

China Tax & Investment News

New regulations on business registration proposed by the SAIC to encourage domestic M&A in China

Background

The pace of mergers and acquisitions (M&A) as well as corporate restructurings has been accelerating in various industries and areas in recent years, among which, merging or splitting companies have been a very common step. Early in August 2010, the State Council released Guofa [2010] No. 27 (Circular 27) to promote the mergers of companies that have comparative advantages, to enhance company merges across regions and overseas, to support outbound investments, to encourage large-sized companies grouping and to speed up the upgrade of industrial structure in China market. Nevertheless, Circular 27 did not provide any detailed implementation rules but only served as a general guideline.

On 29 August 2011, the State Administration of Industry and Commerce (SAIC), i.e., the authority in charge of company registrations at the central government level, published a discussion draft of a new regulation on business registration for company mergers, acquisitions and splits (the "Discussion Draft") on its official website to solicit public opinion. The Discussion Draft clarifies and regulates the rules regarding company forms, registration types, capital requirements, etc., in the process of mergers and splits. This Discussion Draft, as it indicates, only applies to domestic companies (as detailed below). The solicitation for public opinion will be closed on 12 September 2011. This issue of China Tax & Investment News introduces the key features of the Discussion Draft and summarizes our observations for your reference.





Key features of the Discussion Draft

The Discussion Draft provides the following clarifications:

► Scope of application

The Discussion Draft only applies to mergers or splits among domestic companies or those will be converted into domestic companies after mergers or splits. It is worth noting that the Discussion Draft does not apply to business registrations for mergers among Foreign Investment Enterprises (FIEs) or business registrations for FIEs' splits after which surviving companies/newly established companies are categorized as FIEs. In other words, the Discussion Draft is not issued for registrations of companies which are categorized as FIEs after mergers or splits (the detailed analysis will be introduced in Our Observations).

On the other hand, the "Provisions for Foreign Investors to Merge or Acquire Domestic Companies" which was amended in 2009 (the "Foreign Investor M&A Provisions") applies to M&A activities carried out by foreign investors to merge and acquire domestic companies in China, where the "Provisions for Merger and Division of FIEs" amended in 2001 (the "FIE M&S Provisions") applies to merger and splits among Equity Joint Ventures (EJV), Cooperative Joint Ventures (CJV), Wholly Foreign-Owned Enterprises (WFOE), Foreign Investment Companies Limited by Shares (FICLS) (hereinafter referred to as "FIEs") as well as mergers between FIEs and domestic companies to form a new FIE (among which, shares of foreign investors should not be less than 25% of the total equity after the merger).

The table below illustrates forms of merger or splits and the respective applicable rules for your easy reference:

Forms of mergers or splits	Applicable rules
Mergers or splits among domestic companies	The Discussion Draft
Mergers among FIEs	The FIE M&S Provisions
Merges between domestic companies and FIEs with surviving or newly established companies categorized as FIEs after mergers (foreign investor shareholding shall not be less than 25% of the total equity)	The FIE M&S Provisions
Merges between domestic companies and FIEs with a surviving or newly set up company categorized as domestic company	The Discussion Draft
Foreign investors acquire domestic companies to form new FIEs (no requirements for the portion of foreign investor shares, however, a qualifying FIE which could enjoy preferential treatments shall have no less than 25% of foreign investor shares)	The Foreign Investor M&A Provisions
A split of a FIE with the a surviving or newly established company categorized as a domestic company.	The Discussion Draft

► **Definitions of mergers and splits**

The Discussion Draft specifies the detailed forms of mergers and splits. In addition, the PRC Company Law, the FIE M&S Provisions and Caishui [2009] No. 59 (Circular 59) all have respective definitions on mergers and splits. We summarize these definitions below for your easy reference:

Types	The Discussion Draft	The FIE M&S Provisions	The PRC Company Law	Circular 59	
Merger	Absorption merger	A company absorbs another company and the absorbed company is dissolved.	A company accepts another company to merge into it and the latter dissolved.	A company absorbs another company and the absorbed company is dissolved.	A merger refers to a transaction where one or more enterprises (enterprises being merged) transfer all of their assets and liabilities to an existing or newly established enterprise (post-merger enterprise) whereby the shareholders of the enterprise being merged would, in exchange, receive equity ownership rights in the post-merger enterprise or non-equity payments, and result in a legal merger of two or more enterprises.
	Consolidation merger (新设合并)	Two or more companies combine together for the establishment of a new entity, and the existing entities are dissolved.	Two or more companies combine together for the establishment of a new entity, and the entities involved in the merge are dissolved.	Two or more companies combine together for the establishment of a new entity, and the existing entities are dissolved.	
Splits	Split /spin-off	A company is divided into two or more companies and the company being divided remains in existence.	A company is divided into two or more companies. The company being divided remains in existence and one or more new companies are established.	All assets of a company under a split shall be divided among the companies that established after the splits. While all liabilities of the divided company shall also be transferred to the companies that were established after the splits.	Division refers to a transaction where an enterprise (enterprise being divided) transfers all or part of its assets to an existing or newly established enterprise (post-division enterprise) whereby the shareholders of the enterprise being divided would, in exchange, receive equity ownership in the post-division enterprise or non-equity payments, and result in a legal division of the enterprise being divided.
	Split-up	A company is divided into two or more companies and the company being divided is dissolved.	A company is divided into two or more companies and the company divided is dissolved, and two or more companies are newly established.		

► **Company types after mergers and splits**

According to the Discussion Draft, the surviving or newly established companies after mergers or splits may be registered as limited liability companies or companies limited by shares subject to the requirements prescribed in the PRC Company Law.

► **Relevant requirements for the registration**

1. What is the timeframe for the relevant registration?

According to the Discussion Draft, the registration application for merger and division should be lodged after 45 days upon the announcement made on newspapers.

The applicants are allowed to apply for de-registration, new company establishment registration or alteration at the same time.

Pursuant to the PRC Company Law, for a merger or a split, the companies involved shall enter into an agreement and make a public announcement on newspapers within 30 days after the resolution is made. Meanwhile, the Administrative Measures on Company Registration released by the State Council in 2005 reiterates that other than the required registration procedures for the alteration; de-registration and registration for establishment, companies under mergers or splits shall lodge the application for

registration; alteration or de-registration within 45 days after the announcement is made on newspapers and submit relevant contracts, board resolutions and announcements; relevant licenses and certificates together with declaration on liabilities clearance plan including redemption or guarantee. Approval letters for certain mergers or splits may also be required.

In this respect, the time frame requirement, i.e., 45 days upon announcement, for de-registration, newly establishment registration or alteration stipulated in the Discussion Draft, is consistent with the previous rules.

2. Limitation on the amount of registered capital and paid-in capital

For a surviving or newly established company upon a merger, its registered capital or paid-in capital should be determined by the amounts agreed on the agreement but is limited to the sum of the capital (or the paid-in capital) of all companies before the merger. The Discussion Draft also clarifies how to determine the sum of registered capital (or paid-in capital) of all companies before mergers in cases there are investments among merged companies, i.e., the corresponding registered capital (or paid-in capital) of the investee companies should be deducted from the sum of registered capital (or paid-in capital) of all companies before the mergers.

For the surviving or newly established companies upon a split, the sum of registered capital (or paid-in capital) of all companies after the split shall be determined by the amount agreed on the agreement but is limited to the capital (or paid-in capital) of the company before the split.

3. Shareholding ratio, share subscription and paid-in capital requirements

For the surviving or newly established companies from mergers or splits, the shareholding ratio, share subscription and paid-in capital of shareholders (founders) should be stipulated in merger or split agreements. If there are approval requirements stipulated in relevant laws, regulations or decisions of the State Council in this regard, specific approval would be required.

The Discussion Draft only applies to mergers or splits among domestic companies or those will be altered as domestic companies after mergers or splits.

For a company whose registered capital has not been fully paid up before a merger or a split, the surviving or the newly established company should make up the capital injection requirement according to the timing prescribed for the companies prior to the reorganization.

4. The transfer of branches or share ownership

The Discussion Draft stipulates that if a merged or a split company has branches, the settlement plan of such branches shall be indicated in the relevant resolutions. In case where it is stated that the branches belong to the surviving or newly established companies after the merger or the split, only a name alteration registration is required for these branches.

By the same token, if a merged or a split company holds shares of other limited liability companies, the settlement plan of such shares shall be indicated in the relevant resolutions. In case where it is stated that the shares belong to the surviving or newly established companies after the merger or the split, only equity share alteration registration is required for such shares. On the contrary, if it is noted in the resolution that the share ownership will be withdrawn, the legal procedures for the relevant share transfer and capital investment should be completed before the merger or the split.

Our observations

► Scope of application

As aforesaid, the Discussion Draft only applies to:

- Mergers and splits between domestic companies,
- A split of a FIE with a surviving or newly established company categorized as domestic company, and

- Mergers between domestic companies and FIEs with a surviving or newly set up company categorized as domestic company

In short, the Discussion Draft only applies to business registrations for mergers and splits after which the surviving or newly established companies are categorized as domestic companies. Nevertheless, there is no further explanation in the Discussion Draft that whether the “domestic companies” resulted from mergers or splits also cover the companies with less than 25% foreign equity. However, the FIE M&S Provisions indicated that it applies to FIEs resulted from mergers between FIEs and domestic enterprises, while the FIEs has been defined as those with no less than 25% foreign equity. Accordingly, it is not unreasonable to conclude that the Discussion Draft also applies to those foreign invested companies (post mergers and splits) with less than 25% foreign equity.

► Simultaneous de-registration, establishment or alteration registration

According to the current “Administrative Regulations on Enterprises Registration”, surviving companies after mergers or splits should apply for alteration registration; companies dissolved after mergers or splits should apply for de-registration; companies newly set up after mergers or splits should apply for establishment registration. Unlike previous requirements, the Discussion Draft allows applicants to make de-registration, new establishment and alteration registration simultaneously. Further, the Discussion Draft indicates that as for mergers and splits with multiple registration authorities, it is the registration authorities' obligations to coordinate and communicate with each other to facilitate the process. This statement would effectively reduce the time cost of mergers and splits.

However, the applicants applying for de-registration, establishment and alteration registrations at the same time may also need coordination and connection of different governmental authorities. In the absence of a jointly issued circular, such simultaneous application may face practical implementation hurdle. For example, under a consolidation merger, if the new company is still in the course of establishment, without transferring the title of its assets, the original company cannot be de-registered, whilst its branches or subsidiaries also cannot be transferred to the new company as it has not been officially established. Nevertheless, if there is a transitional system jointly developed by different governmental authorities to provide special treatment for such projects, the above-mentioned simultaneous process would be more feasible.

► **Flexibility in post-M&A capital**

Unlike the regulations on mergers and splits of FIEs, the Discussion Draft allows the registered capital (or paid-in capital) of a surviving or newly established company from a merger or a split to be determined by the merger or split agreement. However, the amount of registered capital (or paid-in capital) of Post-M Company cannot exceed the sum capital of all merged companies. Identically, the sum of registered capital (or paid-in capital) of all Post-S Companies cannot exceed the amount of the company's before the split.

Interestingly, under the aforesaid conditions, companies might be able to share capital resources through restructuring. For example, in the process of a merger, Company A can obtain 50% of equity interests of the merged company while investing 80% of assets, as long as both parties agree, the balance of the investment of Company A could be made in the form as share premium.

Further, for a company (Prior-M&S Company) whose registered capital has not been fully paid up before a merger or a split, the registered capital of the surviving or the newly established company should be paid in accordance with the timing requirement originally prescribed. It could be interpreted that if a company has not fully paid its registered capital, the underpaid part could be made up by another investor as long as it is stipulated in the merger agreement. In a case where it is impossible to reduce the registered capital but the payment deadline is approaching, mergers between profit-making companies with adequate cash and companies with underpaid registered capital could be a good option to fulfill capital requirement without raising extra funding.

► **Simplified procedures for transfer of branches and share ownership**

The transfer of branches or shares in business mergers or splits was not clarified in previous regulations. In practice, the registration procedures vary in different locations. Some local registration authorities required that the branches or subsidiaries should follow a full de-registration and a new set-up registration procedures. Apart from time cost, it may lead to a series of tax impacts. The Discussion Draft indicates that the surviving branches after mergers or splits or the shares transferred during mergers or splits only need alteration registration after the mergers or splits, which is definitely good news for companies with lots of branches or subsidiaries.

As aforesaid, the Discussion Draft stipulates that shares (e.g., shares of subsidiaries) involved in a merger or a split only need an alteration registration. In other words, it should not be treated as a share

transfer. In practice, more detailed implementation rules may need to be released to facilitate such alteration registration so as to avoid any misunderstandings, especially from a tax perspective.

You can make a difference

The SAIC is open to collect public opinions by 12 September 2011. This would be a good opportunity for us to get involved earlier and express our opinions to the legislators of the government. You may submit your comments to the SAIC via the following four channels:

- Log on the SAIC website (www.saic.gov.cn), enter into "Public opinion solicitation system for draft regulations" from the "Public opinion solicitation on draft regulations" section on the right side of home page;
- Send faxes to 010-68017816
- Send emails to qyjzdc@saic.gov.cn; or
- Send mails to the following address: No. 8 of East Sanlihe Road, Xicheng District, Beijing, Enterprise Registration Bureau of SAIC (postal code: 100820)

Summary

With increased M&A activities recently, the Chinese governmental authorities have released many circulars to regulate M&A activities. The Discussion Draft mainly applies to the alteration, de-registration and newly established registration of domestic enterprises resulted from mergers or splits. From this point of view, registration related to foreign enterprises should follow other relevant circulars rather than this one. For companies with M&A plans ahead or have been in the course of such activities, they should read this draft thoroughly and understand relevant requirements, including the starting time of registration, the requirements of registered capital, caps of paid-in capital, proportion of investment, subscription and paid-in amounts of capital, so as to mitigate potential risks.

Contact us

To obtain more information, please contact your usual Ernst & Young contact or one of the following of Ernst & Young's China tax client service partners.

► Central China

Alfred Shum (Corporate Tax)
+86 21 2228 2298
alfred.shum@cn.ey.com

Audrie Xia (Corporate Tax)
+86 21 2228 2886
audrie.xia@cn.ey.com

**Bas Leenders
(International Tax Services)**
+86 21 2228 4782
bas.leenders@cn.ey.com

Bill Zhang (Transaction Tax)
+86 21 2228 2871
bill.zhang@cn.ey.com

Bryan Tang (Indirect Tax)
+86 21 2228 2294
bryan.tang@cn.ey.com

Carrie Tang (Corporate Tax)
+86 21 2228 2116
carrie.tang@cn.ey.com

Chuan Shi (Corporate Tax)
+86 21 2228 4306
chuan.shi@cn.ey.com

Derek Chow (Corporate Tax)
+86 21 2228 3009
derek.chow@cn.ey.com

Freeman Bu (Human Capital)
+86 21 2228 3880
freeman.bu@cn.ey.com

Genqiang Gao (Corporate Tax)
+86 21 2228 2105
genqiang.gao@cn.ey.com

Henrik Hansen (Transfer Pricing)
+86 21 2228 3366
henrik.hansen@cn.ey.com

Iris Tao (TARAS)
+86 21 2228 3268
iris.tao@cn.ey.com

**Jennifer Williams
(International Tax Services)**
+86 21 2228 2011
jennifer.williams@cn.ey.com

Jesse Lv (Transaction Tax)
+86 21 2228 2798
jesse.lv@cn.ey.com

Jessica Tien (Transfer Pricing)
+86 21 2228 2115
jessica.tien@cn.ey.com

Julian Hong (Transfer Pricing)
+86 21 2228 2726
julian.hong@cn.ey.com

Linda Liu (Corporate Tax)
+86 21 2228 2801
linda-sy.liu@cn.ey.com

Michael Lin (Indirect Tax)
+86 21 2228 3006
michael-cs.lin@cn.ey.com

Min Fei (International Tax Services)
+86 21 2228 2582
min.fe@cn.ey.com

Norman Yu (Human Capital)
+86 21 2228 2287
norman.yu@cn.ey.com

Patricia Xia (Corporate Tax)
+86 21 2228 2878
patricia.xia@cn.ey.com

Robert Smith (Indirect Tax)
+86 21 2228 2328
robert.smith@cn.ey.com

Sarah Chan (Corporate Tax)
+86 21 2228 2327
sarah-kw.chan@cn.ey.com

Titus von dem Bongart (German Desk)
+86 21 2228 2884
titus.bongart@cn.ey.com

**Toshikazu Tagawa
(International Tax Services)**
+86 21 2228 2118
toshikazu.tagawa@cn.ey.com

Travis Qiu (Transfer Pricing)
+86 21 2228 2941
travis.qiu@cn.ey.com

Vickie Tan (Corporate Tax)
+86 21 2228 2648
vickie.tan@cn.ey.com

Walter Tong (Corporate Tax)
+86 21 2228 6888
walter.tong@cn.ey.com

Yeeckle Zhou (Transaction Tax)
+86 21 2228 2833
yeeckle.zhou@cn.ey.com

► Northern China

Alan Lan (Corporate Tax)
+86 10 5815 3389
alan.lan@cn.ey.com

**Andrew Choy
(International Tax Services)**
+86 10 5815 3230
andrew.choy@cn.ey.com

Andy Chen (Corporate Tax)
+86 10 5815 3381
andy.chen@cn.ey.com

April Liao (Human Capital)
+86 22 5819 4700
april.liao@cn.ey.com

Catherine Li (Corporate Tax)
+86 10 5815 3890
catherine.li@cn.ey.com

**Connie Kwok
(International Tax Services)**
+86 10 5815 2855
connie.kwok@cn.ey.com

David Kuo (Transaction Tax)
+86 10 5815 3377
david.kuo@cn.ey.com

Henry Chan (Corporate Tax)
+86 10 5815 3397
henry.chan@cn.ey.com

**HongRae Jang
(International Tax Services)**
+86 10 5815 3625
hongrae.jang@cn.ey.com

Jason Mi (Human Capital)
+86 10 5815 3990
jason.mi@cn.ey.com

Joanne Su (Transfer Pricing)
+86 10 5815 3380
joanne.su@cn.ey.com

Joseph Lee (Corporate Tax)
+86 10 5815 3383
joseph.lee@cn.ey.com

Julie Hao (International Tax Services)
+86 10 5815 2805
julie.hao@cn.ey.com

Kenneth Leung (Indirect Tax)
+86 10 5815 3808
kenneth.leung@cn.ey.com

Laura Wu (International Tax Services)
+86 10 5815 3880
laura.wu@cn.ey.com

Leo Chiu (Transaction Tax)
+86 10 5815 3622
leo.chiu@cn.ey.com

Manabu Takahama (Transfer Pricing)
+86 10 5815 2834
manabu.takahama@cn.ey.com

Martin Ngai (Corporate Tax)
+86 10 5815 3231
martin.ngai@cn.ey.com

Samuel Yan (Corporate Tax)
+86 10 5815 3226
samuel.yan@cn.ey.com

Si Si Xiang (Corporate Tax)
+86 10 5815 2822
si-si.xiang@cn.ey.com

William Cheung (Human Capital)
+86 10 5815 3301
william.cheung@cn.ey.com

► **Southern China**

Becky Lai (International Tax Services)
+852 2629 3188
becky.lai@hk.ey.com

Chris Finnerty (International Tax Services)
+852 2629 3868
chris.finnerty@hk.ey.com

Christian Pellone (International Tax Services)
+852 2629 3308
christian.pellone@hk.ey.com

Clement Yuen (Corporate Tax)
+852 2629 3355
clement.yuen@hk.ey.com

David Chan (Transaction Tax)
+852 2629 3228
david.chan@hk.ey.com

David Chiu (Corporate Tax)
+86 755 2502 8180
david.chiu@cn.ey.com

Enoch Chan (Corporate Tax)
+86 20 2881 2738
enoch-yt.chan@cn.ey.com

Enoch Hsu (Transfer Pricing)
+86 755 2502 8287
enoch.hsu@cn.ey.com

Ivan Chan (Corporate Tax)
+852 2629 3828
ivan.chan@hk.ey.com

Jane Hui (Transaction Tax)
+852 2629 3836
jane.hui@hk.ey.com

Ken Chung (Transaction Tax)
+852 2629 3991
ken.chung@hk.ey.com

Lawrence Cheung (Corporate Tax)
+86 755 2502 8383
lawrence-f.cheung@cn.ey.com

Loretta Shuen (Corporate Tax)
+852 2629 3778
loretta.shuen@hk.ey.com

Mak Ho Sing (Corporate Tax)
+86 755 2502 8289
ho-sing.mak@cn.ey.com

Patrick Cheung (Transfer Pricing)
+852 2846 9905
patrick.cheung@hk.ey.com

Paul Wen (Human Capital)
+852 2629 3876
paul.wen@hk.ey.com

Rio Chan (Corporate Tax)
+86 20 2881 2878
rio.chan@cn.ey.com

Sam Pang (Human Capital)
+86 755 2502 8160
sam.pang@cn.ey.com

Simon Wang (Corporate Tax)
+86 20 2881 2822
simon-sm.wang@cn.ey.com

Tami Tsang (Transaction Tax)
+852 2849 9417
tami.tsang@hk.ey.com

Ernst & Young

Assurance | Tax | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

For more information about our organization, please visit www.ey.com

About Ernst & Young's Tax Services in China

Ernst & Young's 930 tax professionals in China provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. Our talented people, consistent methodologies and unwavering commitment to quality service help you to build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its ambitions. It's how Ernst & Young makes a difference.

© 2011 Ernst & Young (China) Advisory Limited
All Rights Reserved.
FEA no. 03001381

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither Ernst & Young (China) Advisory Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

www.ey.com/china