



Private Equity

**Fund formation and transactions
in 42 jurisdictions worldwide**

2009

Contributing editor: Casey Cogut



Published by
GETTING THE DEAL THROUGH
in association with:

Advokatfirman Delphi
Appleby
Batalla Abogados
Blake, Cassels & Graydon LLP
Bowman Gilfillan
Carey Olsen
CHSH Cerha Hempel Spiegelfeld Hlawati
Dillon Eustace
Esinlsmen
G Breuer
Gide Loyrette Nouel
Hamelink & Van den Tooren NV
Hernández & Cía Abogados
HJM Asia Law & Co LLC
Homburger
Jones Day
Kennedy Van der Laan NV
Kromann Reumert
Latournerie Wolfrom & Associés
Lee & Ko
Lepik & Luhaäär LAWIN
Loyens & Loeff, Luxembourg
Lydian
Moussas & Tsibris
Mundie e Advogados
Navarro Abogados
Nishith Desai Associates
P+P Pöllath + Partners
Proskauer Rose LLP
Rodés & Sala
SAI Consultores, SC
Salomon Partners
Simpson Thacher & Bartlett LLP
Slaughter and May
Smaliukas, Juodka, Beniusis & Partners
Stoica & Asociatii – Attorneys at Law
Wiesner & Asociados Ltda, Abogados
WongPartnership LLP
Yangming Partners



Private Equity 2009

Contributing editor

Casey Cogut
Simpson Thacher & Bartlett LLP

Business development manager

Joseph Samuel

Marketing managers

Alan Lee
Dan Brennan
George Ingledew
Edward Perugia
Robyn Hetherington
Dan White
Tamzin Mahmoud
Elle Miller

Marketing assistant

Ellie Notley

Subscriptions manager

Nadine Radcliffe
Subscriptions@
GettingTheDealThrough.com

Assistant editor

Adam Myers

Editorial assistants

Nick Drummond-Roe
Charlotte North

Senior production editor

Jonathan Cowie

Subeditors

Jonathan Allen
Laura Zúñiga
Kathryn Smuland
Sara Davies
Ariana Frampton
Sarah Dookhun

Editor-in-chief

Callum Campbell

Publisher

Richard Davey

Private Equity 2009

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 7908 1188
Fax: +44 20 7229 6910
© Law Business Research Ltd
2009

No photocopying: copyright
licences do not apply.

ISSN 1746-5524

The information provided in this publication is general and may not apply in a specific situation. Legal advice should always be sought before taking any legal action based on the information provided. This information is not intended to create, nor does receipt of it constitute, a lawyer-client relationship. The publishers and authors accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of February 2009, be advised that this is a developing area.

Printed and distributed by
Encompass Print Solutions.
Tel: 0870 897 3239

Law

Business

Research

CONTENTS

Global Overview Casey Cogut, William Curbow and Kathryn King Sudol <i>Simpson Thacher & Bartlett LLP</i>	3
FUND FORMATION	
Bermuda Sarah Moule <i>Appleby</i>	6
British Virgin Islands Valerie Georges-Thomas <i>Appleby</i>	13
Canada J Rob Collins and Frank P Arnone <i>Blake, Cassels & Graydon LLP</i>	19
Cayman Islands Bryan Hunter and André Ebanks <i>Appleby</i>	23
China Caroline Berube, Linford Liu, Patrick Pu, Ivy Yang and James Yule <i>HJM Asia Law & Co LLC</i>	29
Denmark Vagn Thorup and Lisa Bo Larsen <i>Kromann Reumert</i>	35
England & Wales Timothy Drake <i>Proskauer Rose LLP</i>	40
Germany Amos Veith <i>P+P Pöllath + Partners</i>	48
Guernsey Ben Morgan, Geoff Ward-Marshall and Emma Penney <i>Carey Olsen</i>	54
India Vikram Shroff and Richie Sancheti <i>Nishith Desai Associates</i>	60
Ireland Andrew Lawless and Sean Murray <i>Dillon Eustace</i>	66
Italy Bruno Castellini, Stefano Crosio and Velislava Popova <i>Jones Day</i>	73
Jersey Andrew Weaver and Mark Lewis <i>Appleby</i>	80
Luxembourg Gilles Dusemon and Marc Meyers <i>Loyens & Loeff, Luxembourg</i>	85
Mauritius Malcolm Moller <i>Appleby</i>	92
Netherlands Louis Bouchez, Floor Veltman and Maurits Bos <i>Kennedy Van der Laan NV</i> Jan van den Tooren and Reinier Noort <i>Hamelink & Van den Tooren NV</i>	99
Singapore Low Kah Keong <i>WongPartnership LLP</i>	106
Spain Carlos de Cardenas, Victor Domenech, Alejandra Font, Javier Morera and Julio Veloso <i>Rodés & Sala</i>	111
Sweden Anders Lindström, Anders Björk and Peter Utterström <i>Advokatfirman Delphi</i>	118
United States Thomas H Bell, Barrie B Covit, Jason A Herman, Glenn R Sarno and Michael W Wolitzer <i>Simpson Thacher & Bartlett LLP</i>	124
TRANSACTIONS	
Argentina Diego Fissore <i>G Breuer</i>	131
Austria Albert Birkner and Hasan Inetas <i>CHSH Cerha Hempel Spiegelfeld Hlawati</i>	137
Belgium Peter De Ryck <i>Lydian</i>	143
Brazil Arthur R Viñau and Ricardo P C Villela <i>Mundie e Advogados</i>	149
Canada J Rob Collins and Frank P Arnone <i>Blake, Cassels & Graydon LLP</i>	155
Cayman Islands Stephen James and Simon Raftopoulos <i>Appleby</i>	160
China James Yule, Ivy Yang, Patrick Pu and Caroline Berube <i>HJM Asia Law & Co LLC</i>	164
Colombia Mauricio Rodríguez A and Eduardo A Wiesner <i>Wiesner & Asociados Ltda, Abogados</i>	171
Costa Rica Rodrigo Zelaya <i>Batalla Abogados</i>	176
Denmark Vagn Thorup and Bent Kemplar <i>Kromann Reumert</i>	180
England & Wales Timothy Drake <i>Proskauer Rose LLP</i>	185
Estonia Gerli Kilusk <i>Lepik & Luhaäär LAWIN</i>	191
France Pierre Lafarge, Claire Langelier and Nicolas Duboille <i>Latournerie Wolfrom & Associés</i>	196
Germany Andres Schollmeier <i>P+P Pöllath + Partners</i>	202
Greece Michael Tsibris <i>Moussas & Tsibris</i>	207
Hong Kong Benita Yu and Risen Tan <i>Slaughter and May</i>	211
India Archana Rajaram and Amrita Singh <i>Nishith Desai Associates</i>	217
Ireland Andrew Lawless and Sean Murray <i>Dillon Eustace</i>	223
Italy Bruno Castellini, Stefano Crosio and Velislava Popova <i>Jones Day</i>	227
Korea Wonkyu Han and Je Won Lee <i>Lee & Ko</i>	232
Lithuania Robert Juodka, Inga Martinkute, Tomas Venckus, Vaida Pacenkaite, Arunas Kasparas, Ramunas Svencionis and Mindaugas Rimkus <i>Smaliukas, Juodka, Beniusis & Partners</i>	238
Mexico Juan Pablo Martínez Velasco and Luis Alberto Aziz Checa <i>SAI Consultores, SC</i>	244
Netherlands Louis Bouchez, Floor Veltman and Maurits Bos <i>Kennedy Van der Laan NV</i> Jan van den Tooren and Reinier Noort <i>Hamelink & Van den Tooren NV</i>	248
Peru Juan Luis Hernández, Alfredo Filomeno and Alvaro del Valle <i>Hernández & Cía Abogados</i>	255
Romania Cristiana I Stoica <i>Stoica & Asociatii – Attorneys at Law</i>	260
Russia Anton Klyachin and Igor Kuznets <i>Salomon Partners</i>	264
Singapore Ng Wai King and Dawn Law <i>WongPartnership LLP</i>	269
South Africa David Anderson and Shahid Sulaiman <i>Bowman Gilfillan</i>	275
Spain Julio Veloso, Javier Morera and Victor Domenech <i>Rodés & Sala</i>	283
Sweden David Aversten, Clas Romander, Peter Sjögren and Michael Juhlin <i>Advokatfirman Delphi</i>	289
Switzerland Dieter Gericke, Reto Heuberger and Jürg Frick <i>Homburger</i>	295
Taiwan Robert C Lee and Claire Wang <i>Yangming Partners</i>	301
Turkey Ismail Esin and Arzum Gunalcin <i>EsinIsmen</i>	306
Ukraine Karl Hepp de Sevelinges and Illya Tkachuk <i>Gide Loyrette Nouel</i>	310
United States William Curbow and Kathryn King Sudol <i>Simpson Thacher & Bartlett LLP</i>	315
Uruguay Alfredo Navarro Castex and Alfredo H Navarro <i>Navarro Abogados</i>	322

China

Caroline Berube, Linford Liu, Patrick Pu, Ivy Yang and James Yule

HJM Asia Law & Co LLC

Formation and terms operation

1 Forms of vehicle

What legal form of vehicle is typically used for leveraged buyout (LBO) funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In the People's Republic of China (the PRC), LBO funds are being used more frequently irrespective of the fact that there are currently no national laws and regulations directly associated with them (aside from a few local regulations as discussed in question 8 below). In practice, the vehicles used for LBO funds are limited partnerships or companies. Limited liability companies (LLC) are commonly used, in the form of fund management companies, equity investment companies and equity investment management companies. The LLC has a separate legal personality and exists until the liquidation, bankruptcy or termination of its term, as stated in the articles of association of the LLC. Investors bear liability up to the extent of their contributions to the registered capital of the LLC. The LLC will pay tax in accordance with the Enterprise Income Tax Law of the PRC and the individual investors will pay the individual income tax in accordance with the Individual Income Tax Law of the PRC. As the equity investment enterprises and equity investment management enterprises can be described as new concepts in the PRC, some Chinese local governments construct policies which allow for their preferential tax treatment (in order to encourage their formation).

There are no detailed laws and regulations specifically regarding a manager of the LBO fund vehicle, therefore, the manager is subject to the general laws which govern the managers of an LLC under the Company Law of the PRC. As for the limited partnership, it is not regarded as a separate legal entity so the general partners take unlimited joint and several liability of the partnership, but the limited partners only bear the liability up to the extent of their financial contributions to the partnership. The individual partners pay tax but the partnership as a whole does not.

2 Forming an LBO fund vehicle

What is the process for forming an LBO fund vehicle in your jurisdiction?

Presuming we are using an LLC as the LBO fund vehicle, and the LLC is set up by a Chinese legal entity or Chinese individual, the general process is as follows:

- 1 reserve the name of the LLC;
- 2 open a basic bank account for the LLC;
- 3 prepare and submit the first round of application documents for the LLC's incorporation to the relevant Administration of Industry and Commerce (the AIC);

- 4 receive the LLC's business licence from the AIC;
- 5 inject the first part of the required registered capital (the greater of 20 per cent of the total registered capital and 30,000 renminbi must be injected within three months of the issuance of the business licence);
- 6 apply for the issuance of the organisation code certificate to the local bureau of quality and technical supervision;
- 7 apply for the issuance of the state tax certificate to the state tax bureau;
- 8 apply for the issuance of the local tax certificate to the local tax bureau; and
- 9 apply for the issuance of the finance certificate to the local finance bureau.

Generally speaking, it takes about 30 working days (inclusive of the application processing times) to obtain the business licence and about 15 working days for the remaining steps (5 to 9).

If the LLC is set up by a foreign investor, or by a Chinese legal entity and a foreign investor, the process is as follows:

- 1 reserve the name of the LLC;
- 2 prepare and submit the application documents to the district foreign economic and trade bureau;
- 3 prepare and submit the application documents to the city foreign economic and trade bureau;
- 4 prepare and submit the documents to the province foreign economic and trade bureau;
- 5 prepare and submit the documents to the ministry of commerce and obtaining the certificate of approval;
- 6 prepare and submit the first round of application documents for the LLC's incorporation to the relevant AIC;
- 7 receive the LLC's business licence from the AIC;
- 8 apply for the issuance of the organisation code certificate to the local bureau of quality and technical supervision;
- 9 apply for the issuance of the state tax certificate to the state tax bureau;
- 10 apply for the issuance of the local tax certificate to the local tax bureau; and
- 11 apply for the issuance of the finance certificate to the local finance bureau; and
- 12 apply for the issuance of the certificate of foreign exchange by the relevant state administration of foreign exchange.

It takes about 95 working days (inclusive of the application processing times) to obtain the business licence and about 15 working days for the remaining steps (8 to 12).

The major official fee for the establishment of the LLC is the registration fee charged by the AIC, which is 0.08 per cent of up to and including the first 10 million renminbi of the LLC's registered capital, and 0.04 per cent of the LLC's registered capital between 10

million renminbi and up to and including 100 million renminbi. No fee is incurred for the portion above 100 million renminbi.

3 Requirements

Is an LBO fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

An LLC must maintain a registered office and a legal representative who can act on its behalf. Offices can only be registered in commercial buildings (it is forbidden to register an office in a residential building, although in practice some companies ignore this rule).

Any subsequent amendments to the LLC (such as to its registered address, name, or business scope) must be submitted to the authorities for approval, and then registered or filed at the relevant government authorities.

4 Access to information

What access to information about an LBO fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

A lot of the LLC's general information, for example the identities of investors and the amount of registered capital, is available to the public. The information can be obtained easily by submitting an application letter to the AIC office which handled the LLC's incorporation. At first glance, only lawyers or government clerks have access to the LLC's more detailed information (such as information that was disclosed during annual government checks and information such as annual accounting, financial or registered capital verification reports). However, such information can be obtained by members of the public quite easily – they can instruct any Chinese lawyer to retrieve it on their behalf, and provided the law firm the lawyer belongs to gives their consent, the information can be retrieved.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in an LBO fund formed in your jurisdiction not be respected as a matter of local law?

There are currently no rules or legislation that might increase the liability of third-party investors, except of course where criminal activity is involved. Otherwise, the liability of third-party investors would only be affected by the agreement between the two relevant parties, with this agreement being subject to the more general Contract Law of the PRC.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to an LBO fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The 'fund manager' in this context is the LLC, and the directors of the LLC are under the standard director's duties of loyalty, good faith and avoidance of the conflict between duty and interest. No agreement can change or moderate these duties, and any such article in an agreement will be regarded as null.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of an LBO fund?

Not strictly, but if the LLC (as the vehicle of the LBO fund) is under a trust set-up, the fund manager will operate the funds in accordance with the Trust Laws of the PRC. Pursuant to this law, if the trustee, namely the LLC, causes losses to the funds due to violation of the management duties or improper handling of the fund affairs, the third-party investor has the right to apply to the court, or ask the LLC, to refund their investment or give compensation for their loss. The investor can apply to the court for the aforesaid within a period of one year after he or she is made aware or has evidence of the 'gross negligence'.

If it is proven that the LLC has committed a serious fault when managing or operating the fund, the third-party investors have the right to remove the trustee (namely the LLC) according to the provisions of the investment agreement or also can apply to the court to remove the trustee.

8 Other special issues or requirements

Are there any other special issues or requirements particular to LBO fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Some municipal governments in China (eg, Shanghai, Beijing and Ningbo) make reference to LBO fund vehicles in terms of their minimum registered capital requirements. For example, in Shanghai, when a foreign investor invests in an LLC that is acting as an LBO fund vehicle, the minimum registered capital requirements set by the Shanghai AIC must be more than US\$500,000. Another current requirement is that the investors shall be between two and 50 entities (ie, companies or persons). The conversion or redomiciling of vehicles is not permitted in China. The foreign vehicle shall set up its wholly owned foreign enterprise subsidiary or joint venture if it wishes to manage the LBO fund in China. However, foreign vehicles can also acquire Chinese enterprises.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of LBO funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the LBO fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the LBO fund's sponsor (eg, automatic trigger of dissolution or removal rights at fund level)?

As there are no detailed laws and regulations regarding the operation of LBO funds in China, we can turn to the Bankruptcy Law of the PRC to answer this question. If the general partners of an LBO fund vehicle (in the form of a partnership) become insolvent or cannot repay their debts, they will be forced to retire from the initial partnership. For LBO fund vehicles in an LLC form, the shares of an insolvent shareholder become a part of the 'bankruptcy assets' which shall be distributed according to bankruptcy laws. If an investment adviser to the LLC as the LBO fund vehicle becomes bankrupt, the LLC can terminate its relationship with the investment adviser and hire another.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over an LBO fund and its manager in your jurisdiction, and what are the audit and inspection rights available to those regulators?

As the management of LBO funds is still in a grey zone, there is no specific regulatory body monitoring these funds. The AIC may require the audit and annual reports of the fund companies. The AIC also has powers to carry out investigations (whether onsite or offsite) and require companies to provide certain documents related to their operations.

There are also regulations regarding the supervision and management of specific types of fund companies. For example, securities investment companies are under the scrutiny of the Chinese Securities Regulatory Commission (the CSRC), the Chinese securities industry watchdog. The CSRC shall have the rights to check and supervise the corporate governance, business operations, and risk management policies of the companies and the companies must also submit their annual financial report, internal risk management evaluation report, and auditing report to the CSRC. If any influential or urgent change occurs to the fund management company, it shall be reported to the CSRC. If the financier of the fund management company is a Chinese commercial bank, the People's Bank of China and the Chinese Banking Regulatory Commission (the CBRC) shall be also involved – both are regulatory organs for commercial banks.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to an LBO fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Again, there are no specific laws or regulations at the national level regarding LBO funds. However, some cities have implemented trial measures which are related to equity transactions. For example, Ningbo's municipal government issued a direction on encouraging the development of equity investment enterprises in October 2008. In this direction, an equity investment enterprise is defined as an entity that is mainly engaged in equity investment activities, and the direction allows for such enterprises to register as a limited liability partnership or LLC. The minimum registered capital for these equity investment companies is 30 million renminbi and all of the registered capital shall be injected as cash. The key point of this direction is that such equity investment enterprises shall enjoy preferential tax treatment for the first five years after its incorporation. Individuals, legal persons (such as LLCs) or other organisations both within and outside China can be investors in the above equity investment enterprises.

Since this direction was issued only late last year, none of the newly-formed equity investment enterprises have been involved in any significant business transactions, at least no information on such transactions have entered into the public realm. Most of the significant equity transactions occurring in China are still handled by international private equity funds and their sponsors (who, in any context, can also be referred to as investors).

12 Registration of investment adviser

Is an LBO fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

The relevant regulations here are the 'Provisional Regulation on Administration of Qualifications of the Staff engaged in Securities

Investment Fund Transactions' (note: this is the translation from the official Chinese version) that took effect in 1999 and the 'Code of Conduct for Sales Agents of Securities Investment Fund', issued in mid-2008.

The first regulation mentioned above proscribes that the fund's sales people and fund managers shall be entitled the rights to engage in the sales activities of securities investment fund only upon passing the qualification exam organised by the Securities Regulatory Commission of the PRC and obtaining the relevant experiences engaged in securities or fund transactions activities and the credentials for registering as a sales agent for securities investment fund.

The Code of Conduct for Sales Agents of a Securities Investment Fund outlines voluntary guidelines in relation to the professional standards and behaviours of the fund managers and sales agents. As these are voluntary guidelines, they have no legal weight.

3 LBO fund manager – requirements

Are there any specific qualifications or other requirements imposed on an LBO fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The general requirements imposed on an LLC's senior management and/or a securities investment fund manager, and their respective employees, are applicable here.

While not specific to an LBO fund's manager, the legal representative or senior manager(s) of an LLC must have a clean criminal record and also not have been directly involved in, or responsible for, the company's bankruptcy.

A fund management company that deals in securities must be legally incorporated and accredited by the Securities Regulatory Commission of the PRC. The registered capital of the fund management company shall be more than 100 million renminbi and paid-in capital. Regarding the personnel of such companies, there shall be more than 15 qualified personnel in the fund management company who have passed obtained the relevant credentials outlined in question 12 above.

Any change to the manager or other senior employees of the fund management company which deals in securities must be filed with the Securities Regulatory Commission. There is also a non-plurality requirement for senior managers of fund management companies – the director, supervisor, manager or other employees are not allowed to hold a position in the fund's trustee or other fund management companies or engage in any activities which infringe the benefits of the LBO fund's shareholder.

Taxation

14 Tax obligations

Would an LBO fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to an LBO fund to qualify for applicable tax exemptions.

If it is a standard LBO fund LLC and not subject to any of the specific guidelines and rules regarding local government incentives, its income or gains shall be subject to enterprise income tax of 25 per cent; if it is a limited partnership, its individual partners' income and gains shall be subject to individual income tax at progressive rates ranging from 5 per cent to 35 per cent.

The fund is legally required to pay withholding taxes, enterprise income tax (25 per cent for LLCs and not applicable to limited partnerships) or individual income tax (taxed at progressive rates ranging from 5 per cent to 35 per cent), when distributing profits to its investors unless there are any tax treaties concluded between the PRC

and the investor's home country. In these instances, the tax treaty will apply in the event of any inconsistencies.

If the fund were subject to any local government direction as described in question 11 above, tax incentives may apply. For example, according to the Beijing's local regulation, if the LBO fund is in the form of a limited partnership, the general partner shall be exempted from the business tax (which is separate to enterprise income tax) normally payable if it satisfies any of the following conditions:

- it invests in the private equity fund with intangible or real estate assets and it bears its own risks in such investment; or
- it engages in a share transfer with the private equity fund.

As well as this, the Beijing municipal government also exempts the senior staff of the LBO fund from individual income tax.

15 Local taxation of non-resident investors

Would non-resident investors in an LBO fund be subject to taxation or return-filing requirements in your jurisdiction?

According to the enterprise income tax and individual income tax rules of the PRC, theoretically, the income obtained by a non-resident investor, individual or enterprise, from the LBO fund is subject to both forms of income tax. As mentioned in question 14, the fund is legally required to withhold the income tax for its investors. The withholding tax rate in China is 10 per cent for foreign company investors and 20 per cent for foreign individual investors. These taxation requirements are subject to any tax treaties between China and the non-resident investor's country of origin.

As China has implemented a strict foreign exchange control policy, the return of profits obtained from investment shall be reported by the fund company to the relevant bureaus of administration of foreign exchange and the fund company shall purchase the foreign currency from certain commercial banks which are licensed to engage in foreign currency transactions.

16 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of an LBO fund vehicle formed in your jurisdiction? Are there any special rules relating to investors that are residents of your jurisdiction?

Due to the multiple taxation layers (eg, local, provincial, national) in China, companies can often find themselves paying various taxes. For this main reason, it is often desirable (though not necessary) for an LBO fund company to obtain a ruling from local tax authorities regarding special tax considerations.

There are no special tax rules relating to LBOs' investors that are based in China but different tax rates can apply to foreign investors. However these tax rates are subject to tax treaties existing between China and the foreign entity's country of origin.

17 Organisational taxes

Must any significant organisational taxes be paid with respect to LBO funds organised in your jurisdiction?

As discussed in question 14, the organisational taxes to be paid differ according to the legal forms of both the LBO fund and its sponsors. If the private equity investor is an LLC, enterprise income tax (25 per cent) will be paid by the LBO fund company. If the private equity sponsor is a limited partnership, the enterprise income tax shall not apply to the partnership but partners shall be subject to the corresponding income tax depending on whether such partner is an individual or an enterprise.

18 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to an LBO fund's sponsor.

Where the LBO fund is a Chinese LLC, the income (for example, management fees) earned from investors is be subject to enterprise income tax. Where the LBO fund is a limited partnership, its income will be distributed to the partners who are liable to pay individual income tax.

19 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

China has entered into bilateral tax treaties with more than 80 countries in order to avoid double taxation. Whatever the legal form is used for the LBO fund, the tax treaties will usually affect the foreign investors in LBO funds both formed within China's jurisdiction and outside of it. For example, a tax treaty was entered into between China and Singapore on 11 July 2007, and dictates that profits earned by Singapore LBO funds, or Singaporean individual investors, from LBO transactions in China are only to be levied with Singaporean income tax.

20 Other significant tax issues

Are there any other significant tax issues relating to LBO funds organised in your jurisdiction?

In order to encourage the development of private equity transactions in China, some municipalities (eg, Beijing and Ningbo) have issued directions that contain preferential tax policies regarding such transactions and have been mentioned above.

Selling restrictions and investors generally

21 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in LBO funds formed in your jurisdiction, including the type of investors to whom such funds (or LBO funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

There are no restrictions set forth on the type of investors under laws relating to securities. However, in accordance with the 'Guidelines on Risk Management of M&A Loans of Commercial Banks', issued by the CBRC on 6 December 2008, the principal legal and regulatory restrictions in question are set for the institutions offering LBO fund loans.

Firstly, the institutions offering LBO fund loans are limited to those commercial banks which are legal entities incorporated in accordance with the relevant Chinese laws and regulations; secondly, five conditions have to be satisfied in order for commercial banks to conduct LBO fund transactions:

- they must have a sound risk management system and an effective internal control system;
- the ratio of adequacy of the loan loss is at least 100 per cent;
- the ratio of capital adequacy is at least 10 per cent;
- the general reserve balance is at least 1 per cent of the loan balance during the same period; and
- the commercial bank has a team of experienced persons to conduct the LBO fund transaction loan's due diligence and risk assessment.

Even if the above conditions are satisfied, the commercial banks offering LBO funds shall be under strict scrutiny of the CBRC during the process of offering the LBO funds.

22 Types of investor

Describe any restrictions on the types of investors that may participate in LBO funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

The restrictions on the types of investors that may participate in LBO funds are not clear at the moment; the only laws and regulations applicable are the more general Company Law of the PRC and the Partnership Law of the PRC, which regulate the incorporation of a companies and partnerships respectively. Where foreign investors wish to acquire Chinese companies through LBO funds, they can either directly use LBO funds formed in other jurisdictions or participate in LBO funds formed in China's jurisdiction.

Where foreign investors acquire Chinese companies through LBO funds (as well as through other forms) the Guidance Catalogue for Foreign Investment Industries (the GCFI) shall be observed. The GCFI encourages foreign investment in certain industries (for example the biotech and high-technology industries) while limiting the scale of foreign investment in certain industries such as the medical industry and banning altogether foreign investment in industries such as the information media industry.

23 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in an LBO fund (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

No matter what legal form is employed in an LBO fund (see question 1), the identity of investors shall be filed or registered with the relevant authorities (eg, the municipal administration for industry and commerce and the tax bureau, among others). Where any information related to the investors change, such information shall be filed or registered with the relevant authorities. Further, in China, every company shall go through the annual inspection procedure (usually from March to June every year) to make sure the activities conducted by the company are in compliance with the relevant laws.

24 Licences and registrations

Does your jurisdiction require that the person offering interests in an LBO fund have any licences or registrations?

The requirements for entities offering interests in an LBO fund are covered in question 21. There are no extra licenses or registrations required other than the usual ones required for the incorporation of a commercial bank. The supervising organisation, the CBRC, will continuously scrutinise the conditions and qualifications of the person offering interests in LBO funds as set forth in question 21.

25 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in an LBO fund or the individual members of the sponsor.

There are no specific rules relating to money laundering for LBO funds, and the general rules of the Law on Anti-money Laundering and the Regulations on Anti-money Laundering for Financial Institutions, both effective as of 1 January 2007 apply to LBO funds. These rules require confirmation and record keeping of the identities (such as ID cards or passports for individuals, and business licences for entities) of each investor. Moreover, deals involving large amount and suspicious activity shall be reported to the relevant authorities

for closer scrutiny. What constitutes a 'large amount' differs depending on the form of transaction, for example 200,000 renminbi or US\$10,000 for a daily total cash transaction constitutes a 'large amount', while 2 million renminbi or US\$200,000 constitutes such amount for online or credit card (and similar) transactions. Some examples of 'suspicious activity' include the cancelling of bank account immediately after completing a large stock transaction, and the conducting of banking transactions are not in accordance with the entity's business operations.

Exchange listing**26 Listing**

Are LBO funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

While technically possible, as LBO funds are quite new in China and the requirements for the incorporation of stock company are quite high, there is no listed fund management company in China as yet. The number of initial shareholders in a stock company shall be between two and 200 inclusive), and the registered capital (both initial and ongoing) must be at least 5 million renminbi (US\$730,780).

In an LBO fund context, the advantage of a listing would be liquidity and the relative 'permanence' of capital; but the disadvantage is that listing would be a time-consuming solution which places limits on the transfers of interests (for more information, see question 27).

27 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

As mentioned above, there is not a listed fund management company so far in China. However, in accordance with the Company Law of the PRC and the related laws on securities, the shares of the sponsors of a listed company cannot be transferred within one year upon the company's incorporation, and the shares issued prior to the public listing shall not be transferred within one year upon the public listing date. There are also some other restrictions on the transferring of the shares held by directors, supervisors and managers.

Participation in LBO transactions**28 Legal and regulatory restrictions**

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in LBO transactions or otherwise affect the structuring of LBO transactions completed inside or outside your jurisdiction?

Funds formed within the Chinese jurisdiction for a specific purpose can of course not be involved in LBO transactions, nor can they affect the structuring of LBO transactions completed inside or outside the country.

LBO transactions require a mature capital market related to the bond, stock and commercial loans from the banks. The LBO loans policy issued by the CBRC in the end of 2008 (as mentioned in question 21) states that the ratio of LBO funds coming from commercial banks is limited to 50 per cent of the total amount of the LBO fund, which affects the funds' participation in LBO transactions and the scale of the LBO transactions.

In practice, the scale and type of target companies shall also affect the LBO transactions. The state-owned enterprises or the enterprises with high credit rates can obtain loans more easily. LBO transactions completed outside China will be also under the scrutiny of Chinese

Update and trends

As provided for in the 'Guidelines for Trust Companies to Invest in Private Equity' enacted by the CBRC on 27 June 2008, when a trust company engages in a private equity investment project, the capital of the trust company to be invested in the project can now be no more than 20 per cent of its total investments, and the capital possessed by the trust company to be invested in private equity investment projects can now be no more than 20 per cent of the net assets of the trust company.

In accordance with the 'Guidelines on Risk Management of M&A Loans of Commercial Banks' issued by the CBRC on 6 December 2008, there are now strict conditions set for the Chinese commercial banks offering LBO loans, as described in question 21. The loans from commercial banks used for LBO funds shall be no more than 50 per cent of the total capital needed to acquire the target company. In other words, the LBO fund has to invest less than 50 per cent to acquire the target company.

authorities if the final target company is a Chinese company and the cash flow under the LBO transactions will abide by the Chinese laws and regulations regarding foreign exchange. New LBO funds could be affected by the performance and situations of investors and commercial banks during the LBO transaction process, such as due to a change in major shareholders or a change in major investment projects.

29 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

There are no direct restrictions on the receiving of profits from the fund – they are all subject to the provisions of profit-sharing under

the Company Law of the PRC. Some of these general regulations may indirectly affect compensation and profit-sharing arrangements. The remuneration of the fund management company is mainly sourced from the management fees which shall be collected by the fund management company on a daily basis based on the net value of the fund.

The rate of management fees varies according to the types of funds: stock-oriented funds are around 1.5 per cent, stock index-oriented funds range from 0.8 per cent to 1.0 per cent, bond-oriented funds range from 0.6 per cent to 0.8 per cent and the currency-oriented funds are 0.33 per cent. As the profit-sharing mechanism depends much on the net value of the fund instead of the profitability of the fund, the fund management company sometimes inflates the net value of the fund through their investment techniques which leads to an unusual phenomenon in the fund market - the fund operates badly but the fund management company still earns money. Such outcomes will inevitably attract the Chinese authorities.

**Caroline Berube****cberube@hjmasialaw.com**

46, Office 104
Shamian Main Street
Li Wan District
Guangzhou
510 133 Guangdong
China

Tel: +86 20 8121 6605
Fax: +86 20 8121 6505
www.hjmasialaw.com

GETTING THE DEAL THROUGH

Annual volumes published on:

Air Transport	Merger Control
Anti-Corruption Regulation	Mergers & Acquisitions
Arbitration	Mining
Banking Regulation	Oil Regulation
Cartel Regulation	Patents
Construction	Pharmaceutical Antitrust
Copyright	Private Antitrust Litigation
Corporate Governance	Private Equity
Dispute Resolution	Product Liability
Dominance	Project Finance
e-Commerce	Public Procurement
Electricity Regulation	Real Estate
Environment	Restructuring & Insolvency
Franchise	Securities Finance
Gas Regulation	Shipping
Insurance & Reinsurance	Tax on Inbound Investment
Intellectual Property & Antitrust	Telecoms and Media
Labour & Employment	Trademarks
Licensing	Vertical Agreements

**For more information or to
purchase books, please visit:**
www.GettingTheDealThrough.com



Strategic research partners of
the ABA International section



THE QUEEN'S AWARDS
FOR ENTERPRISE
2006



The Official Research Partner of
the International Bar Association