon which the</p>	<p>The final version of the Regulation has added the resolution rule for conflicts between the <i>Foreign Investment Law</i> and the Regulation and other foreign investment</p>

	<p><i>Republic of China on Sino-foreign Equity Joint Ventures, the Interim Provisions on the Contract Term of Sino-foreign Equity Joint Ventures, the Detailed Rules for the Implementation of the Law on Wholly Foreign Owned Enterprises and the Detailed Rules for the Implementation of the Law of the People's Republic of China on Sino-foreign Cooperative Joint Ventures shall be repealed.</i></p>	<p><i>Regulation on the Implementation of the Law of the People's Republic of China on Sino-foreign Equity Joint Ventures, the Interim Provisions on the Contract Term of Sino-foreign Equity Joint Ventures, the Detailed Rules for the Implementation of the Law on Wholly Foreign Owned Enterprises and the Detailed Rules for the Implementation of the Law of the People's Republic of China on Sino-foreign Cooperative Joint Ventures shall be repealed.</i></p> <p><b>In the case of any discrepancy between the provisions on foreign investments made before January 1, 2020 and the <i>Foreign Investment Law</i> and this <i>Regulation</i>, the</b></p>	<p>related regulations.</p>
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		<p>provisions of the <i>Foreign Investment Law</i> and this Regulation shall prevail.</p>	
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### III. Issues Regarding the Validity of the Foreign Investment Contract Related to Negative List

The negative list is the most important mechanism established by the *Foreign Investment Law*. Article 36 of the *Foreign Investment Law* prescribes the responsibilities that shall be assumed by foreign investors who violate the restrictive or prohibitive requirements in the negative list, including being ordered to make rectification, dispose of shares, restore to the original state, and confiscation of the illegal gains, etc.<sup>12</sup>

However, neither the *Foreign Investment Law* nor

the Regulation clarifies the issues regarding the validity of the investment contract violating the restrictive or prohibitive requirements in the negative list. On December 26, 2019, *The Interpretation of the Supreme People’s Court on Certain Issues Concerning the Application of the Foreign Investment Law of the People’s Republic of China* (the “**Judicial Interpretation on Foreign Investment Law**”) promulgated by the Supreme People’s Court and coming into force on January 1, 2020 clarifies this issue. As prescribed in the Judicial Interpretation on Foreign Investment Law, the decision on the validity of the investment contract related to the negative list can be different under different situations<sup>13</sup>:

12. Article 36 of the *Foreign Investment Law*: “Where a foreign investor invests in an area listed on the *Foreign Investment Access Negative List* as a prohibited area, competent authorities shall order it to stop investment activities, and dispose of shares or assets, or adopt other necessary measures within a specified period of time to restore it to the status prior to when the investment was made; any illegal gains shall be forfeited. Where a foreign investor’s investment activity is in violation of the special administrative measures on an area listed on the *Foreign Investment Access Negative List* as a restrictive area, competent authorities shall order it to make corrections within a specified period of time and to adopt necessary measures to satisfy the requirements imposed by the special administrative measures; if corrections are not made within the specified period of time, the provisions in the preceding paragraph shall be applied. Where a foreign investor’s investment activity is in violation of the rules provided by the *Foreign Investment Access Negative List*, the foreign investor shall assume, in addition to the consequences as provided in the preceding two paragraphs, the corresponding legal liabilities in accordance with the law.”

13. Article 1 of the *Interpretation on Foreign Investment Law*: “In this Interpretation, an ‘investment contract’ refers to a relevant agreement entered into by a foreign investor, i.e., a foreign natural person, foreign enterprise, or any other foreign organization, when directly or indirectly investing in the territory of China, including a contract for the establishment of a foreign-invested enterprise, a contract for transferring shares of the stock of a joint-stock company, a contract for transferring equity in a limited liability company, a contract for transferring the interests in assets or other like rights and interests, or a contract for establishing a new project, etc.. This Interpretation applies to a contractual dispute arising from acquiring a right or interest by a foreign investor through accepting a gift, partitioning a property, or the merger or separation of enterprises.”

	Investment Area	Violations	Validity of the Investment Contract
1	<b>Beyond</b> the negative list	Not being approved or registered by the competent administrative authorities	Having no influence to the validity of the investment contract
2	Within the negative list	Violating the <b>prohibitive</b> requirements for foreign investment	The investment contract is <b>invalid</b>
3	Within the negative list	Violating the <b>restrictive</b> requirements for foreign investment	The investment contract is <b>invalid</b>
	Investment Area	Violations	Exception
4	Within the negative list	Violating the <b>restrictive</b> requirements for foreign investment	Whereby, <b>before a court makes a final judgment or ruling</b> , the party has taken necessary measures to <b>satisfy the restrictive requirements in the negative list</b> , the court shall uphold a claim made by the party that the investment contract is valid.
5	Within the negative list	Violating the <b>restrictive</b> or <b>prohibitive</b> requirements for foreign investment	Whereby, <b>before a court makes a final judgment or ruling</b> , the negative list has been adjusted so that the area invested by a foreign investor is no longer listed on the negative list as a prohibited or restricted area, the court shall uphold a claim made by a party that the investment contract is valid.

Through the above mechanisms, The Judicial Interpretation on Foreign Investment Law endeavors to ensure the validity of the investment contract and the legal interest of the investors under the premise of maintaining and ensuring

the legal administration of the foreign investment.<sup>14</sup>

#### IV. Adjustment or Repeal of the Relevant

14. A speech made by the Supreme People's Court at a press conference dated December 27, 2019 regarding *the Interpretation on Foreign Investment Law, Opinions regarding "the Belt and Road"*, and *the Opinion regarding the New Area*.

## Department Rules and Regulatory Documents

According to the pre-establishment national treatment established in Articles 4 and 24 of the *Foreign Investment Law*, unless otherwise clearly provided in the **laws** and **administrative regulations**, relevant department rules, local governmental rules, local regulations and other local regulatory documents shall not impose conditions or obligations that are different from those imposed on Chinese investors on foreign investors in establishing foreign-invested enterprises. Given that many department rules and regulatory documents produced before the *Foreign Investment Law* contain special approval conditions and requirements on foreign-invested enterprises, such regulations are all in conflict with the principles of the *Foreign Investment Law*.

According to Article 49 of the Regulation, in case of any discrepancy between the provisions on foreign investment made before January 1, 2020 and the *Foreign Investment Law* and the Regulation, the provisions of the *Foreign Investment Law* and this Regulation shall prevail. We understand that after the *Foreign Investment Law* and the Regulation come into effect, the above rules and regulatory documents shall be

either adjusted or repealed as soon as possible so that foreign investments outside the *Foreign Investment Access Negative List* shall be treated consistently with domestic investments in accordance with the principles set by the *Foreign Investment Law*.

In fact, the Ministry of Commerce has already finished part of the housekeeping work and issued the *Announcement of the Ministry of Commerce on the Repeal of Certain Regulatory Documents* (Ministry of Commerce 2019 Decree No. 59) on December 26, 2019 to repeal 56 regulatory documents related to foreign investment on January 1, 2020. This covers matters such as the terms of Sino-foreign equity joint-venture enterprises, total investment and registered capital of wholly owned foreign-invested enterprises.

Besides the above, we believe that other department rules, including but not limited to the following related to foreign investment administration, will also need to be adjusted or repealed in order to comply with the *Foreign Investment Law* and to provide clear and operational instructions to foreign investors investing in relevant areas:

	Department Rules	Reasons for Adjustment or Repeal
1	<i>Administrative Measures for the Approval and Filing of Foreign-invested Projects (2014 Amendment)</i> of the National Development and Reform Commission	<b>Inconsistent treatment of foreign-invested and domestic enterprises</b>
2	<i>Provisional Regulations of the Ministry of Commerce on Certain Matters in the Establishment of Foreign-invested Joint Stock Companies</i> (issued in 1995 and amended in 2015)	Contains the <b>qualification, lock-up period and minimum shareholding ratio requirements</b> of foreign investors setting joint stock companies in China as promoters; contains restrictions such as requiring foreign-invested limited liability enterprises proposing to transform into joint stock companies to have <b>made a profit over the past three continuous years</b> .
3	<i>Provisions of the Ministry of Commerce on the Establishment of Holding Companies by Foreign Investors</i> (Ministry of Commerce 2015 Decree No. 2)	Contains requirements on the <b>qualification and capital contribution</b> of investors, the <b>business scope</b> of the company and the <b>recognition of regional headquarters</b> of foreign investors and their investment companies
4	<i>Interim Provisions of the Ministry of Commerce on Equity Contributions Involving Foreign-invested Enterprises</i> (Ministry of Commerce 2012 Decree No. 8)	Contains <b>conditions, restrictions, procedures and approval</b> on the equity contributions to foreign-invested enterprises using the <b>shares of domestic companies</b> held by foreign investors
5	<i>Provisions on M&amp;A of a Domestic Enterprise by Foreign Investors</i> by the Ministry of Commerce and five other departments (issued in 2006 and amended in 2009)	Contains the following restrictions on foreign investors acquiring domestic enterprises: (1) domestic enterprises or individuals' acquisition of <b>affiliated companies</b> through controlled overseas companies shall be <b>approved by the Ministry of Commerce</b> (Article 11); (2) <b>if an acquisition will cause a change of the control of a domestic company owning any resound trademark or China's time-honored brands, such an acquisition shall be filed with the Ministry of Commerce</b> (Article 12); (3) <b>foreign investors can only use the shares of qualified overseas listed companies as payment in the acquisition</b> (Section 4), etc.

	Department Rules	Reasons for Adjustment or Repeal
6	<i>Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors</i> issued by the Ministry of Commerce, the China Securities Regulatory Commission and three other departments (issued in 2005 and amended in 2015)	Contains requirements regarding <b>qualification, minimum shareholding ratio, lock-up period, and conditions and procedures of approval</b> on investment by foreign investors in domestic listed companies.
7	<i>Provisions Concerning the Administration of Foreign-invested Start-up Investment Enterprises</i> issued by the former Ministry of Foreign Trade and the Ministry of Science and three other departments(issued in 2003 and amended in 2015)	Contains restrictions on the <b>qualification, contribution ratio, condition of transfer of shares of foreign investors as indispensable investors, when investing in start-up investment companies.</b>

## V. Practical Issues that May Be Further Clarified

The Regulation further clarifies and specifies several issues prescribed by the *Foreign Investment Law* regarding the new mechanisms of foreign investment administration in China. Considering the comprehensive and openness of such new mechanisms, there may be plenty of questions and challenges in the process of implementation, during which progression and further improvement are inevitable. We list below certain practical issues that may need to be further clarified and resolved by the legislature and supervisory authorities after the implementation of the *Foreign Investment Law* and the Regulation.

### 1. Governing Law after the Change of an Investor's Nationality

There are increasing numbers of Chinese citizens migrating overseas. In a case whereby a Chinese citizen acquires foreign nationality and loses his/her Chinese nationality, the question of whether the *Foreign Investment Law* is applicable to the enterprise established by such a person before their change of nationality is not specified in the Regulation. Also, for enterprises established by a foreign person, it is not clear whether the *Foreign Investment Law* is still applicable to such entities after its investor acquires Chinese nationality and renounces his/her foreign nationality. Besides, in a more complicated situation, having a Chinese natural person investor who acquires foreign nationality without deregistering his/her Chinese household register and ID card<sup>15</sup> should also be considered. Thus, we suggest that the legislature and supervisory authorities clarify these issues.

<sup>15</sup>According to Article 9 of *the Nationality Law*, any Chinese citizen who has settled abroad and who has been naturalized as a foreign national or has acquired foreign nationality of his own free will shall automatically lose their Chinese nationality. Thus, Chinese citizens acquiring foreign nationality will not lose their Chinese nationality automatically if such a person has not settled abroad.

## 2. Governing Law for Sino-foreign Partnership Agreements and Investment Agreements for New Construction Projects

Article 126 of the *Contract Law* provides that “parties to a contract with a foreign element may choose the law to be applied in the handling of contractual disputes, except where laws provide otherwise. Where the parties to a contract with a foreign element fail to choose the governing law of the contract, the law of the country with the closest connection to the contract shall be applied.

*Sino-foreign equity joint venture contracts, Sino-foreign cooperative enterprise contracts and Sino-foreign contracts for the cooperative exploitation and development of natural resources which are to be performed within the territory of the People's Republic of China shall be governed by the law of the People's Republic of China.”*

Hence, after the repeal of the FIE Laws, joint venture contracts of Sino-foreign equity joint ventures that are incorporated in accordance with the *Company Law* shall still be governed by Chinese laws. However, in the absence of any rules in the *Contract Law* requiring a partnership agreement of Sino-foreign partnership under the *Partnership Enterprise Law* to be governed by the Chinese law, will the parties to the Sino-foreign partnership agreement be free to choose a foreign governing law, pursuant to the *Contract Law*? This issue is not specified in the Regulation. Besides, the Regulation does not mention the governing law of the investment contract executed between the foreign investor and the Chinese investor for the investment of new construction projects according to Article 2 of the *Foreign Investment Law*.

It is worth noting that, theoretically, the restriction in Article 126 of the *Contract Law* on the choice of law **refers only to a restriction made by laws**, thus neither administrative regulations (such as the Regulation) nor department rules may

formulate provisions that are not in compliance with the *Contract Law*. Therefore, if the legislature wishes to apply the same rule, using the Chinese law as the governing law, to the above two contracts as the Sino-foreign equity joint venture contracts, such an issue may be prescribed in the amendment of the *Contract Law* or the *Civil Code* in the future.

## 3. Whether the Business Operation of Foreign Enterprises within China Belongs to Foreign Investment

According to the definition of foreign investment in Article 2 of the *Foreign Investment Law*, other than foreign investment made in enterprises or new construction projects, foreign investment also includes ‘investment in any other manner as specified by a law or administrative regulation or the State Council’.

According to the *Measures for the Administration of Registration of Enterprises from Foreign Countries (Regions) Engaging in Production and Business within the Territory of China* issued by the State Administration for Industry and Commerce in 1992 and amended in 2016, foreign enterprises shall apply for registration if they are engaging in the following production and business:

- Exploration and exploitation of onshore and offshore oil and other mineral resources ;
- Contract projects for the construction and fit out of houses and civil engineering, or the installation of circuits, pipelines and equipment;
- Operation and management of foreign-invested enterprises by contracts or authorization
- Branches established in China by foreign banks
- Other production and business

permitted by the State.

The Regulation remains mute as to whether the above business operations engaged by foreign enterprises in China belong to ‘foreign investment’ activities and shall further be governed by the *Foreign Investment Law* and the Regulation.

We suggest that the legislature clarifies the foregoing issue and, if such activities are considered as ‘foreign investment’ activities, further provide how such activities can fit into the relevant regulations mainly designed for foreign-invested enterprises, such as national security review and information reporting.

#### 4. Possibility of the Establishment of Foreign Individual Proprietorship

Article 31 of the *Foreign Investment Law* provides that ‘the business forms, structures, and rules of activities of foreign-invested enterprises shall be governed by the *Company Law of the People's Republic of China*, the *Partnership Law of the People's Republic of China*, and other laws.’

Since the *Foreign Investment Law* has **enumerated** the applicable laws of the organization forms and structure of foreign-invested enterprises **in an incomplete way**, theoretically a foreign individual investor shall be able to set up an individual proprietorship pursuant to the *Individual Proprietorship Law*<sup>16</sup>.

However, Article 47 of the current *Individual Proprietorship Law* provides that ‘this law shall not apply to foreign-invested enterprises’. If the purpose of the *Foreign Investment Law* is to establish a national treatment and consistency treatment for foreign investment in areas outside the negative list, foreign individuals shall be allowed to form individual proprietorships in China pursuant to the *Individual Proprietorship Law* just

as Chinese individuals are, and such issues may need further clarification by the legislature in the future.

## VI. Outlook

As mentioned in the press conference regarding the relevant issues of the *Implementing Regulations of the Foreign Investment Law* convened by the principals of the Ministry of Justice, Ministry of Commerce, and the National Development and Reform Commission on December 31, 2019, the *Foreign Investment Law* concludes the practical experience of foreign investment legal pluralism over 40 years of reform and opening up in China. It adapts to the new requirements in the new era, establishes a new basic administration framework for foreign investment in China, and provides a unified rule on the access, promotion, protection, administration and other aspects of foreign investment. It thereby becomes the new fundamental law in respect of foreign investment in China and provides reliable legal guarantees for promoting a higher level of opening up. Thus, formulating and completing the supporting regulations to crystallize the legal system established by the *Foreign Investment Law* is of great significance for ensuring the efficient implementation of the *Foreign Investment Law*.

JunHe has been invited to participate in the legislative work of the *Foreign Investment Law* and the Regulation. Certain suggestions raised by JunHe regarding the formulation of the Regulation are reflected in the Regulation. JunHe will continue to follow the relevant legal and practical issues that may appear during the implementation of the *Foreign Investment Law* and the Regulation, and share our practical experience and research results with legal practitioners.

<sup>16</sup> Article 2 of the *Individual Proprietorship Law* provides that ‘The individual proprietorship enterprise referred to by this Law means a business entity which, in accordance with this Law, is established within China and invested in by one natural person and the property of which is personally owned by the investor who shall assume unlimited liabilities for the debts of the enterprise with his own property.’

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