



JONES DAY
COMMENTARY

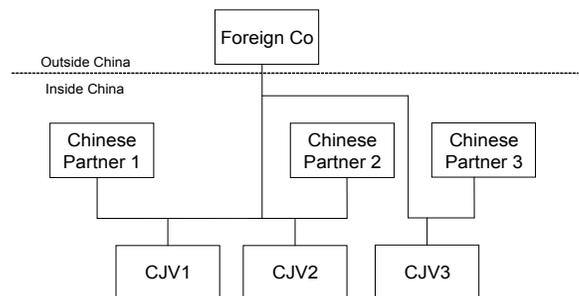
RETHINKING THE INVESTMENT STRUCTURE FOR MINERAL EXPLORATION IN CHINA

On July 18, 2008, the PRC's Ministry of Commerce and Ministry of Land and Resources issued Administrative Measures for Foreign-Invested Mineral Exploration Enterprises (the "Measures"), which came into effect on August 20, 2008. The Measures are applicable to foreign-invested enterprises ("FIEs") established under Chinese law and engaged in mineral (excluding oil, gas, and coalbed methane) exploration and related activities. The Measures clarified various issues concerning the application, approval, and operations of exploration FIEs, which appears to provide more flexibility for foreign companies structuring their investments in natural resources in China.

COMMON STRUCTURE OF EXPLORATION FIEs

A foreign company generally needs to form a local entity, an FIE, to conduct exploration activi-

ties in natural resources (other than oil and gas) in China. The FIE must be approved by the Ministry of Commerce or its local office. The exploration licenses are granted by either the Ministry of Land and Resources or the Bureau of Land and Resources at the provincial level. Due to the regulatory restrictions on granting exploration licenses, the common Chinese structure for multinational companies is the Chinese-foreign cooperative joint venture ("CJV"). The chart below illustrates this structure.



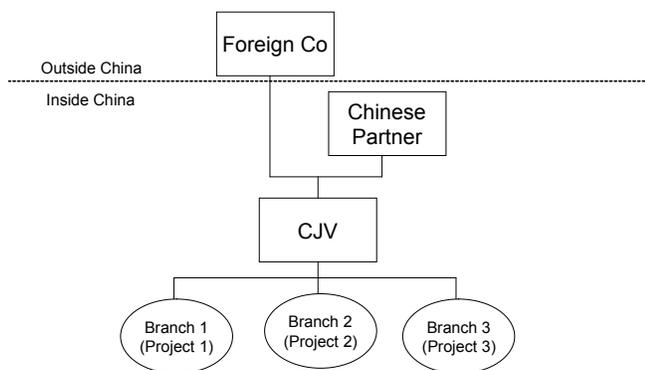
CJVs are typically set up as Chinese legal persons with limited liability. Each CJV is a separate taxpayer. Profits of one CJV cannot be offset by losses of another. The losses on abandonment of one project are wasted for Chinese tax purposes. Furthermore, approval for establishing a CJV is often a time-consuming process.

POSSIBLE STRUCTURE UNDER THE NEW RULES

The Measures establish the following clarifications, among others, concerning exploration FIEs:

- An FIE should not be restricted from obtaining an exploration license outside the place of its registration;
- An FIE may set up branches;
- A CJV may undertake multiple exploration projects; and
- CJV partners may agree to different profit-sharing ratios for different exploration projects undertaken by the CJV.

Based on the above provisions of the Measures, a foreign company may consider setting up one CJV to conduct multiple exploration and mining projects. The chart below illustrates the structure.



Under the China Corporate Income Tax Law, the CJV should include the income and losses of all the branches in computing its taxable income. This way, the profits and losses can be offset among the branches; abandonment losses from one project could be used by the CJV within the five-year loss-carryforward period. Because different profit-sharing ratios are permitted for different projects, there is a possibility that a partner can invest in the CJV and share profits from specific projects rather than the whole CJV, which should provide more flexible investment and financing opportunities.

CONCLUSION

The Measures have provided multinational companies with planning opportunities for their investments and operations in mineral exploration and mining in China. However, foreign investments in mining sectors are still subject to various restrictions under mining and foreign investment regulations, as well as practical interpretations by the Chinese central and local governments. For this reason, the implementation of theoretically permissible structures needs to be tested in practice.

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