Charltons - China Law Newsletter - 25 October 2005

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# SAFE formal Notice to replace existing SAFE restrictions on red chip restructurings effective 1 November 2005

The State Administration of Foreign Exchange (SAFE) has issued a notice regarding issues of foreign exchange administration of PRC residents financing and making "return investment" through offshore special purpose vehicles, in final form (Notice) which will become effective on 1 November 2005. Please click here to view a copy of the Chinese Notice and click here to access a rough English summary translation of the Notice. The Notice supersedes the previous "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), which were issued in January and April 2005, respectively, and which have in practice severely restricted "red chip" and other similar restructurings of Chinese enterprises. The principal changes from the draft of the notice previously circulated are: definitions of "PRC residents" have been added; instead of prohibiting SPVs (except offshore listed companies) from retaining funds raised through offshore financing, only funds earmarked for use in the PRC have to be remitted back to the PRC after offshore financing in accordance with the application of funds as stated in the business plan or prospectus; additional information has to be provided during the foreign exchange registration formalities before setting up the SPV and in relation to the net assets of the SPV; and PRC residents who have set up SPVs and completed the "return investment" (not included in the earlier draft) before 1 November 2005 but have not completed the required registration formalities are required to complete such formalities under the Notice and the deadline has been extended to 31 March 2006.

The following table summarises the provisions of the final form 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 the purpose of equity financing offshore

"Return investment"

means PRC investment activities by PRC residents through an SPV, including but not limited to purchase of equity interests of a PRC party in a PRC enterprise, establishment of a foreign invested enterprise in the PRC to purchase or control PRC assets by agreement through such enterprise, the purchasing of PRC assets by agreement and, with such assets, investing and setting up a foreign invested enterprise, injecting capital into a PRC enterprise

PRC residents which are legal persons

mean enterprises, legal persons and other economic organizations established under the laws of PRC

PRC residents who are individuals

mean holders of PRC identity cards or passports etc., or individuals who do not have legal status in PRC but ordinarily reside in the PRC due to economic interests

Control

means the acquisition by PRC residents of the rights to operate, receive income and make decisions in relation to the SPV or PRC enterprises through methods such as acquisition, 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 basic conditions of the PRC enterprises, shareholding structure of the SPV and arrangement of offshore financing)

in relation to legal persons, registration documents in the PRC; and in relation to individuals, identification documents

business plan of 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

Net assets held by SPV and their changes

where PRC residents inject assets of or equity interests in PRC enterprises into the SPV, or launch equity financing offshore after injecting assets or equity interests into the SPV, PRC residents have to go through the amendment of foreign exchange registration formalities in relation to his/its interests in the net assets of the SPV and the changes, and submit the following documents:

written application (details of the shareholders of the PRC enterprises and SPV, changes of equity interests, pricing method of the assets or equity interests in relation to the PRC enterprises and SPV)

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

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

where state assets are involved, documents confirming the value of assets or equity interests in the PRC enterprises issued by the state assets administrative authorities

incorporation documents and business registration of the SPV

Use of funds

after the SPV has completed offshore financing, PRC residents should remit funds earmarked for use in the PRC back to the PRC in accordance with the plans for application of funds as stated in the business plan or prospectus

No payment before completing required formalities

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

Others

in relation to PRC residents who have already set up or controlled offshore SPVs and completed "return investment" before the implementation of this Notice but have not completed the registration formalities in accordance with the regulations, they must do so before 31 March 2006. After PRC residents have completed such registration formalities, regional office of the SAFE can go through the foreign exchange registration formalities of foreign capital and foreign debt in relation to the relevant PRC enterprises 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 become effective on 1 November 2005 and 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), which were issued in January and April 2005, respectively

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**Charltons - China Law Newsletter - Issue 2 - 25 October 2005**