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Overseas Investment by Chinese Individuals - Current Legislation and Recent Developments

With the strong and rapid growth of its economy, China is becoming more anxious to invest abroad. The Chinese Yuan (RMB) has continuously appreciated and is on its inevitable track to internationalisation. The legislation concerning direct outbound investment by Chinese institutions has also witnessed substantial progress. However, in the area of Chinese individuals investing abroad a similar break-through is still to come.

This newsletter presents legislation and recent developments in relation to Chinese overseas investment.

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Overseas Investment by Chinese Individuals - Current Legislation and Recent Developments

by Michael Tan* and Cara Meng**

Current Status and Practice of Legislation on Individual Outbound Investment

The existing Chinese statutes are almost silent in the area of individual outbound investment activities.[1] There is no specific legislation on this topic. Only a few general regulations relating to overseas investment of Chinese individuals which are scattered over the existing foreign exchange control regulations.

Although the existing laws seem to provide for a general legal basis permitting Chinese individuals to invest abroad, the regulations are not fully consistent. In practice, the legal framework for Chinese individuals investing abroad is not implemented due to absence of detailed rules and the frequent reluctance of the competent authorities to involve themselves in this topic.

One might interpret this as a certain disunity between various governmental authorities and also the feeling of hesitation of the competent authorities to take over the examination and approval responsibility as well as related supervision work.

Against this background Chinese individuals investing abroad follow different routes, aiming at going around the practical obstacles caused by the vague legislation and the hesitating authorities, which are further described below.

Corporate Investment

Since the present legislation on outbound investment by Chinese enterprises is more comprehensive and executable, most Chinese individuals who wish to invest abroad tend to set up companies to channel their overseas investment. The major disadvantage of using investment companies is the additional tax burden because the investing companies are usually subject to corporate income tax. Furthermore, establishing and maintaining an investment company leads to additional administrative burdens (e.g. regarding management and accounting).

Outbound investment through investment companies is governed by the rules and regulations applicable to enterprises investing abroad. Among such rules and regulations the only specific regulations related to individual outbound investment are the rules on the so called "round trip investments". According to these rules, any establishment of an outbound vehicle by Chinese individuals for financing purposes is subject to complicated filing procedures with the State Administration of Foreign Exchange (SAFE). A round trip investment is typically used if an offshore company (a special purpose company) is set up for an initial public offering (IPO) in order to finance business operations in mainland China. The most recent legislation in this aspect are the SAFE's *Guidance Rules on Procedures of Foreign Exchange Administration on Financing and Round-trip Investment Conducted by Residents in China via Special Purpose Companies* issued on May 20, 2011. The focus of these regulations is the control of external financing by Chinese individuals from abroad. Since the "outbound investment" (i.e. the establishment of an off-shore investment vehicle) in this context is only an intermediate technical step to achieve the final purpose of financing of domestic businesses, the mentioned rules are not typical regulations on outbound investment by Chinese individuals.

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Practice in the Grey Area

In practice, another way followed by many Chinese individuals is to transfer substantial amounts for investment purposes via “underground banks” which use various legally questionable means to remit funds out of China. For example, each Chinese individual is permitted to remit up to USD 50,000/year out of China [2] for current account transactions (e.g. tourism), but not for capital account transactions like an outbound investment. The risks are obvious: According to the present laws, such money transfer is illegal, can result in a fine up to the amount equivalent to the investment and even trigger criminal liability.

Suspended Pilot Scheme in Wenzhou

On January 7, 2011, the Wenzhou Foreign Trade & Economic Cooperation Bureau (Wenzhou BOFTEC) launched a pilot policy to grant individuals in Wenzhou the permission to invest abroad. These policies, if implemented, would have become the first rather practicable regulations for Chinese individuals to legally conduct outbound investment. However, on January 21, 2011, it was reported by public media in China that SAFE had ordered suspension of these pilot policies.

The real reasons behind the sudden withdrawal of the Wenzhou pilot policies might be a power competition and conflict between different governmental agencies. For example the National Development and Reform Commission (NDRC), which is in charge of project planning approvals for all outbound investment, was not involved in the enactment of the Wenzhou pilot project. In general, any successful new legislation project usually requires very good coordination and balance of power among all involved authorities.

Shanghai Ambitions

The failed Wenzhou pilot policies are not the only case of a local legislation attempts in this area. Shanghai is reported to have submitted a detailed legislation proposal on the topic of Chinese individual outbound investment to the State Council for approval. This proposal is reported to have started its journey through various concerned authorities at the central level for the purpose of soliciting comments. According to public reports and compared with the revoked Wenzhou policies, the legislation proposal of Shanghai covers a broader scope of permitted investment areas. A remarkable difference is that the Shanghai proposal permits Chinese individuals to engage in real estate and in the field of equity investment.

Considering the level of the authorities involved in the process and the officially announced support from the central government given to Shanghai regarding its ambitions to become an international financial center, it is expected that Shanghai will take a shot: It is likely that the Shanghai proposal will become the ice breaker in terms of practical rules enabling Chinese individuals to invest abroad.

Outlook

Considering the rapid growth of China’s demand for outbound investment, its status as the world’s second largest economy and the long term trend of the Chinese currency towards appreciation and internationalisation, one has plenty of reasons to believe that a breakthrough in the liberation of the foreign exchange control regime as regards outbound investment both by institutions and by all Chinese individuals is to be expected in the near future. China’s turns from one of the world’s most attractive destinations for foreign direct investment into one of the leading global stake holders in other countries is just a matter of time.

[1] Please also refer to Taylor Wessing's China Alerter of January 2010 “New Rules on Chinese Overseas Investment” available [here](#).

[2] Art. 2 of the *Implementation Rules of Individual Foreign Exchange Measures*.

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Michael is the first Chinese Senior Counsel of Taylor Wessing. He has profound experience in supporting multinational as well as medium-sized corporations in their business operations and investments in mainland China. His experience includes advising on the establishment of foreign investment enterprises in various industries, M&A, restructuring and liquidation of foreign investment enterprises, technology and software imports. Michael has advised on several projects in the automotive, aviation, telecommunication, computer technology, natural resources and real estate sectors. Michael also provides support to Chinese companies in their “going abroad” activities, including business expansion and IPO in Europe.

Michael studied law at the University of International Business and Economics in Beijing (UIBE), China, where he also completed his LLB and LLM degrees in 1997 and 2000 respectively. In 2006, Michael received his law doctorate from UIBE.

In 1997, Michael was admitted to the Chinese bar. After practicing in domestic law firms, he worked in the Beijing office of a major international law firm from 2000 to 2002. In 2002, he joined Taylor Wessing in the Shanghai office. As of 2007, he has been appointed as a Senior Counsel of Taylor Wessing. Michael is a frequent commentator on Chinese business and legal matters. Michael speaks Mandarin, Fujian dialect as well as English fluently.



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Cara studied law at East China Normal University in Shanghai, China, where she completed her LLB and LLM degrees in 2006 and 2009 respectively. In 2007, Cara passed the judicial examination of China. Cara joined Taylor Wessing in 2010. Cara speaks Mandarin and English fluently .

*Since Cara is working for a foreign law firm, she is presently not permitted to simultaneously practice as a Chinese lawyer.





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