Local Initiatives Facilitate Rmb Private Equity Funds

Since the promulgation of the Partnership Enterprise Law, which came into effect in June 2007, local Chinese governments have taken important steps to facilitate the establishment of private equity funds pursuant to such Law.

As early as November 2007, the Administration of Industry and Commerce (“AIC”) in Tianjin issued the Opinions on Registration of Private Equity Investment Funds and Private Equity Investment Fund Management Enterprises (the “Opinions”) allowing both domestic and foreign investors to establish private equity (“PE”) funds in the form of limited liability company and company limited by shares. Domestic investors can also establish limited partnerships to make PE investments. Tianjin authorities seem to treat foreign invested enterprises as “domestic” investors in their establishment of PE partnerships.

On August 11, 2008, the Shanghai AIC jointly with the Financial Services Office, and the State and Local Tax Bureaux issued the Circular on Matters with respect to Registration of Equity Investment Enterprises (the “Circular”). The Circular regulates the establishment of “equity investment enterprises” and “equity investment management enterprises”. It explicitly allows equity investment enterprises to be established as limited partnerships and clarifies the income tax treatment of individuals who are general partners or limited partners. It authorizes these enterprises to have “equity investment” and “equity investment management”, respectively, as their registered business scope, without making their establishment subject to any industry-specific approval or oversight. Unlike existing venture capital regulations, there is no requirement to invest in high tech industries.

The local regulations attempt to address many issues important to the establishment of PE funds, such as timing for the capital contribution and tax treatments of the partners. For example, the Circular does not specify a time limit for the minimum equity funding of Rmb 100 million be injected. Thus, in accordance with the Partnership Enterprise Law, the partners of a Shanghai PE fund organized as a limited partnership may agree in the partnership agreement the time period and conditions the GP may draw on the commitments of the LPs. On taxation, the Tianjin authorities allow the GPs and LPs the flexibility to choose the local tax bureau at which they will pay income tax on income derived from the PE fund. However, such policy is not necessarily accepted by other localities.

While local authorities, such as Shanghai and Tianjin, encourage domestic investors in onshore private equity funds, it is not the same for foreign investors. Regulations governing partnerships with foreign general or limited partners were drafted in 2007 but have not yet been adopted. Thus foreign investment in PE funds is still limited by regulations of venture capital investments in high tech industries.

By Hans-Günther Herrmann, counsel
Paul, Weiss Rifkind, Wharton & Garrison
Hong Kong Club Building, 12th Floor
3A Chater Road, Central, Hong Kong
Email: hherrmann@paulweiss.com
Ph: (852) 2846-0331