

**PRC MINISTRY OF COMMERCE
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TO EQUITY CONTRIBUTIONS
INVOLVING FOREIGN-INVESTED
ENTERPRISES**

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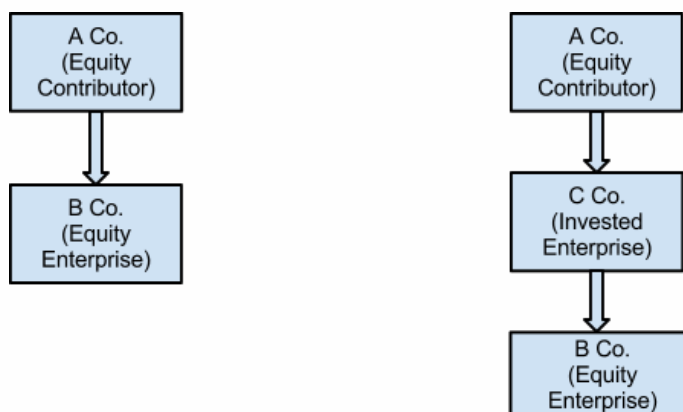
PRC Ministry of Commerce Gives ‘Green Light’ to Equity Contributions Involving Foreign-Invested Enterprises

— An analysis on the *PRC Ministry of Commerce’s Interim Provisions on Equity Contributions Involving Foreign-Invested Enterprises*

The *PRC Ministry of Commerce’s Interim Provisions on Equity Contribution Involving Foreign Invested Enterprises*¹ (商务部关于涉及外商投资企业股权出资的暂行规定, hereinafter referred to as the “Regulation”) was promulgated on September 21, 2012. The Regulation provides feasible regulatory guidance on equity contributions involving foreign-invested enterprises. This article sets out to give an analysis on the main contents of the Regulations and their potential problems in real practice.

I. The scope of application

The Regulation applies to where domestic/foreign investors (hereinafter referred to as “Equity Contributor(s)”) make capital contributions by their equity in a PRC company (hereinafter referred to as “Equity Enterprise”) to establish or change foreign-invested enterprises (hereinafter referred to as “Invested Enterprises”) including: (1) establishing foreign-invested enterprises through the incorporation of new companies; (2) increasing the capital to change the nature of the Invested Company from non-foreign-invested to foreign invested; (3) increasing the capital to change the equity of the Invested Enterprises. The graphs below illustrate the above situations.



¹ See <http://www.mofcom.gov.cn/aarticle/b/c/201210/20121008398882.html>

I Limitations on the equity used for capital contribution

Although the PRC Ministry of Commerce has been upbeat on equity contributions, it does not mean all types of equity can be used for capital contributions. The Regulations do impose limitations on the eligibility of equity used for capital contributions.

First, equity used for capital contributions must be legally transferable with integrated rights, and with no disputes regarding their ownership.

Secondly, it is required by the Regulations that equity cannot be used for capital contributions under the following circumstances:

- 1 The registered capital of the Equity Enterprise has not been paid in full;
- 2 The equity has been pledged;
- 3 The equity has been frozen in accordance with the law;
- 4 The equity was transferred in accordance with the Articles of Association or contract of an Equity Enterprise;
- 5 The equity is from a foreign-invested enterprise that failed to participate in, or failed the joint annual inspection, for foreign-invested enterprises during the previous year;
- 6 The equity is from a real estate enterprise, foreign investment company, or foreign-invested venture capital (VC) investment enterprise;
- 7 Other types of equity prohibited by law, regulations or decisions of the State Council.

Thirdly, the Regulation clearly states that domestic or foreign investors shall not illegally take advantage of equity contributions to evade foreign investment administration.

Finally, it should be noted that when submitting for the approval of an equity contribution, a legal opinion from a law firm regarding the above limitations is an indispensable supporting document.

II Equity used for capital contributions must be evaluated and equity contributions cannot exceed 70-percent of the registered capital of the Invested Enterprises

It is required by the Regulation that the equity used for capital contributions must be evaluated by a legally established domestic evaluation institution. The amount of the equity price and the amount of the equity contribution shall be negotiated between the Equity Contributors and the shareholders of the Invested Enterprises on the basis of the equity's evaluated price. Furthermore, the amount of equity contributions shall not exceed the evaluated price of the equity. Most importantly, the total amount of equity

contributions cannot exceed 70 percent of the registered capital of the Invested Enterprises.²

The basic contents of the Regulation are introduced above. It can be seen that the Regulation is a very detailed guide which can make a real difference in equity contribution practices involving foreign-invested enterprises. We think, however, the Regulation may have the following potential problems which will demand further clarification.

First, if Equity Enterprises are limited liability companies, how does one prove the legality of an equity transfer which is used for capital contributions? Currently, equity contributors are not required to submit shareholders' resolutions as well as statements to give up the right of first refusal from other shareholders of Equity Enterprises.

Secondly, it will be extremely difficult for the evaluation institution to evaluate the equity price of the Equity Enterprises provided those enterprises are listed companies. Since the equity price in the stock exchange is highly flexible, further guidance on the evaluation of equity is strongly recommended.

Finally, there is the issue of taxes. The Regulation is rather vague on tax applications for equity contributions. It only generally states that equity contributions shall conform to the provisions of the tax administration, but unfortunately lacks references to specific provisions.

We believe that the above problems will be identified by the competent authorities and be properly resolved in the future. The focus should be on the progress of this topic, and it is expected the regulation will greatly benefit the development of foreign capital in China.

² see also P.R.C Company Law

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