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**FOREIGN-INVESTED PARTNERSHIP ENTERPRISES PRESENT
NEW OPPORTUNITIES FOR INVESTORS**

Introduction

On 1 March 2010, three new laws came into effect which could have a significant impact on the foreign investment landscape in China. They each pertain to foreign-invested partnership enterprises (**FIPEs**), a new type of investment vehicle available to foreigners. Previously, only PRC nationals and domestic entities were permitted to set up partnerships in China.

The laws in question (collectively, the **FIPE Rules**) are:

- the *Administrative Measures for the Establishment of Partnership Enterprises by Foreign Individuals or Enterprises in China*;
- the *Administrative Provisions on the Registration of Foreign-Invested Partnership Enterprises*; and
- the *Notice for Implementing the Administrative Measures for the Establishment of Partnership Enterprises by Foreign Individuals or Enterprises in China*.

FIPEs offer unique advantages over other foreign-invested enterprises (**FIEs**) such as wholly foreign-owned enterprises and joint ventures. For example, the partners of FIPEs can determine the percentage of profits received by each investor, (otherwise permitted in contractual joint ventures, but not equity joint ventures), as well as the timing for capital contributions, at their discretion by written agreement. Moreover, profits can be distributed to the partners without first being taxed at the enterprise level. FIPEs have therefore garnered a great deal of international interest, particularly as a potential market entry vehicle for overseas private equity and venture capital groups.

However, the FIPE Rules provide only a broad legal framework: they lack the details on the establishment and operation of FIPEs which are necessary to give foreign investors a full understanding of how these vehicles will actually function in practice. Many investors are therefore taking a more conservative approach to FIPEs than they might originally have anticipated.

Key Provisions and Issues

1. Establishment of FIPes

Both foreign individuals and entities are permitted to form FIPes, and may do so alone or jointly with other Chinese or foreign individuals, entities or organizations. Foreign individuals and entities may also create FIPes by investing in existing domestic partnerships.

2. Restrictions on Business Activities

FIPes may not engage in any business which is prohibited to wholly foreign-owned entities under the *2007 Catalogue for the Guidance of Foreign Investment (Catalogue)*. Thus, FIPes are precluded from investing in any sector which is classified under the Catalogue as:

- closed to foreign investment; or
- only permitted for Sino-foreign joint venture enterprises or other entities with a limited percentage of foreign investment.

3. Change in Supervisory Authority

The State Administration for Industry and Commerce (**SAIC**) is responsible for both the approval and registration of FIPes. All other FIEs must be approved by the Ministry of Commerce (**MOFCOM**) before being registered with the SAIC. The SAIC's approval role is intended to simplify the formation procedures for FIPes.

FIPes that will engage primarily in equity investments (**Investment FIPes**, the type of FIPE most likely to be used by private equity and venture capital groups) must be approved by the SAIC branch with jurisdiction over the province, autonomous region or directly administered municipality in which they are being established. All other types of FIPE can be approved by the SAIC at the local level.

4. Key Outstanding Questions

While the FIPE Rules provide a general framework for the establishment of FIPes, they are silent on several important issues concerning how such partnerships will actually operate. These issues need to be addressed through further implementing regulations:

- What are the specific approval and registration procedures for the establishment of Investment FIPes? At present, different rules are applied in different locations. For example, the Shanghai local branch of the SAIC requires that approval applications to set up an Investment FIPE contain the written consent of the Shanghai Financial Services Office. In Tianjin, however, pursuant to a recent internal directive of the National

Development and Reform Commission (**NDRC**), the NDRC's Tianjin local branch must first submit all Investment FIPE applications to the NDRC for examination and approval, before the SAIC becomes involved.

- Will domestic entities invested in by FIPes be regarded as FIEs? If so, FIPes would arguably become no more attractive for foreign investors than the other types of FIE. This is because obtaining MOFCOM approval is generally both cumbersome and time-consuming.
- How would claims for compensation for liabilities be handled if the FIPE does not have sufficient assets to cover such liabilities, and the general partner has no other assets in China? Collecting compensation from the FIPE's foreign general partner could very well be difficult.
- What are the specific procedures for converting a foreign partner's capital from foreign currency into Renminbi, for investment by the FIPE and other purposes? For most other FIE, such procedures are contained in regulation promulgated jointly by the State Administration of Foreign Exchange, MOFCOM and the SAIC. However, the FIPE Rules are silent on this issue and give no indication of how or when it might be addressed.

TAL Commentary

While the enactment of the FIPE Rules has generally been regarded as a positive development for foreign investors, the ultimate utility and opportunities presented by FIPes remain unclear at this stage. As mentioned above, FIPes provide tax benefits and greater flexibility compared to other FIE structures. In view of these advantages, some private equity foreign investors, such as the Carlyle Group, established a FIPE soon after the FIPE Rules were enacted. However, there has not been a significant overall shift towards this market entry vehicle in the four months since the FIPE Rules came into effect.

Due to the lack of specific procedures for the establishment of Investment FIPes, most foreign investors remain cautious about adopting this new form of FIE, preferring to adopt a "wait and see" approach. Until more detailed guidelines for FIPes are enacted, the majority of foreign investors will likely still fund their investments through wholly foreign-owned enterprises and joint ventures, which can be operated with greater predictability under the comprehensive set of rules currently in place.

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