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M&A in China: What is different compared to Europe ?

By Jonathan Selvadoray

On the occasion of a seminar organised jointly by ACC and CMS in Geneva, on June 25th 2008

Agenda

- CMS
- M&A in China: background information
- Industry and competition restrictions
- The players
- Transaction milestones

CMS and …

- CMS – convergence among nine European law firms
- 595 partners, more than 2,240 legal and tax advisers and a total staff in excess of 4,600
- Global web of over 55 offices and referred offices in Europe (including CEE), Asia, Americas and Middle East (Association with The Levant Lawyers)

… **CMS China**

- Offices in Shanghai and Beijing
- 30+ lawyers
- Unlike many competitors, we don't just focus on big deals, but offer a full range of services from labor law to IP and tax advice
- Closely integrated cross-border teams
- Sector specialists
- Mix of expat and locally qualified lawyers

M&A in China: background information

The Chinese legal system:

- A revolution in the laws
- A slower evolution in the minds

M&A in China: background information

- From greenfield to M&A

- Some of the reasons:
  - Investor/Buyer: timing/strategic investments/PE
  - Seller: growth (extra capital, markets, know-how, no successor, IPO)

M&A in China: Industry sector restrictions

- The Guideline Catalogue of Foreign Investment Industries
  - Latest version effective January 1st, 2005
  - Implementation of China’s WTO commitments
  - Regulations by fields of activity
  - 4 categories of foreign investment projects: encouraged, restricted, permitted, prohibited
  - Foreign investment in central and western regions
- Industry specific approval
  - Special legislation for the industry considered

M&A in China: competition restrictions

- **Anti-monopoly law**
  - Any party's market share exceeds 1.5 billion (RMB) in the current year
  - Number of companies in related sectors taken over by a foreign investor exceeds 10 within one year
  - Any party's market share reaches 20%
  - The deal may result in any party's market share reaching 25%

M&A in China: the players

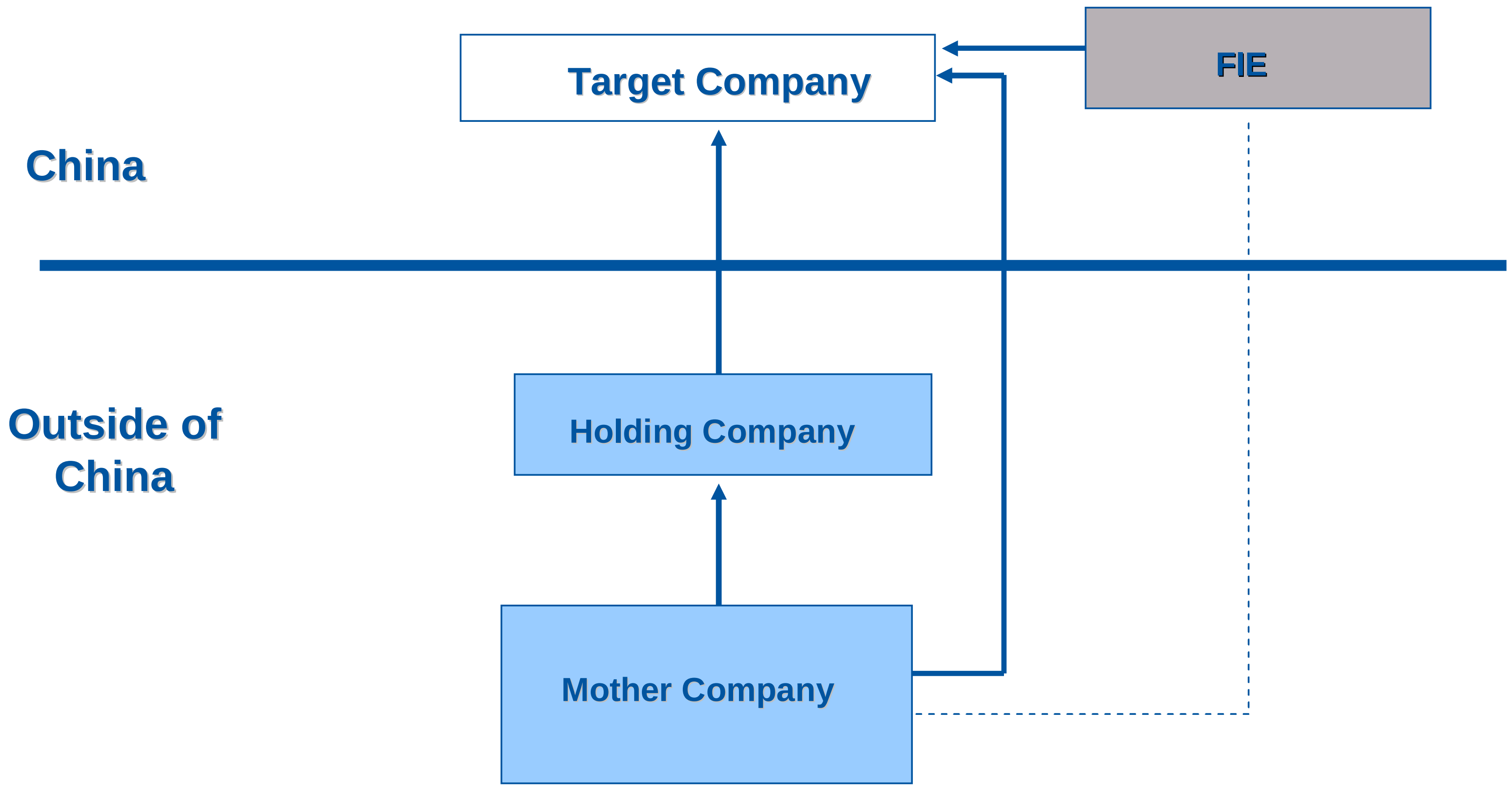
- Chinese Authorities: it takes three …
- Which Buyer ? Investment structure
- Which Seller ? Know your target

M&A in China: Chinese authorities it takes three …

CMS

- **Approvals authorities**
  - Ministry of Commerce (“MOFCOM”)
  - State Development and Reform Commission (“SDRC”)
  - State-owned Assets Regulatory Commission (“SARC”)
  - China Securities Regulatory Commission (“CSRC”)
  - State Administration of Foreign Exchange (“SAFE”)
  - State Administration for Industry and Commerce (“SAIC”)
  - Ministry of Environment protection (MOE)

M&A in China: Which Buyer? investment structure



China Withholding Tax ("WHT")

		Hong Kong SAR	Singapore	Cayman Islands
1. Availability of Double Tax Treaty / Agreement with PRC		Yes	Yes	No
2. Passive income from PRC	Dividends	5% / 10% ***(note 1)***	7% / 10% ***(note 1)***	10%
	Interest	7%	10%	10%
	Royalties	7%	10%	10%
	Capital gains	0 / 10% ***(note 2)***	0 / 10% ***(note 2)***	10%

Note 1: 5% or 7% WHT on dividend payment to Hong Kong or Singapore only applies to the Hong Kong or Singapore investor who holds 25% or more of the total shares in the mainland company.

Note 2: Capital gains derived by a Hong Kong or Singapore seller from the disposal of shares in a mainland company, which is not an immovable property holding company, will be exempt from China WHT, unless the Hong Kong or Singapore seller owns no less than 25% shareholding in that mainland company at any time during the 12-months period before disposal. 10% WHT applies to the latter scenario.

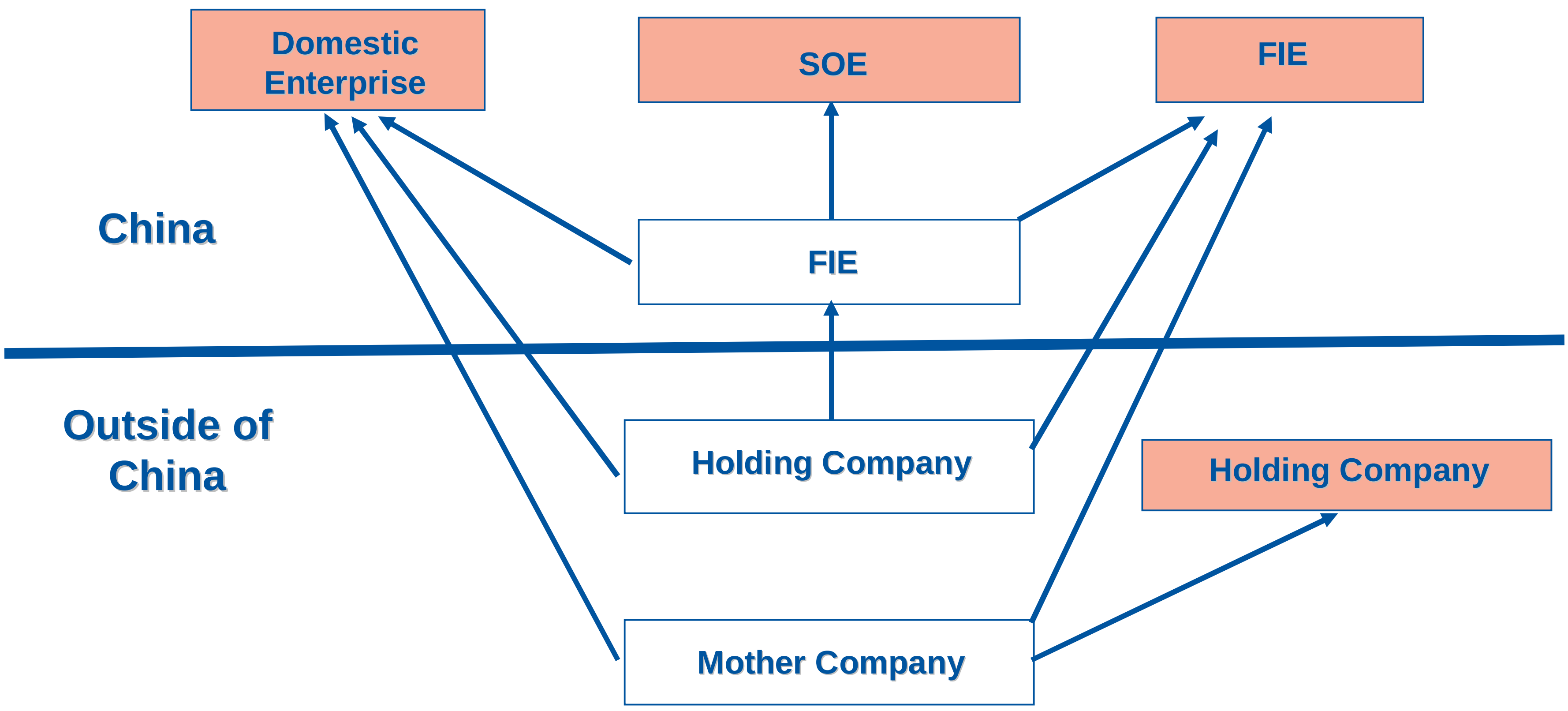
Tax optimisation continued

	Hong Kong SAR		Singapore		Cayman Islands	
	Receipt from PRC	Outbound payment	Receipt from PRC	Outbound payment	Receipt from PRC	Outbound payment
Dividends	**not taxable**		**exempted for certain dividends *(note 2)***	**not taxable**	**not taxable**	
Interest	**not taxable**		**taxable generally, but tax credit allowed**	**15% WHT or a reduced rate of DTA**	**not taxable**	
Royalties	**not taxable**	**4.95% or 16.5% WHT *(note 1)***	**taxable, generally but tax credit allowed**	**10% WHT or a reduced rate of DTA**	**not taxable**	
Capital gains	**not taxable**		**not taxable**		**not taxable**	

Note 1: 4.95% WHT applies to the royalties payment from Hong Kong to overseas non-associated companies, while 16.5% WHT is for the royalties to associated companies in certain circumstances.

Note 2: Foreign sourced dividend retained outside Singapore is not taxed in Singapore. Moreover, if several conditions are met, e.g. the highest corporate tax rate of the foreign country is at least 15% and the dividend has been subject to tax in the foreign country, the dividend remitted into Singapore is tax free.

M&A in China: Which Seller ?
Know your Target



M&A in China: Transaction Milestones

- Letter of Intent (LoI):
  - Exclusivity
  - Organisation post acquisition
- Due Diligence (DD)
- Term Sheet (TS): price
- Legal Documents (SPA, ancillary documents)
  - Keep them short and sweet
  - Courts vs Arbitration
- From Execution to Closing/Post Closing
  - Time consuming
  - Monitor CP/CS

M&A in China: Legal due diligence

Typical risk factors

- Property rights
- Tax privileges/liabilities
- Employment/Social security
- Environment
- Bribes

Impact on Value, transaction documents, future operations

M&A in China: Success factors

- The right team:
  - during but mostly after the deal
- Working the Executive committee/board of directors at HQ

Concluding remark

水至清无鱼

« Where the water is too clean

you will not catch any fish »

Chinese saying

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