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SAFE Regulates Foreign Exchange Issues for Foreign-invested Partnership Enterprises

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On 19 November 2012, the State Administration of Foreign Exchange ("SAFE") released the *Circular on Issues Concerning Foreign Exchange Administration of Foreign-Invested Partnership Enterprises* ("**Circular 58**"), which shall take effect on 17 December 2012. Circular 58 clarifies the standard procedure of foreign exchange administration on foreign-invested partnership enterprise ("**FIPE**"), covering the complete procedure of FIPE's foreign exchange registration, foreign exchange account opening, capital contribution confirmation, alteration registration, partnership interest transfer and liquidation.

Background

After the promulgation of the Measures for *the Administration of the Establishment of Partnerships in China by Foreign Enterprises or individuals* (外国企业或者个人在中国境内设立合伙企业管理办法)(State Council Notice No. 567) by State Council on 25 November 2009, FIPE has become a new alternative vehicle for foreign investment in China in addition to wholly foreign-owned enterprise ("**WFOE**"), Sino-foreign equity joint ventures ("**EJV**") and Sino-foreign cooperative joint ventures ("**CJV**"). Accordingly, the former collective name for foreign-invested enterprise, "ventures of three kinds", will expand into "ventures of four kinds".[1] Further, the State Administration of Industry and Commerce ("**SAIC**") promulgated the *Administrative Regulations for the Registration of Foreign-invested Partnership Enterprises* (SAIC Notice No. 47) on 29 January 2010, regulating the SAIC registration and administration of FIPE.

Before Circular 58, there has never been any systematic regulation to govern the foreign exchange administration concerning FIPE. Even the *Newly Established Foreign-Invested Enterprise Foreign Exchange Registration Application Form* formerly issued by SAFE provides just four options of enterprise form, being "WFOE", "EJV", "CJV" and "Others", without listing FIPE at the same status with its fellow investment vehicles (the WFOE, EJV and CJV) in foreign exchange administration.

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On 19 November 2012, SAFE promulgated the *Notice of the State Administration of Foreign Exchange on Further Improving and Adjusting Foreign Exchange Control Policy for Direct Investment* (Hui Fa [2012] No. 59) ("**Circular 59**"), which substantially amends and simplifies the current foreign exchange administration procedure. On the same day, SAFE released Circular 58 especially for FIPE, clarifying the complete process of standard foreign exchange administration on FIPE. Circular 58 also follows the principle of simplifying administration procedure adopted by Circular 59, and comes out with samples of relevant application forms attached for FIPE.

Brief Introduction of Circular 58

- FIPE under Circular 58

According to Circular 58, FIPE governed hereunder shall include: (i) partnership enterprises legally established within China by more than two foreign enterprises or individuals; and (ii) partnership enterprises legally established within China by foreign enterprises or individuals and Chinese individuals, legal persons and/or other organizations. In other words, Circular 58 shall apply to wholly foreign-invested partnership enterprises and Sino-foreign partnership enterprises. In addition, Circular 58 expressly requires that the establishment of partnership enterprises in mainland China by enterprises or individuals from Hong Kong Special Administrative Region, Macau Special Administrative Region and Taiwan shall refer to its regulation.

It is noteworthy that Circular 58 expressly specified that other applicable foreign exchange administration rules will be further released for FIPEs established within China by foreign partners and primarily engaged in investment business, which we will discuss in Part Three Section One below in detail.

- Initial Foreign Exchange Registration

FIPE shall undergo the foreign exchange registration with the competent authorities of foreign exchange, bringing relevant documents (detailed documents list is specified in the Circular 58) within 30 days after obtaining the business license. In the event that a domestic partnership enterprise becomes a FIPE resulting from joining of new foreign partner(s) or partnership interests transfer from original partner(s) to new foreign partner(s), the above rules shall also apply in the relevant foreign exchange registration.

In addition, Circular 58 specified that branches of FIPE are not required to undergo additional foreign exchange registration.

- Foreign Exchange Account Opening and Conversion of Foreign Currency

In the event that the foreign partner subscribes capital contribution to the FIPE in foreign currency, the FIPE shall bring its foreign exchange registration certificate to open up a foreign exchange account in designated banks dealing foreign exchange. The rules for capital account of foreign-invested enterprise shall apply to the management of such foreign exchange account, i.e., each outward payments of current account shall first be examined by the designated banks for the genuineness of funds exchanged, and outward payments of capital account shall be first registered at or approved by SAFE.

Moreover, Circular 58 also allows foreign partner(s) (with actual needs) to remit funds in foreign currency into China before the completion of foreign exchange registration by FIPE. Such procedure will be identical to those governing the "ventures of three kinds", where the FIPE is allowed to apply to SAFE for opening a foreign exchange account for early-stage fee.[2]

- Capital Contribution Confirmation Registration

Circular 58 provides that after the payment of capital contribution by foreign partners, the FIPE shall undergo capital contribution confirmation registration with competent authorities of foreign exchange, and only after which, may such FIPE convert its capital (in foreign currency) into RMB or make transfer of such in China. In addition, only after the fully completion of capital contribution confirmation registration by the foreign partner, may such foreign partner remit funds obtained from the liquidation, capital decrease, partnership interests transfer, or profit distribution outside China or use such in further investments inside China.

- Alteration Registration of Foreign Exchange

In the event that any information registered at the enterprise registration authorities is changed, the FIPE shall undergo the registration alteration with such authorities, and shall further apply to competent authorities of foreign exchange for registration alteration within 30 days from the date of making such changes with enterprise registration authorities, bringing relevant documents (detailed documents list is specified in the Circular 58).

After reviewing the *Foreign-Invested Partnership Enterprise Foreign Exchange Application Form* as attached to Circular 58, we understand the registration items mainly include: enterprise name, business term, main business address, subscribed capital contribution, amount and proportion of capital contribution by foreign partner, enterprise type (general partnership or limited liability partnership), whether involving round-trip investment, information of foreign partners and domestic partners (such as capital contribution amount, percentage, way of contribution and profit distribution measures). In the event that the above registration items are changed, the FIPE shall undergo the foreign exchange registration alteration according to the rules in previous sections.

- Foreign Exchange Administration for Partnership Interests Transfer

Foreign partner transfer interests to domestic partner: In the event that the domestic partner in the FIPE intends to remit the transfer price for the purchase of partnership interests from the foreign partner, the domestic partner shall first undergo the foreign exchange registration alteration with the competent authorities and then carry out the foreign currency conversion and remittance process with the bank at where the domestic partner is located.

Domestic partner transfer interests to foreign partner: In the event that the foreign partner purchases partnership interests from the domestic partner, the FIPE shall undergo the foreign exchange registration alteration with the competent authorities. The transferring domestic partner shall open a special account for converting assets into cash to receive payment from the foreign partner. However, it is noteworthy that Circular 59 has already abolished the approval requirement for opening and remitting funds into the special account for converting assets into cash. Instead, Circular 59 provides that the bank shall be responsible for such account opening and fund remitting procedures.

➢ Profit Distribution outside China

Circular 58 provides that when the FIPE intends to remit profits outside China, it will only need to submit relevant documents to the bank, and the bank will be responsible to file relevant information with the corresponding department of SAFE. Before remitting out profits for the FIPE (to its foreign partner), the bank will first examine whether its foreign partner has completed the capital contribution confirmation registration, whether the certificate proving tax payment regarding such remitting profit is duly obtained, and will check and review the relevant information of such remitting profit.

➢ Annual Inspection for Foreign Exchange

FIPE shall comply with the annual inspection for foreign exchange, and the relevant rules for general foreign-invested enterprise shall also apply to the FIPE.

➢ De-registration of Foreign Exchange

After the winding-up and liquidation of the FIPE, the liquidator shall additionally undergo the de-registration with the competent authorities of foreign exchange within 30 days after de-registering with the competent authority of industry and commerce, bringing relevant documents (detailed documents list is specified in the Circular 58).

In the event that the FIPE intends to remit the funds of exit or the remaining funds after liquidation to its foreign partner outside of China, the FIPE shall first undergo the alteration registration or de-registration of foreign exchange and then undergo the foreign currency conversion and remit process at the bank, providing corresponding certificates to prove the payment of tax and relevant foreign exchange registration documents.

Noteworthy Issues

➢ Foreign Exchange Settlement of Foreign-invested RMB Funds in Form of Partnership Still Hindered

According to the Circular 58, the management of the FIPE's foreign exchange account shall be carried out in accordance with the rules for capital account of foreign-invested enterprise. According to the *Circular of the General Affairs Department of the State Administration of Foreign Exchange on the Relevant Operating Issues concerning the Improvement of the Administration of Payment and Settlement of Foreign Currency Capital of Foreign-invested Enterprises* (Hui Zong Fa [2008] No. 142) ("**Circular 142**"), unless otherwise provided, RMB funds converted from the foreign currency capital of a foreign-funded enterprise shall not be used for equity investment in China.

However, the above rules are still silent on the circumstance where a foreign-invested RMB fund in form of a partnership uses RMB fund converted from the foreign currency capital to make domestic equity investment. Therefore, Circular 58 expressly specified that "other applicable foreign exchange administration rules will be further issued for FIPEs established within China by foreign partners and primarily engaged in investment business". So far, only four municipalities including Shanghai, Tianjin, Beijing and Chongqing has released relevant pilot rules for foreign-invested enterprises primarily engaged in equity investment business, setting out regulations on the conversion of foreign exchange capital for FIPEs engaging in equity investment. Such rules generally specify that the qualified pilot partnership enterprises may use RMB fund converted from the foreign currency capital to make domestic equity investment after obtaining the approval from SAFE.[3] Other than the above, there is no national or local rule governing the foreign exchange of the FIPE which is primarily engaged in investment business. Therefore, RMB funds in form of partnership that are not yet qualified for the above pilot projects are still hindered from using foreign currencies converted into RMB to make domestic investments in China.

➢ No Undisclosed Agreement or Guarantee

According to the *Foreign-Invested Partnership Enterprise Foreign Exchange Application Form* attached to Circular 58, when applying for foreign exchange registration, the FIPE shall make specific warranties to SAFE that other than the approved articles of association, contracts and other legal documents, the domestic partners and the foreign partners do not have any undisclosed legal documents which further specify or change their rights and obligations, or any documents which guarantee any party with a fixed return on investment or contain other debt financing structures, such as interests buy-back agreements, assets buy-back agreements, capital decrease or interests alteration agreements. Considering the above requirements, the FIPE will bear the risk of being deemed as non-compliance to the above rules by SAFE, if the partners conclude a simpler partnership agreement just for purpose of registration with the authority of industry and commerce while internally having and performing another partnership agreement. Nevertheless, with Circular 58, SAFE has not directly specified the validity of such internal partnership agreements, thus such issues shall be further analyzed comprehensively in accordance with other provisions, judicial practice and actual conditions.

➢ Profit Distribution Mechanism Shall Be Disclosed in Detail

The *Foreign-Invested Partnership Enterprise Foreign Exchange Application Form* attached to Circular 58 requires FIPE to clearly specify the detailed profit distribution mechanism for each partner in the application form for foreign exchange registration. Circular 58 also provides that if the profit distribution mechanism is complex, the FIPE shall further illustrate such in detail in the "Note" section of the application form. In addition, as mentioned in the above section, such profit distribution mechanism shall not guarantee any party any fixed return of investment.

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1. For the detailed introduction of foreign exchange account for early-stage fee, please refer to our corporate bulletin of November, 2012: *The Newly Issued Regulations on Foreign Exchange Administration of Direct Investment Simplifying Several Approval and Registration Processes of Foreign Exchange Administration*, http://www.llinkslaw.com/shangchuan/20121126184053.pdf.
2. For the detailed introduction of foreign exchange account for early-stage fee, please refer to our corporate bulletin of November, 2012: *The Newly Issued Regulations on Foreign Exchange Administration of Direct Investment Simplifying Several Approval and Registration Processes of Foreign Exchange Administration*, http://www.llinkslaw.com/shangchuan/20121126184053.pdf.
3. For the detailed introduction of Shanghai pilot rules, please refer to our corporate bulletin of January, 2011: Shanghai Issued Measures for Pilot Projects of Foreign-invested Equity Investment Enterprise, http://www.llinkslaw.com/shangchuan/2011111150746.pdf.
   For the detailed introduction of Tianjin pilot rules, please refer to our corporate bulletin of December, 2011: Tianjin Issued Pilot Measures for Foreign-invested Equity Investment Enterprises, http://www.llinkslaw.com/shangchuan/20111227105543.pdf.

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