

foreign exchange issue in regard of foreign invested partnership enterprises

Description

Since China cabinet issued the Administrative Measures on Foreign Entities or Individuals Establishing Partnership Enterprises in China (the "Measures"), it has stirred up waves of interests among foreign investors. We have translated the Measures into English language and listed the advantages of this new investment vehicle (you can click here for a copy of the Measures).

I have been approached by a number of inquirers who have read the translated Measures, asking questions about setting up a FIPE in China. However, so far, due to a number of reasons to be discussed below, this plausibly promising investment vehicle does not work at large in practice.

I. Foreign currency cannot be converted into RMB

This has been the No. 1 problem that largely makes a FIPE unworkable for most foreign investors. Though, China's State Administration of Industry and Commerce (the "SAIC") has issued, prior to the effectiveness of the Measures, the Administrative Provisions on Registration of Foreign Invested Partnership Enterprises (the "Provisions"), which has paved the way for legally creating a FIPE. But foreigners find that their invested money denominated in foreign currencies cannot be converted into RMB and that the FIPE cannot even open a foreign exchange bank account, simply because there are no related rules handed down from China State Administration of Foreign Exchange (the "SAFE"). This will dampen the hearts of most investors who seek to employ this investment vehicle.

Our inquiry into SAFE's Shanghai headquarter got a reply that local SAFE offices do not handle foreign exchange matters relating to foreign invested partnership enterprises.

For sake of cultivating and fostering local private equity investment industry, local governments in Beijing, Shanghai and Tianjin have attempted to make breakthrough for the current deadlock situation by introducing local rules. Shanghai has initiated to allow FIPes whose foreign investors are approved as qualified foreign investors to convert certain-quota foreign exchange into RMB and use such RMB proceeds to make private equity investment. Also foreign invested investment management companies upon being approved may convert part of its foreign exchange denominated registered capital into RMB and use this RMB to further set up RMB-denominated PE fund.

However Shanghai's initiative is tailored to help foreign invested PE funds that are structured as limited partnership enterprise and therefore not available for other FIPes.

II Capital Contribution in RMB

As capital contribution in foreign exchange faces the conversion issue said above, alternatively, foreign investors may consider using RMB to set up a FIPE. Under the Measures, it is provided that foreign investors may use their lawfully obtained RMB money to contribute capital into the FIPE.

What is "lawfully obtained RMB money"? It is initially gestimated that foreigners may be allowed to use their RMB money received in the form of salaries or service remuneration and other legal proceeds earned or otherwise obtained in China.

The Provisions cast dim lights on that answer by providing that, where foreign partners want to make capital contribution in RMB money, they shall submit certification issued by local SAFE offices certifying that the RMB money to be contributed is profits received from within China or such RMB money is otherwise lawfully gained. The wording is still too vague. It is still not clear whether foreigners

can use their salaries received for their work rendered in China to set up a FIPE.

It is our opinion that in addition to RMB money resulting from profits of other investment activities in China, other RMB-denominated proceeds deprived from liquidation of existing foreign invested enterprises and from transfer of equity interests in other foreign invested enterprises should also be allowed to be used for capital contribution into FIPES.

Latest development indicated in a notice issued earlier this year by China Ministry of Commerce signaled that RMB money obtained by foreign investors as a result of cross-border trade settlement and other RMB money lawfully obtained by foreign investors outside China will be allowed to be used for capital contribution in making investment in China.

Even though, before detailed rules regarding foreign exchange matters of FIPES are issued, FIPES may not be a practical instrument for making investment in China.

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