

## Legal Framework for Chinese Outbound Investments

Following the market economy reforms of the late 1970s, the importance of trade ties between companies located in the People's Republic of China has constantly been on the rise. In recent years, the role of Chinese outbound investments has undergone considerable change and has been subject to ever stricter regulation. Some of the rules applicable to Chinese outbound investments have recently, with effect as of March 1, 2018, been modified. The present article takes a closer look at the current legal framework for Chinese outbound investments.

Against the background of reduced growth rates and weak renminbi exchange rates, the Chinese National Development and Reform Commission (NDRC) (Chinese: 国家发展和改革委员会) has introduced new rules regarding Chinese outbound investments (Administrative Measures for the Outbound Investment of Enterprises (New Measures), Chinese: „企 境外投资管理 法“).

On the one hand, these rules, which have become effective on March 1, 2018, are aimed at increasing the competitiveness of Chinese investors abroad.

On the other hand, they are intended to provide an incentive for Chinese companies to put more emphasis on domestic Chinese business in order to thereby minimize the risks of outbound investments for China's domestic economy, especially uncontrolled capital outflows.

The New Measures complement and expand the reach of the existing "Administrative Measures for the Verification and Approval and Record-Filing of Outbound Investment Projects" (2014 Measures).

Due to the importance of the People's Republic of China on the global political and economic stage, these innovations provide an opportunity to take a closer look at the issues regarding the regulation of Chinese outbound investments.

### An Overview of Outbound Regulations

If a Chinese company plans to invest abroad, various regulatory measures must be taken under Chinese law: The investor must either apply to both the NDRC and the Ministry of Commerce (MOFCOM - Chinese: 中 人民共和国商 部) for an approval or register the investment project.

Once the prospective investor company has successfully completed the relevant procedural steps, the investment project is registered with a state-approved foreign exchange bank in accordance with the requirements of the State Administration of Foreign Exchange (SAFE) (Chinese: 国家外 管理局). State-owned enterprises and publicly traded companies must meet additional requirements.

### The Procedure at the NDRC

Whether the investment project is subject to approval or must only be notified to the NDRC largely depends on three criteria: The sensitivity of the project, the classification as a direct or indirect investment and the investment volume.

In case a direct or indirect investment relates to a sector that has been classified as "sensitive", a permit will be required, regardless of the envisaged investment volume.

The potential classification of a sector as sensitive can be taken from an official catalogue. For all non-sensitive direct investments an application is sufficient. A non-sensitive indirect investment does not require any application. However, a project investment report must be submitted for investments exceeding USD 300 million.

### The Procedure at MOFCOM

The approval and registration procedure with the Chinese Ministry of Commerce is essentially the same as that of the NDRC. Accordingly, the decision on the procedure to be applied also here depends on the type of investment as well as the sector in which it shall

be made.

### **Registration with a Foreign Exchange Bank**

Finally, the investment must be registered with a foreign exchange bank that has received the "SAFE" identification code for financial institutions and has been granted access to the capital account information system.

Documents to be submitted inter alia include the application form for the required currency for the foreign direct investment to be made as well as the company's business license, which contains the so-called "unified social credit number".

In conjunction with an online rating system, the unified social credit number allows to make conclusions on the creditworthiness and overall behavior of a company. In case a company, based on the rating system, would for example have to be considered "dishonest", the foreign exchange bank would typically refuse to register the investment.

### **The New Rules for Chinese Outbound investments as of March 1, 2018**

The New Measures, which came into effect on March 1, 2018, relate to the approval and registration procedures with the NDRC.

Among other things, the reform has broadened the scope of applicability of the NDRC rules to include both direct and indirect investments, provided that the investor is a legal entity or natural person from China.

Another new feature consists in that the NDRC approval no longer constitutes a condition precedent for the validity of the investment agreement as such (i.e. usually the SPA/APA concerned), but is designed as an enforceable requirement which can be made part of the closing conditions. It is therefore sufficient if the relevant approval has been obtained before the closing of any given transaction.

Another important change relates to the classification of certain sectors as sensitive: Following a sharp increase in outbound investments (and their related capital and currency outflows) in the hotel, real estate, film and sport sectors of previous years and public declarations made by various Chinese government departments in December 2016 and classifying such investments as "undesirable", these sectors have now been included in the catalogue of "sensitive" sectors.

Like the 2014 Measures, the New Measures leave some important questions unanswered.

The subdivision into sensitive and non-sensitive target sectors is particularly broad, so that in individual cases there may be uncertainty as to which regulatory regiment will be used to assess an investment. However, the main weakness remains that, without the approval of the competent Chinese authorities, Chinese investors are not really in a position to enter into legally binding agreements (unless the other party to a given transaction is willing to accept that the closing of such transaction will depend on the relevant approval being granted). This can entail considerable delays in the transaction process. Even if the investment project only needs to be registered, the investor requires a "record-filing" notice from the NDRC in advance.

Despite the partial simplification of the regulatory procedures with the NDRC, the current amendments represent a shift from the familiar focused reviews during the initial stages to an extensive monitoring of the entire transaction process.

### **Summary**

In summary, it can be said that the procedures that a Chinese investor must endure in order to be able to lawfully engage in outbound investment activities are complex, time-consuming and, despite recent welcome amendments, still place a considerable strain on the time frame and planning of any transaction. The impact that the new rules will have will be heavily influenced by the development, consolidation and application of administrative regulations as well as the position that the public administration will take in applying the rules. Therefore, the impact of the newest reforms cannot be fully foretold at the present stage.

For the time being, German or European companies engaged in the contemplated transactions involving Chinese partners or investors should take the specifics caused by the rules applicable to Chinese outbound investment into consideration and ensure to obtain sufficient advice on these issues. Also Chinese companies planning to go for outbound investments should proactively analyze the rules so as to avoid that dealing with these rules and associated requirements will become a showstopper for transactions in Europe.

# Contacts

Dr. Michael Fischer

Partner

[mifischer@deloitte.de](mailto:mifischer@deloitte.de)

Tel.: +49 89 29036 8902

Xenia Pisarewski

Manager

[xpisarewski@deloitte.de](mailto:xpisarewski@deloitte.de)

Tel.: +49 89 29036 8863

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