

Corporate

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In This Issue...

- China Eases Foreign Exchange Restrictions on FDI



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On November 21, 2012, China's State Administration of Foreign Exchange ("**SAFE**") released a new circular, "Circular on Further Improvement and Amendment of Foreign Exchange Control Policies on Direct Investment ([2012] No. 59)," which took effect on December 17, 2012 ("Circular 59"). Circular 59 implemented certain changes to the foreign exchange control policies on capital account transactions in foreign direct investment ("**FDI**") transactions and mergers and acquisitions ("**M&A**") activities involving foreign investors which should simplify the current SAFE approval procedures of many FDI and M&A transactions. Other than the procedural simplification, Circular 59 also contains certain important provisions that may be seen as a further step in the liberation of SAFE's tight control over capital accounts as part of the financial reform to attract more foreign investment after the decline of FDI in 2012.

The key provisions of Circular 59 are summarized below:

- **Foreign Currency Accounts.** The current SAFE regulations require a foreign investor to obtain various SAFE approvals before opening bank accounts in China to receive foreign currency to be used in specific FDI or M&A activities. Circular 59 largely eliminated the SAFE approval requirements and consolidated various types of such bank accounts. The banks will now process foreign investment accounts based on electronic information maintained by banks and SAFE.
- **Reinvestment of Foreign-Invested Enterprises ("**FIEs**") and Foreign-Invested Holding Companies ("**FIHCs**").** Proceeds from capital reserves, retained profit and foreign loans can be used to increase an FIE's registered capital without SAFE approvals. Similarly, an FIE can reinvest in another domestic entity through operational profits, equity transfer proceeds, capital reduction, liquidation and other legal means without SAFE approvals. Importantly for FIHCs and many foreign invested private equity and venture capital firms, the reinvestment process and the profit repatriation process between the investment companies and their portfolio companies have been simplified to eliminate the SAFE approval process although the capital injected into the portfolio companies continues to be subjected to the restrictions of capital accounts of FIEs.
- **Payment of Transfer Prices of Cross-Border M&A.** When a foreign company is acquiring a Chinese company's equity from a Chinese party in cash, the payment will be verified through an automatic system via a bank without the registration process at SAFE; and a specific SAFE approval is no longer required before a domestic buyer makes payment in foreign currency to a foreign counterparty in an equity transfer transaction.

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- **Outbound Payments by Domestic Persons.** The following activities are permitted without SAFE approvals:
 - Repatriation of proceeds obtained by FIEs from liquidation and capital decrease;
 - Start-up costs for offshore investments (up to 15% of the total investment amount);
 - Loans by FIEs to offshore shareholders (although the loan amount may not exceed the offshore shareholder's declared but unpaid profit and pro rata undeclared profit);
 - Foreign exchange loans by domestic companies to foreign persons; and
 - The payment of proceeds from sales of real properties held by offshore persons (including a foreign entity's domestic branch, representative office and foreign individuals).

Circular 59 is still relatively new. Similar to previous SAFE rules and regulations, it will take a while before SAFE and banks start to reconcile their practices in accordance with the rules. However, Circular 59 shows a clear sign that SAFE is reducing administrative procedures and even relaxing certain rigid rules in terms of domestic reinvestment and outbound payments which is consistent with the on-going financial reform.

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