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CHINA ENCOURAGES OUTBOUND INVESTMENTS

On July 13, 2009, the State Administration of Foreign Exchange ("SAFE") issued new rules to regulate the administration of foreign exchange with respect to overseas investments by Chinese entities. The *Administrative Rules for the Foreign Exchange Administration of Domestic Entities' Overseas Direct Investment* (the "Rules") is another sign of Chinese government's encouragement for Chinese companies to invest abroad.

CHINESE GOVERNMENT'S "GO OUT" POLICY SPURS OVERSEAS ACTIVITIES

In recent years, Chinese companies have begun large-scale overseas investments, including several large mergers and acquisitions, such as the unsuccessful Chinalco and Rio Tinto deal. State-owned enterprises and private-owned companies are growing rapidly and increasingly seek to expand overseas and compete in the global market with other multinational companies. In particular, Chinese companies with the support of the Chinese government have been particularly active in seeking to invest in natural resource companies and assets to lock in raw material supplies. As a result, China's outbound direct investment reached US$55.6 billion in 2008, a 19.4 percent increase compared to 2007.

As the country with the world's largest foreign currency reserve, the Chinese government has taken several measures to facilitate and increase these overseas investment activities under the "Go Out" policy, including:

- The State Council's *Opinion on Encouraging and Managing Overseas Investment by Domestic Entities* ("Circular No.10"), issued on March 20, 2007.
- The National Development and Reform Commission's ("NDRC") *Notification of the "Eleventh Five-Year Plan Regarding Overseas Investment* ("Circular No. 974"), issued in 2007.
- The State Administration of Taxation's *Opinion upon Doing Well in the Taxation Service and Management of Overseas Investment in Chinese Enterprises*, issued in 2007. This opinion announced three major measures with the primary aim of supporting overseas investment, which includes:

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a) Instituting uniform taxation service guidelines for Chinese enterprises' overseas investments;

b) Streamlining the tax information and consultancy channels for Chinese enterprises' overseas investments; and

c) Strengthening the taxation training for Chinese overseas investment enterprises.

- The Ministry of Commerce ("MOFCOM") issued the *Administrative Measures on Overseas Investment* ("Circular No. 5"), which came into effect on May 1, 2009, and lowered most required approvals for overseas investments to the provincial level, with central level approval only in the following circumstances:

a) The overseas investment amount is US$100 million or more;

b) Investments in certain specified countries or regions (as determined by MOFCOM and Ministry of Foreign Affairs);

c) Investments in countries that do not yet have diplomatic relations with China;

d) Investments involving more than one country or region; or

e) An offshore Special Purpose Vehicle ("SPV") is to be established.

Another factor in whether overseas investment will be approved is its potential effect on national security. Circular No. 5 also requires that an economic and technological Feasibility Study Report for such offshore investment be submitted along with other application documents. Once a complete set of application documents is submitted, MOFCOM will make a decision on such overseas investment within 15 working days.

These new measures from MOFCOM clearly reflect the central government's encouragement of overseas investments by domestic companies. Soon after the promulgation of Circular No. 5, other relevant ministries also announced new initiatives to support the offshore investment activities.

On April 22, 2009, the State Administration of Taxation announced that it has held internal discussions on new tax regulations for overseas investment activities with the expectation that such new tax policy will provide practical guidance to Chinese companies with overseas investments.

Following this trend, the new Rules issued by SAFE will play an important role to clarify the overseas foreign exchange policy and will significantly facilitate and support domestic entities' overseas investments.

SOURCES OF FOREIGN EXCHANGE EXPANDED FOR OVERSEAS INVESTMENTS

The Rules allow domestic entities to obtain foreign exchange for their overseas investments from different and additional sources than what was previously permitted, including:

a) Domestic foreign exchange loans;

b) Foreign exchange purchased with Chinese currency;

c) Foreign currency that such entities possess;

d) Physical assets;

e) Intangible assets;

f) Profits gained abroad; and

g) Any other financial source permitted by SAFE, which indicates that further flexibility and new foreign exchange resources may be added by SAFE in the future.

To further streamline the process, domestic companies are no longer required to obtain SAFE's approval before obtaining the foreign exchange for their overseas investments. Instead, companies are now required to register the source of their foreign exchange only after making the overseas investment.

OVERSEAS PROFITS NOT REQUIRED TO BE REMITTED

Prior to the promulgation of the Rules, Chinese government policy required domestic companies to remit their

foreign currencies back to China. SAFE's prior regulations on overseas investments[1] required that all profits and other foreign exchange earnings from overseas investment must be remitted back to China within six months, and SAFE approval is required to use such profit and foreign exchange earnings overseas.

The Rules reversed this policy by explicitly permitting overseas profits to remain offshore and used for further overseas investment. Prior SAFE approval is not required if such overseas profits are used for the establishment or acquisition of overseas entities, although SAFE registration for the foreign exchange will be required. The Rules require that foreign currency obtained through capital reduction, stocks transfer, and liquidation should be remitted back to China unless SAFE permission is obtained.

INITIAL EXPENSES OF OVERSEAS INVESTMENT REMITTED PRIOR TO FORMAL APPROVAL

The Rules permit Chinese companies to remit their initial expenses abroad before obtaining formal approval for the investment projects, which is also a major shift in China's foreign exchange policy.

According to the Rules, Chinese enterprises can apply to remit money overseas for the following purposes:

a) Deposit required by law or at the request of the seller in an equity or asset transfer transaction;
b) Deposit for a bidding; or
c) Necessary fees for market survey, leasing office, and hiring consultants before commencement of an overseas project.

Such initial expenses should generally not exceed 15 percent of the total overseas investment project, unless special approval has been obtained from SAFE.

Chinese companies still need to submit application documents to SAFE with respect to each overseas investment project, including letters of intent, memorandums of understanding, framework agreements, written commitment letters regarding initial expenses, and other related documents.

SUMMARY

In conclusion, Chinese government has changed its long-term stringent foreign currency control policy to facilitate overseas expansions by Chinese companies. Following such policy change, outbound merger and acquisition activities by Chinese companies are likely to increase exponentially.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Ben Tai
86.10.5866.1185
btai@jonesday.com

Jessie Tang
86.10.5866.1183
jtang@jonesday.com

1. *Measures for Foreign Exchange Control Relating to Overseas Investment*, issued on March 6, 1989, by SAFE.

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