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# New SAFE Notice likely to replace existing SAFE restrictions on red chip restructurings

This note provides a summary overview of a draft of a Notice (Notice) which we understand may be issued by the State Administration of Foreign Exchange (SAFE) in the near future, although whether the Notice will be issued in the anticipated form and exactly when it will be issued are not certain. Please click here to view a copy of the Chinese draft Notice and click here to access a rough English summary translation of the Notice.

The Notice, when issued, would replace the "Notice regarding issues of improving foreign exchange administration in relation to mergers and acquisitions with foreign investment" and the "Notice regarding issues of registration of personal offshore investment by local residents and registration of foreign exchange in relation to mergers and acquisition with foreign investment" (Notices 11 and 29) issued in January and April 2005 respectively, which have in practice severely restricted "red chip" and other similar restructurings of Chinese enterprises.

The following table summarises the provisions of the Notice:

Special purpose vehicle (SPV)

an offshore enterprise set up directly or controlled indirectly by PRC residents (whether legal persons or individuals) using assets or equity interests in PRC enterprises for equity financing offshore

"Return investment"

means PRC investment activities by PRC residents through an SPV, including purchase of equity interests of a PRC party in a PRC enterprise, establishment of a foreign invested enterprise in the PRC and the purchase of PRC assets through such enterprise, the purchasing of PRC assets by agreement and, with such assets, investing and setting up a foreign invested enterprise, or injecting capital into a PRC enterprise

Control

means the acquisition by local residents of control and the right to make decisions through methods such as trusts, voting power, repurchase and convertible bonds

Formalities before setting up SPV

before setting up and controlling the offshore SPV, PRC residents should go through offshore investment foreign exchange registration formalities at the regional office of SAFE and submit following documents:

written application (details of the shareholding structure of the SPV)

business plan of the offshore financing

arrangement in relation to the funds after the offshore financing

in relation to legal persons, approval of the source of foreign capital (assets) and approval documents issued by the offshore investment administrative authorities

Assets or equity interests held by SPV

in relation to SPVs which hold assets or equity interests of PRC enterprises through "return investment", PRC residents have to go through the amendment of foreign exchange registration formalities in relation to the net assets of the relevant PRC enterprises and submit the following documents:

written application (details of the shareholding structure before and after the amendment and valuation of assets or equity interest of the relevant PRC enterprise)

in relation to legal persons, provide an "offshore investment foreign exchange registration certificate"; and in relation to individuals, a "personal offshore investment foreign exchange registration form"

approval or filing documents on "return investment" issued by the administrative authorities

valuation report on assets or equity interests of the PRC enterprise issued by a qualified intermediary; if state assets are involved, confirmation from the state assets administrative authorities

incorporation documents and business registration of the SPV

Use of funds

funds received by PRC residents through the financing of an SPV should be used in the manner committed to at the time of the foreign exchange registration of the offshore investment; any amendments should be filed with SAFE beforehand except in the case of an offshore listed company, funds raised through offshore financing shall not be retained by the SPV

No payment before completing required formalities

it is only after PRC residents have completed the offshore investment foreign exchange registration and amendment formalities that they can make payments to the SPV in relation to profits, equity transfers and reduction of capital etc. profits and income from a change in capital received by PRC residents through an SPV should be remitted back in full within 180 days of receipt

Others

in relation to PRC residents (legal persons and individuals) who have already set up and/or controlled offshore SPVs before the issue of this Notice and have not completed the registration formalities in accordance with the regulations, they must do so before 31 December 2005 local venture capital investment enterprises may set up offshore SPVs in accordance with this Notice and engage in venture capital investment activities

Note

this Notice shall supersede the "Notice regarding issues of improving foreign exchange administration in relation to mergers and acquisitions with foreign investment" and the "Notice regarding issues of registration of personal offshore investment by local residents and registration of foreign exchange in relation to mergers and acquisition with foreign investment" (Notices 11 and 29), January and April 2005 and shall become effective upon release

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