



## PRESS RELEASE

### MEMO OF CHINA'S FOREIGN-INVESTED PARTNERSHIP RULES

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The *Administrative Measures for Foreign Enterprises and Individuals to Establish Partnership Enterprises in China* (the “Measures”), promulgated by China’s State Council on December 2, 2009, became effective on March 1, 2010. Pursuant to the Measures, non-Chinese enterprises and individuals can now be partners of a partnership in China. The Measures open up partnership as a new vehicle for foreign investment in China. It will help to further enrich our way of utilizing foreign investment, expand economic cooperation and technical exchanges, to improve the quality of using foreign capital and promote economic development mode.

Compared with other forms/options of foreign investment, there are several advantages for Foreign Invested Partnership Enterprises (“FIPEs”):

1. Simplified Establishment Procedures. The Measures provide that a FIPE may be established without the approval of the PRC Ministry of Commerce (“MOFCOM”) or its local counterparts. Approval by MOFCOM or its local counterparts is and has been required for establishing JVs or WFOEs. Only with MOFCOM approval can a JV or WFOE be registered with the State Administration of Industry and Commerce (“SAIC”). As a new procedure introduced by the Measures, a FIPE can be registered with SAIC directly. MOFCOM or its local counterparts need only be informed of the registration.
2. More flexible methods of capital contribution. Unlike the normal foreign invested companies whose foreign shareholders cannot use RMB cash as capital contribution except for only a few occasions (such as RMB dividends, proceeds of equity transfer or liquidation), partners may make capital contributions to FIPE in freely convertible non-Chinese currencies or RMBs which have been legally obtained in China. In addition, the Measures permit capital contributions other than in currency. Under the *Partnership Enterprise Law*, partners of FIPEs may make capital contributions in the form of cash or other assets, including labor. In contrast, capital contributions in the form of services are not allowed in the case of JVs or WFOEs. The *Partnership Enterprise Law* does not impose a ceiling on non-cash contributions by FIPE partners. In addition, partners may make capital contributions to FIPE in freely convertible non-Chinese currencies or RMBs which have been legally obtained in China. And the timing

of capital contribution is more flexible. Capital contributions to JVs and WFOEs must be made within time limits specified by law. Contributions to FIEs are not subject to statutory time limits.

3. No statutory governance structures. The operation of a FIE is largely based on partners' contract in terms of decision making and business execution. It is not indispensable to set up a board of directors or supervisors. Under the Regulation for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (the "Implementation Regulation of EJV Law"), the board of directors is the decision-making body. Only the board (not the shareholders) can make decisions on behalf of the EJV. The management mechanism of FIEs is governed by the partnership agreement and therefore can be as agreed by the parties, except that under the Partnership Enterprise Law, in the case of a limited partnership, the affairs of the partnership are to be managed by the general partner(s) and the limited partner(s) do not participate in management. This rule applies to FIEs. Under the Implementation Regulation of EJV Law, if one party of an EJV desires to transfer its shares, consent must be obtained from the other party/parties or the transfer is subject to a preemptive

right in the other party/parties. Under the Partnership Enterprise Law, a limited partner may, subject to the partnership agreement, assign his interest to persons other than the partners of the partnership as he sees fit, provided that he notifies the other partners 30 day in advance.

4. Non-dual taxation. Partnership enterprises do not pay enterprise income tax. Partners pay personal income tax only against all their earnings from the FIEs. The Measures are silent on the taxation of FIEs. The Measures provide that FIEs are subject to the Partnership Enterprise Law and other relevant laws and regulations. The Partnership Enterprise Law provides that partnerships are exempt from income tax at the enterprise level. Non-Chinese as well as Chinese partners of FIEs therefore enjoy enterprise pass-through tax treatment. In contrast, JVs and WFOEs pay enterprise level and their investors pay individual income tax. JVs and WFOEs are subject to a 25% tax on enterprise income, and their dividends are taxed to their shareholders at progressive rates from 5% to 45%. FIE partners who are legal persons or organizations themselves pay the enterprise income tax at 25%; general partners who are individuals pay income tax on dividends at progressive tax rates between 5% to 35%, and limited partners who are individuals pay such tax at a flat rate of 20%.

5. The protection of limited liability doctrine is also available. Investors can also choose to be a limited partner in a limited partnership enterprise, enjoying the protection of limited liability, as available to shareholders of limited liability companies.

Notwithstanding the foregoing steps forward, there are still some material issues left pending and

unresolved in the Measures:

1. Investment-oriented FIPES: while a number of foreign investors expected a legislation specifically recognizing the FIPES as the vehicles for private equity or venture capital investments in China, the Measures appear to have failed them to some extent. The issue of establishing investment-oriented FIPES is left partly open in the Measures, in that its Article 14 just foretells more specific regulation(s) to be issued in that regard. In view of the absence of such regulation(s) for the time being, so far it remains legally ambiguous for foreign investors to set up FIPES dedicated for equity investment in China. Relevant official admitted in a press interview that Article 14 of the Measures had been so worded to provide leeway for further lawmaking on investment-oriented FIPES.

2. Legal standing of foreign investors: literally speaking, the Measures merely allow “foreign enterprises” and “foreign individuals” to invest and establish FIPES in China. However, there could be various types of entity in any jurisdiction, which may include, for instance, trust, mutual fund, association and certain pass-through entities and so forth. These types of entity are either absent under the existing PRC laws or not recognized as “enterprises” in China. Whether they would be eligible for setting up FIPES in China needs further clarifications by the legislature.

3. “Controlling” undefined: FIPES’ access to certain industries remains restricted or even banned by the existing foreign investment industrial policies in China. As a result, it is not unlikely that Chinese partner(s) are legally required to have an absolute or relative controlling stake in a FIFE that engages in such business as falling within the “restricted class” industries. However, while abandoning the definition of the notion of “controlling” as proposed in the Draft, the Measures fail to clarify the criteria for identifying the controlling position in a FIFE.

Registration documents for FIFE are as follows:

1. Application form
2. Preamble approval
3. Business certificate of the address
4. Notarized and authenticated qualification certifications of partners
5. Confirmation letter for subscription of contributions to FIFE
6. Credit worthiness(only required if foreign partner is general partner)
7. Partnership agreement
8. Statement compliance of business scope with FDI catalogue
9. Authorization fro general partner to operate
10. For professional service FIP, qualification of partners is needed
11. SAFE certificate for legal acquisition of RMB

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12. Power of Attorney to future FIP's legal representative
13. Pre-approval of restricted industries according to FDI catalogue
14. Other documents required by SAIC

Lehman, Lee & Xu can provide expert legal representation and counsel throughout the investment process. Beyond contract drafting, the firm can also perform due diligence on Chinese firms and projects, provide corporate and tax counsel on the structure and operation of an investment, from mere CERs purchase deal, to direct engagement in the project development with a Chinese partner, or to technologies sales/licensing and equity injections in project companies. For more information about the firm, please visit our website at [www.lehmanlaw.com](http://www.lehmanlaw.com).