



**PRC Retail Newsflash**  
*19 May 2005*

**Newsflash: Notice on Issues Relating to Business Scope Expansion of Foreign-Invested Enterprises in Non-Merchandising Sectors to Include Distribution Rights**

We write regarding a notice that pertains to China's opening of its distribution sector, including retail and wholesale (the *Notice on Issues Relating to Business Scope Expansion of Foreign-Invested Enterprises in Non-Merchandising Sectors to Include Distribution Rights*), which was issued on 2 April 2005 by the PRC Ministry of Commerce and came into effect on the same day.

The Notice addresses issues which were unclear under the *Measures for the Administration of Foreign Investment in Merchandising Sectors (FICE Measures)*, effective as of 1 June 2004, namely:

I. **Business Scope Expanded to Include Distribution Rights**

1. **Expansion of Business Scope**

According to the Notice, Foreign-Invested Enterprises (**FIEs**) in non-merchandising sectors (**Non-Merchandising FIEs**) may expand their business scope to include distribution rights. "Non-merchandising sectors" generally refers to businesses other than the mass-distribution of commodities.

Based upon our understanding and discussions with officials of the Ministry of Commerce (**MOFCOM**), FIEs covered by the Notice include manufacturing, technology and consulting FIEs as well as investment companies and regional headquarters, so long as they are not involved in the merchandising business.

2. **Taxes of Manufacturing FIEs**

The Notice indicates that, if the distribution revenue of a manufacturing Non-Merchandising FIE exceeds 30% of its total sales revenue, it must forego all otherwise available tax holidays.

3. **Restrictions**

Contrary to initial industry speculation, the Notice does not explicitly restrict manufacturing FIEs from distributing third party products of a general type different from those which the FIE itself manufactures.

However, FIEs are generally only permitted to engage in 1 core business sector (*e.g.*, the manufacturing and distribution of a single category of products). Hence, if a manufacturing Non-Merchandising FIE were to apply for the right to distribute

products manufactured by a third party and which fall under some other categories (*e.g.*, food) from those which it produces (*i.e.*, luxury goods), it could be deemed as attempting to engage in more than 1 core business sector and hence be denied the approval to distribute those third party's products.

Therefore, an FIE can distribute products which it manufactures, and products manufactured by a third party if such products are of the same category as those goods which it manufactures. However, an FIE will in general not be permitted to distribute products of a different type from those which it manufactures. For this reason, it may prove difficult to convince the MOFCOM and its local bureau to permit an FIE designated to provide technology/consulting services to engage at all in distribution services.

#### 4. **Procedures**

Non-Merchandising FIEs that wish to include distribution rights in their business scope must follow the procedures outlined in the FICE Measures.

##### (a) Small-scale Retail

Applications by FIEs must be submitted to the local bureau of the MOFCOM for final examination and to the MOFCOM for filing provided that:

- the applicant operates fewer than 30 outlets in the province, with each outlet occupying less than 300m<sup>2</sup> and the applicant's investor operating fewer than 300 outlets in the entire country;
- the applicant operates fewer than 3 outlets in the province, with each outlet occupying less than 3000m<sup>2</sup> and the applicant's investor operating fewer than 30 outlets in the entire country; or
- if the applicant is a joint venture (**JV**) engaged in the retail of products other than books, newspaper, periodicals, pharmaceuticals, automobiles or processed oil, then the Chinese partner must hold the majority of the equity and own the trademark/trade name of the JV.

##### (b) Legal-scale Retail or Wholesale

Applications by FIEs must be submitted to the local bureau of the MOFCOM for preliminary examination and secure the final approval of the MOFCOM.

## II. Establishment of Manufacturing and Distribution FIEs

### 1. **Establishment**

The Notice does not specify whether an FIE can be established to engage in both manufacturing and distribution; however, we understand that such an entity could be construed as "a new FIE including distribution rights", which is explicitly permitted.

## 2. **Procedures**

Pursuant to the Notice, an FIE can be established with a business scope that includes the distribution of products manufactured by a third party pursuant to the procedures outlined in the FICE Measures (*see*: Paragraph I(4) above).

However, as noted above, approval is not likely to be given if such business scope is deemed to permit the FIE to engage in more than 1 core business sector.

## III. **Franchising**

According to the Notice, if Non-Merchandising FIEs with a business scope that includes distribution services wish also to engage in franchising activities, they must comply with the *Administrative Regulations on Franchising in the Merchandising Sector (Franchising Regulations)*.

Under the Franchising Regulations, effective as of 1 February 2005, such FIEs are required to obtain approval from the local bureau of the MOFCOM and expand their business scope to include franchising. However, the Notice does not specify any specific guidelines for implementation, and only indicates that such implementation rules are to be issued separately.

Based upon our discussions with officials of the Shanghai bureau of MOFCOM, we understand that no FIEs in Shanghai have to date been approved to expand their business scope to include both distribution *and* franchising, in absence of such implementation rules.

\* \* \*

We trust that you find the above newsflash useful. If you have any queries, please contact:

- Jesse T H Chang ([jthchang@TransAsiaLawyers.com](mailto:jthchang@TransAsiaLawyers.com)); or
- June Lei ([jlei@TransAsiaLawyers.com](mailto:jlei@TransAsiaLawyers.com)).

---

### **Beijing**

Suite 2218 China World Tower 1  
1 Jianguomenwai Avenue  
Beijing 100004, China  
Tel: (86 10) 6505-8188  
Fax: (86 10) 6505-8189/98

### **Shanghai**

Unit 1101 Platinum  
233 Tai Cang Road  
Shanghai 200020, China  
Tel: (86 21) 6141-0998  
Fax: (86 21) 6141-0995/6

<http://www.TransAsiaLawyers.com>

*This newsflash is for informational purposes only and does not constitute legal advice. Use of this newsflash does not create an attorney-client relationship between TransAsia Lawyers and the reader. Readers should contact appropriate legal counsel for advice on any particular issue. Entire content copyright is owned by TransAsia Lawyers. Reproduction and distribution of this newsflash in whole or in part without the written permission of TransAsia Lawyers is expressly prohibited.*

*This newsflash may have been sent via e-mail. We cannot guaranty the completeness of messages transmitted by e-mail, and will not be responsible for any modification made to this message after sending by us.*