TOPIC:

ESTABLISHING A LEGAL PRESENCE IN CHINA FOR EDUCATIONAL ACTIVITIES

INTRODUCTION:

In recent years, China has become more open to foreign (non-Chinese) universities wishing to provide programming, both for the foreign universities' own students and Chinese students, in China. Still, doing so is by no means easy because Chinese law significantly limits what a foreign university may do in China [1]. Most significantly, Chinese law provides that “[n]o foreign educational institution, other organization or individual may establish unilaterally schools or other educational institutions providing education mainly to Chinese citizens within the territory of China [2].”

The relevant Chinese law and regulations also can be confusing. Different rules exist for foreign involvement in educational programs, which may be either degree-granting or non-degree granting, and training programs, which may either be vocational or “for-profit [3].” Further, the law does not clearly distinguish between educational programs and training programs. Based on anecdotal evidence, “training” encompasses employee training programs at a minimum and may also include executive education programs [4].

Whatever an “educational program” is, foreign universities may not directly provide such programs, whether degree or non-degree granting, to Chinese citizens in China without a Chinese university acting as a partner [5]. The Chinese government actually encourages foreign universities and Chinese educational institutions to cooperate in providing educational programs, but also carefully regulates the programs [6]. In addition, for practical purposes, a foreign university needs a Chinese partner to provide a “training program” to Chinese citizens in China. For training, however, the partner need not be a Chinese university [7].

With any partner, the foreign university is certain to feel some loss of control over its programming. For example, at least half of the members of the board of directors of a Chinese-foreign cooperatively run school must be Chinese [8]. In addition, partner Chinese universities are likely to insist on being closely involved in designing curriculum and on having their faculty teach. This may not always be desirable. To provide programming in China with maximum flexibility and control, a foreign university may wish to consider establishing a permanent legal entity in China. While establishing such an entity may not eliminate the requirement that the institution have a Chinese partner, the entity will be able to perform some functions for the university that the university would otherwise need the partner to perform. This Note will discuss two of the options for doing so: the representative office and the wholly foreign-owned enterprise. It will describe the process for establishing each, the activities each may engage in, and associated costs, taxes and other issues [9].

DISCUSSION:

In many circumstances, partnering with a Chinese educational institution, government agency or
company will be the easiest way for a foreign university to engage in activities in China, including providing to programming to Chinese citizens, conducting group exchanges or operating study abroad programs. A Chinese partner will have direct experience with the cultural, political, and legal atmosphere, and can take the lead on getting the necessary approvals from the Ministry of Education ("MOE") and other authorities, collecting tuition, and securing visas [10]. Even if a foreign university establishes a Chinese legal entity, the MOE only rarely grants approvals for degree-granting programs conducted without a Chinese partner [11]. Establishing a Chinese entity also will not significantly simplify the process and expense of repatriating profits to the university’s home country.

Nevertheless, a number of foreign universities from around the world have decided to establish a legal entity in China for the flexibility such an entity provides, as well as the commitment to the region it demonstrates. A university interested in a permanent legal presence in China generally has two options: to set up a representative office (a “rep office”) or a wholly foreign-owned enterprise (a “WFOE”) [12].

**Representative Offices**

**The Restriction on Non-Profit Universities**

A non-profit foreign university may not directly establish a rep office in China [13]. To get around this restriction, a non-profit university may first create a for-profit subsidiary, through which the rep office could be established.

**Representative Office Activities**

The activities that a rep office may engage in are quite limited. A rep office can conduct research and marketing, coordinate travel and other activities for the foreign university in China, and act as a liaison. It cannot engage in any "profit-making activities," including receiving payments, issuing invoices, executing contracts, buying property or other operational activities, and cannot earn or receive any payments at all in China [14]. Despite the limited scope of the rep office’s activities, it may be useful to a university wishing to have more on-the-ground support for its research activities and study abroad in China. As the rep office would not be a separate legal entity, it could not enter into an agreement with a Chinese university to provide educational or training programs, but it could act as a liaison between the two institutions. As a liaison, the rep office might be useful in making introductions between officials at the foreign university and Chinese university, or coordinating travel and logistics for meetings between the universities.

Government authorities will closely review a rep office’s activities to ensure that the rep office is not engaging in any profit-making activities. If the authorities find such activities, the rep office may be fined, have profits (whether actual profits or amounts deemed profits by the authorities) confiscated or taxed, or have its registration cancelled.

**Establishing a Rep Office**

A rep office is the easier of the two kinds of entities for a foreign university to set up in China. Doing so does not require an upfront capital investment and the application process is less cumbersome. Except in highly regulated fields like banking and securities, establishing a rep office requires only registration with the State Administration for Industry and Commerce (or with the local version of this body) ("AIC") and a “subject matter” agency related to the parent company’s field. (If a for-profit university were to open a rep office, this agency would be MOE. It is likely, however, that MOE
would not allow even a for-profit foreign university to directly establish a representative office. Instead, the university could form a subsidiary for this purpose, just as non-profit institutions must do).

The name of the subsidiary used to establish a rep office may have an impact on the name of the rep office. Rep offices are usually named according to the following formula: Name of Parent (in most cases, the university’s subsidiary) + Location (City) + Representative Office (for example, ABC Shanghai Representative Office). Universities that use subsidiaries to establish a rep office should therefore consider the name of the subsidiary carefully.

Significant costs are associated with opening a rep office. First, the rep office must enter into a lease of at least one year in a government-approved office building [15]. Second, although the rep office cannot earn any money, it still is subject to a 10% tax on its gross expenses [16]. Finally, the rep office cannot hire Chinese nationals directly, but rather must hire employees for a minimum term of two years through a government or quasi-government employment agency (the generic term “FESCO” or “Foreign Enterprise Service Corporation” is used to describe many of these companies) [17]. Since the number of foreign representatives that a representative office may sponsor in China has recently been limited to four, a rep office may need to hire a significant number of Chinese nationals to run the office [18]. To correspond to a new requirement that rep offices renew their registration certifications annually, work permits for foreign nationals working for rep offices are now only valid for a year [19].

Opening a rep office may be a good way for a foreign university to “try out” China without too much investment. Unfortunately, opening a rep office before establishing a WFOE does not make the WFOE set-up process any easier [20]. If the foreign university later decided to establish a WFOE, it must go through both the entire WFOE application process and the process to close down the rep office [21].

**Wholly Foreign-Owned Enterprises**

**WFOE Activities**

Establishing a WFOE is a great deal more complex, but leaves the foreign university with more options. Unlike a rep office, a WFOE may enter into agreements with third parties, earn income, hire employees directly, and open bank accounts. The activities a WFOE may engage in will depend on its business scope. A university’s WFOE is likely to be categorized as a “consulting” company, even if its proposed activities do not resemble consulting in the usual sense, and its business scope may include terms like “investment consulting” and “business consulting [22].” The consulting category is fairly broad, although there are some activities, such as publishing, that are highly regulated and may not be permissible regardless of the scope [23].

Including “consulting” in the business scope of a university’s WFOE will not require MOE approval or even be particularly likely to attract MOE attention, but including “training” is likely to get the MOE interested. A university may be tempted to add “training” to its WFOE’s scope of business if it wishes to provide training programs without a Chinese partner. After all, adding “training” to the WFOE’s scope of business would make the WFOE eligible to be the university’s Chinese partner, enabling the university to provide training services itself, in its own space, and with a maximum of control over the faculty and curriculum. As discussed above, to offer degree-granting educational programs in China in partnership with a Chinese university, a WFOE must obtain MOE approval [24], but there are no formal regulations around including “training” in a WFOE’s scope of business. Until recently, MOE had not paid much attention to training at all, but as more foreign universities have established
WFOEs, MOE has begun cracking down. MOE is concerned that foreign universities are establishing WFOEs to offer educational programs disguised as training. Including “training” in a university-owned WFOE’s scope of business is now likely to disqualify the WFOE’s application.

To be involved in training without including it in its scope of business, a WFOE may still partner with a Chinese university or other entity approved by MOE to provide training. It may also simply provide support to a partnership between the foreign university and a Chinese entity by providing classroom space, marketing, or logistical assistance.

Establishing a WFOE

To begin the process of establishing a WFOE, the foreign university (acting through its subsidiary in most cases) must first apply to the Ministry of Commerce or the local version of this body (which are distinct from AIC) for approval. The initial application must include the WFOE’s proposed purpose, business scope and scale, products, technology and equipment to be used, real estate to be used, conditions and quantities of natural resources to be used, and requirement for public facilities. If the proposed scope of business of the WFOE touches on another agency’s subject matter—education, for example—that agency will also review the scope of business. Ministry of Commerce has 30 days to respond to the application.

Once the university has approval from the Ministry of Commerce and, if applicable, the other agency, the university must submit a fuller application to the examination and approval authority for a Certificate of Approval. The application will include: (1) an application to establish a WFOE, (2) a “feasibility study,” (3) the WFOE’s articles of association, (4) the name of the WFOE’s legal representative or of the members of the WFOE’s board of directors, (5) a creditworthiness letter from the university’s U.S. bank, (6) the Ministry of Commerce’s and relevant agency’s written replies to the initial application described above, (7) a list of supplies that the WFOE will import, and (8) other requested documents. Some of these may be submitted in English, but they all must also be submitted in Chinese.

The examination and approval authority then has 90 days to approve or reject the application. If the application is approved, the university has 30 days to apply to the AIC for a business license. When the WFOE receives a business license, it then has 30 days to register with the tax authorities. Ideally, the whole process takes two to three months.

Within 90 days of receiving the business license, the university must deposit at least 15% of the registered capital (described below) into a capital account (usually at the Bank of China), which must be verified by an accounting firm in China. The WFOE also must register with Customs and with the Foreign Affairs Office of the local Public Security Bureau so that it may obtain the official seals, or “chops,” it will need to do business. If foreign employees will work for the WFOE, it will need to help those employees apply for the necessary visa and work and residence permits.

There are a number of decisions to be made and hurdles to be overcome before and during this process, as described below.

- **Scope of Business**

   As discussed above, a WFOE’s scope of business defines the activities in which it may engage. If a scope of business is out-of-the-ordinary, local authorities may wish to meet to discuss the WFOE’s activities and to negotiate the description. Once the scope is approved, it may not be altered without another approval process. Therefore, it is important to try to capture all of the
possible activities in which the WFOE may engage in the initial application process.

- Minimum Capital

Early on in the application process, the university must decide on the WFOE’s registered capital. Registered capital is the “total amount of capital registered with [AIC] . . . for the purpose of establishing [the WFOE,] . . . i.e. the total amount of investment the foreign investor undertakes to contribute [39].” Depending on where the WFOE is established in China, the minimum required will usually be at least US$140,000. Fifteen percent of the total must be paid in to the WFOE’s bank account within 90 days of receiving the business license. The remaining amount must be paid in within two years.

Since it is difficult both to get large amounts of money into China and to increase the capital investment later, the initial decision on the registered capital should be made carefully, after taking into account needs such as set-up costs and rental expense. The only other options for funding WFOE activities are fees from services agreements between the WFOE and the university (or advances on those fees), which will be subject to tax, and intercompany loans, which are limited by the amount of the capital investment and difficult to obtain approval for. Applying for an increase in capital investment is nearly as cumbersome a process as the application to establish the WFOE [40].

The amount of capital investment is approved on a case-by-case basis, depending on the WFOE’s proposed business scope, lease, and other considerations.

- Name

Early on in the application process, the university must submit the WFOE name to AIC for approval. The name must usually take the following form: Location (City) + Name of University + main business activity + structure, but the order of the location and the name of the University may be reversed (for example, ABC Shanghai Consulting Co., Ltd.). The WFOE’s name may not include a word that has already been registered by another business in China. If another Chinese entity has been using the university’s name, even in an unrelated business or in violation of trademark law, it is possible the university will not be able to use its own name in the WFOE name. It may be helpful to have a few options in case the university’s first choice is not available (perhaps a mascot name or something similarly identifiable with the university). Use of the word “China” is unlikely to be permitted either. Only the Chinese version of the WFOE’s name will be registered, though the WFOE may apply for trademark protection for the English translation as well.

- Insurance and Banking

To complete the set up, the WFOE will need both insurance and bank accounts. The insurance is the easy part; a WFOE must simply purchase insurance from a Chinese insurance agency [41].

Banking is more complex. A WFOE must have three kinds of accounts: a capital account, a basic account and a general account [42]. It may only have one capital account and one basic account; it may have multiple general accounts [43]. The capital account must be with the Bank of China or another bank designated by the state foreign exchange authorities [44]. The WFOE will deposit the registered capital in its home currency in the capital account. To use these funds, they must first be “verified” by a Chinese accounting firm and then drawn down into the basic account [45].
The basic and general accounts are Chinese currency (Renminbi) accounts. The basic account is the only account from which the WFOE may execute cash transactions and draw salaries and bonuses [46]. The WFOE may use the general account (or accounts) for collections and non-cash payments [47]. Since it is not possible to use credit cards in many places in China and many vendors will expect to be paid in cash, the WFOE’s employees will need to draw funds from the basic account by either visiting a bank branch or using an ATM card. Therefore, institutional oversight over access to basic account funds may be a pivotal issue.

Once the applications are completed and authorizations are sent to the bank, setting up the accounts does not take very long, although the accounts must be opened one at a time starting with the capital account. Understanding the system and aligning the university’s usual requirements for control over accounts with the reality can take time. As a result, university financial administration should be involved early to assist with planning for and setting up the WFOE’s bank accounts.

**Other Considerations**

- **Tax and Accounting**

  A WFOE must keep its books in China [48]. Its fiscal year must run from January 1 through December 31 [49]. The WFOE must report to the Tax Administration Department monthly, quarterly and annually and submit an annual audit report. A WFOE will be subject to a number of taxes at the national, provincial and local levels, which will vary from location to location. In general, a WFOE’s profits (after deduction of operating expenses) are subject to a 25% Enterprise Income Tax [50]; its gross revenues from services provided in China are subject to a business tax which varies depending on the services but is likely to be 5% [51]; and dividends to foreign companies are subject to a 20% tax [52].

  Foreign employees of both WFOEs and rep offices must pay Individual Income Tax (“IIT”) on amounts earned in China [53]. If an employee has positions both at the WFOE and at the university in the home country, it is important to clearly indicate what part of the employee’s income is attributable to the employee’s work in China and what part is attributable to work at home. The general manager of the WFOE will be responsible for making monthly IIT filings with the local tax authority when he or she is appointed, regardless of the amount of time spent in China.

- **Getting Money Out of China**

  Once registered capital has been invested in a WFOE, it may not be repatriated to the university’s home country. Profits, on the other hand, may be repatriated, but they are subject to heavy tax [54]. First, the profits are subject to the 25% EIT; then, they are subject to a 10% withholding tax.

  The university may retrieve funds from the WFOE by charging fees for services provided to the WFOE and royalty fees for use of the university’s trademarks or other intellectual property [55]. These fees will be subject to tax (which will depend on the services provided) and should be identified in the WFOE’s articles of association [56].
Liability

A WFOE is a limited liability company. The university's liability in connection with the WFOE is limited to the total investment, the total amount of capital the university spent to get the WFOE up and running [57].

CONCLUSION:

Establishing a permanent legal entity in China may assist a university in gaining greater control of its activities in China. With a rep office, a foreign university may find it easier to assist its students and faculty with research or study abroad activities. With a WFOE, a foreign university may find it easier to provide training or educational programming to Chinese students in China. A foreign university can provide educational or training programming in China to Chinese citizens without establishing an entity in China, but setting up a WFOE may help the university maintain more control over the administration, substance, and revenues of its programming. The university should take into account its long term plans in China when it determines whether to establish a rep office or a WFOE. Either way, the process for establishing a legal entity can be lengthy and changes difficult to make. As a result, having a clear sense from the start of the university's goals and advice from trusted local counsel is essential.

FOOTNOTES:


FN3. For example, the Regulations on Chinese-Foreign Cooperation in Running Schools provide for different approval requirements depending on whether the school will offer “higher education” with or without “academic qualifications,” a “vocational technical training program,” or “for-profit training.” Id., at art.12, 18, 34, 60.

FN4. Only vocational training is defined in the regulations: “Vocational training includes training before employment, training for armymen transferred to civilian work, training for apprentices, on-the-job training, transfer training and other training of vocational nature.” Vocational Education Law of the People’s Republic of China, ch. 2, art. 14 (May 15, 1996).

FN6. The regulations require both government approvals and establishment of a legal entity for a partnership between a foreign university and a Chinese university planning to grant degrees. See supra note, ch. I, art 2.

FN7. In the case of training programs, the university would need a Chinese entity to enter into any vendor agreements, accept RMB tuition payments, arrange for faculty visas, and provide other administrative services.

FN8. See Regulations, supra note, ch. III, art. 21.

FN9. Another option, which this Note will not discuss, is establishing a joint venture with a Chinese entity.

FN10. Where MOE approval for joint programs is sought, it is important to check for yourself that the approval accurately lists the courses in the program, even if the partner is responsible for getting approval.

FN11. See Regulations, supra note, ch. II; see e.g., http://www.uiw.edu/ciw/.

FN12. A chart comparing rep offices and WFOEs follows the discussion.


FN14. Ministry of Foreign Trade and Economic Cooperation, Detailed Implementing Rules on Representative Office of Foreign Company in China (February 13, 1995); Administration for Industry and Commerce, Measures for Administration of Registration of Resident Representative Offices of Foreign Enterprises (March 15, 1983). Per a notice issued by State Administration for Industry and Commerce and the Ministry of Public Security, local SAIC agents will inspect representative offices to ensure that no profit-making activities are taking place; rep offices found to be out of compliance may be subject to administrative penalties. State Administration for Industry and Commerce and Ministry of Public Security, Circular on Further Strengthening Administration of the Registration of Resident Representative Offices of Foreign Enterprises (January 4, 2010).


FN16. State Administration of Taxation, Notice on Relevant Questions concerning Administration of Tax Collection of Resident Representative Offices (March 12, 2003); see also Harris, supra note. In addition, foreign rep office employees are subject to Individual Income Tax.

FN17. See Measures for Administration of Registration of Resident Representative Offices, supra note, art. 10.

FN18. See Circular on Further Strengthening Administration of the Registration of Resident Representative Offices of Foreign Enterprises, supra note.


FN20. See Harris, supra note.

FN21. See id. The foreign university could have both, but the rep office would have very limited
use if the university also had a WFOE.

**FN22.** The other categories are for WFOEs engaging in manufacturing, trading, wholesaling, retailing, or franchising in China.

**FN23.** The current list of encouraged, restricted, and prohibited activities for foreign investors is available in [English translation](accessed July 4, 2010).

**FN24.** Regulations on Chinese-Foreign Cooperation in Running Schools, supra note.

**FN25.** I will refer to the parent company, whether the foreign university or its subsidiary, as “the university” for the remainder of the Note.

**FN26.** The Ministry of Commerce and AIC are distinct agencies. China Business Review has put together a useful chart showing the structure of the Chinese government. Chinese law gives the Ministry of Foreign Economic Relations and Trade and certain provinces, autonomous regions and municipalities with “independent development plans” authority to examine and approve applications to establish WFOEs. Ministry of Foreign Trade and Economy Cooperation, Detailed Implementing Rules for the Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises, ch. 2, art. 7 (April 21, 2001).

**FN27.** Id. at ch. 2, art. 9. Obviously, not all of these will be relevant and need not be included in the application.

**FN28.** Id.

**FN29.** The particular examination and approval authority will depend on the circumstances. According to the regulations, it may be “the Ministry of Foreign Economic Relations and Trade [or] the People’s Governments of the provinces, autonomous regions, municipalities directly under the central government, municipalities with independent development plans and Special Economic Zones.” Detailed Implementing Rules for the Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises, supra note, ch. 2, art. 7.

**FN30.** Chinese law provides for a long list of items that must appear in an application, but not all are relevant. An application for a university’s WFOE is likely to include the name, address, nationality, and location of organization of the foreign “investor” and the position of its “legal representative”; the name and address of the WFOE; the scope of the WFOE’s business; the total investment and registered capital, including the source of it and when and how it will be contributed; the form of organization, structure and legal representative of the WFOE; the main equipment the WFOE will use and its age; discussion of the staffing and real estate; schedule of implementation; and the term of the WFOE. Id. at ch. 2, art. 14.

**FN31.** The feasibility study is a relatively pro forma document that looks like a simple business plan and budget.

**FN32.** The WFOE’s articles of association will look very much like the articles of association for an American limited liability company. See id. at ch. 2, art. 15. Chinese authorities must approve any amendment of the articles. Id. at ch. 2, art. 16.

**FN33.** Note that this may be difficult to obtain if the subsidiary acting as parent of the WFOE has only recently been formed.
FN34.  Id. at ch. 2, art. 10.

FN35.  Id.


FN37.  Law on Wholly Foreign-Owned Enterprises, supra note, at § 7. The date of the business license is the date on which the WFOE is considered to have been established.


FN40.  Changing the amount of capital is a process not unlike the WFOE application process. The change must be approved by the authorities and an accountant must “verify” the capital; finally, the change is registered with the government and the articles of association are amended. Id. at ch. 2, art 17.

FN41.  Id. at ch. 2 art. 80.

FN42.  See HSBC, Setting up Accounts.

FN43.  Id.

FN44.  Law on Wholly Foreign-Owned Enterprises, supra note, at § 18.

FN45.  Implementing Rules on Wholly Foreign-Owned Enterprises, supra note at ch. 2, art. 21.

FN46.  HSBC, supra note.

FN47.  Id.


FN49.  Implementing Rules on Wholly Foreign-Owned Enterprises, supra note, at ch. 2, art. 57.


FN51.  State Administration of Taxation, Provisional Regulations on Business Tax of the People’s Republic of China (December 12, 1993).

FN52.  Enterprise Income Tax Law, supra note.

FN53.  If the employee is regarded as a tax resident of China (because he has resided in China for more than 5 years without leaving for more than 90 days (cumulatively) in any calendar year or 30 consecutive days), then all of his income, regardless of whether it’s related to work in China, will be subject to IIT. State Administration of Industry & Commerce, Personal Income Tax Law of the People’s Republic of China (August 30, 1999). If the employee is not a tax resident, but spends more than 183 days in China during a calendar year, the amount of the employee’s overall income that will be subject to IIT will depend on the number of days the employee spent in China. United

FN54. Law on Wholly Foreign-Owned Enterprises, supra note, at § 19.


FN56. Id.

FN57. Implementing Rules on Wholly Foreign-Owned Enterprises, supra note, at ch. 2, art. 18-19.

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**APPENDIX:**

The chart below illustrates some of the differences between a Rep Office and a WFOE.

<table>
<thead>
<tr>
<th></th>
<th>Rep Office</th>
<th>WFOE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Minimum Capital Investment</strong></td>
<td>None</td>
<td>Capital investment, usually a minimum of US$ 140,000, depending on the business scope and other considerations; 15% within the first 90 days and the rest within 2 years.</td>
</tr>
<tr>
<td><strong>Real Estate</strong></td>
<td>Must lease space in an office building approved by the Chinese government to lease to foreign entities</td>
<td>Must lease space in an office building approved by the Chinese government to lease to foreign entities</td>
</tr>
<tr>
<td><strong>Name</strong></td>
<td>Name of Parent + Location (City) + Representative Office Ex: ABC Shanghai Representative Office</td>
<td>Location (City) + Name of Parent + main business activity + structure Ex: Shanghai ABC Consulting Co., Ltd.</td>
</tr>
<tr>
<td><strong>Permitted Activities</strong></td>
<td>May conduct research, do marketing, coordinate travel and other activities for the university in China, act as a liaison for the university company</td>
<td>Depends on business scope</td>
</tr>
</tbody>
</table>
### Forbidden Activities
No profit-making activities, including receiving payments, issuing invoices, executing contracts, buying property or other operational activities. It may not represent any company other than the university.

### Funding
May only receive money from the university; it may not have its own bank account.

<table>
<thead>
<tr>
<th>Forbidden Activities</th>
<th>Depend on business scope, which is usually pretty broad. However, some activities, such as publishing, are highly regulated and may not be permissible regardless of the scope.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding</td>
<td>May have bank accounts, receive capital from university, and enter into agreements.</td>
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</tbody>
</table>

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