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Beyond Borders

An overview of the rules and regulations that affect outbound investment

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Introduction

The current global economic conditions provide unprecedented opportunities for Chinese companies to secure or enhance a presence in the global market, to acquire technology and know-how or to secure access to the world's natural resources through M&A activity. Chinese companies with global aspirations that are poised to capitalize on these opportunities may prove to be particularly well placed to lead in the coming years. To help you achieve these aspirations, our team has developed the following materials to give you background and information on some of the opportunities and challenges Chinese companies may face both within China and abroad as they seek international opportunities. While these materials cover a range of topics, there are complexities unique to each investor and potential investment and our team of dedicated professionals in offices around the world is always available to assist you in developing and executing a global strategy.

Beyond Borders
China Outbound Investment
May 2009

Regulations concerning Outbound Investment by Chinese Enterprises

A Brief Introduction

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A Brief Introduction

With increasing integration of the world economy, more and more Chinese enterprises are investing abroad. The State supports and encourages various types of enterprises with competitive advantages to invest and establish new enterprises abroad. The relevant government departments have enacted a series of regulations concerning outbound investment.

Ministry of Commerce

REVIEW AND APPROVAL OF OUTBOUND INVESTMENT

MOFCOM promulgated *Administration Measures on Outbound Investment* (the "MOFCOM Measures") on 16 March 2009, which came into effect on 1 May 2009. At the same time, the previous MOFCOM regulations on China outbound investment, Provisions on Review and Approval of Outbound Investment to Establish Enterprises and Provisions on Review and Approval of Mainland Enterprises to Establish New Enterprises in Hong Kong or Macau Special Administrative Regions, were repealed. The MOFCOM Measures provide for, among others,

- the approvals which must be obtained by various types of PRC-registered enterprises in establishing offshore non-financial enterprises or acquiring the ownership right, controlling right or operating and managerial rights of existing non-financial enterprises by way of new establishment, merger and acquisition or other methods;
- a system of regular reports and statistics after completion of investor's outbound investment; and
- administration on and service for outbound investment activities by MOFCOM and other relevant departments.

Back in 2005, MOFCOM promulgated *Detailed Rules for Review and Approval of Outbound Investment to Establish Enterprises* (the "2005 Rules"), repealing the administrative review of feasibility study report. The 2005 Rules specify that each level of the department of commerce should review outbound investment by considering the investment environment and security of the destination country, political and economic relations between China and the destination country, Chinese guidance policy for outbound investment, reasonable layout of investment in destination countries (regions), performance of obligations under relevant international treaties, protection of legitimate rights and interests of the enterprises.

On 19 December 2007, the General Office of MOFCOM released the *Circular on Relevant Issues concerning Adjustment of Review and Approval of Outbound Investment*, which increases the number of destination countries for outbound investment by local enterprises that the provincial counterparts of MOFCOM are delegated to review and approve. Accordingly, the provincial counterparts of MOFCOM are delegated to approve investment in countries (regions) other than those with no diplomatic relations with China and Iraq, Afghanistan and the Democratic People's Republic of Korea.

GUIDANCE FOR OUTBOUND INVESTMENT

MOFCOM has, in conjunction with the Ministry of Foreign Affairs, released three editions of *Catalogue for Guidance on Industries by Countries for Outbound Investment* (the "Catalogue") in 2004, 2005 and 2007 respectively, in a bid to encourage and guide Chinese enterprises to conduct outbound investment in accordance with the principles set out in the Catalogue.

ADMINISTRATION SYSTEM OF OUTBOUND INVESTMENT

During 2002 and 2005, MOFCOM in cooperation with other relevant government departments, established five administration systems in respect of outbound investment, ranging from filing, supervision, statistics and protection of rights:

- *Statistical System of China's Outbound Foreign Direct Investment* (jointly issued by MOFCOM and National Bureau of Statistics);
- *Interim Measures for the Joint Annual Inspection of Outbound Investment and Measures of Outbound Investment Comprehensive Performance Evaluation (for Trial Implementation)* (jointly issued by MOFCOM and State Administration of Foreign Exchange ("SAFE"));
- *Online Filing System for Outbound Mineral Resources Development* (jointly issued by MOFCOM and the Ministry of Land and Resources);
- *Preliminary Reporting System for Outbound Merger and Acquisition Matters* (jointly issued by MOFCOM and SAFE); and
- *Reporting System for Obstacles in Investment and Operating by Countries* (issued by MOFCOM).

National Development and Reform Commission

REVIEW AND APPROVAL OF OUTBOUND INVESTMENT PROJECTS

On 9 October 2004, the National Development and Reform Commission promulgated the *Interim Administration Measures on Review and Approval of Outbound Investment Projects* (the "NDRC Interim Measures"), which provide that all outbound investment projects, including new establishment, acquisition, joint venture projects, capital increase and reinvestment, regardless of types of enterprises, source of capital, form and manner of investment, shall be reviewed and approved according to the NDRC Interim Measures.

CREDIT SUPPORT TO THE STATE-ENCOURAGED KEY PROJECTS

In October 2004, NDRC and the Export-Import Bank of China (the "Ex-Im Bank") issued the *Circular on Giving Credit Support to Key Outbound Investment Projects Encouraged by the State* (the "Bank Circular"). The Bank Circular provides that NDRC and the Ex-Im Bank will jointly establish a credit support mechanism for outbound investment. According to the state development plan on outbound investment, the Ex-Im Bank shall, in annual export credit plan, arrange for credit funds of a certain scale to support an state-encouraged key outbound investment projects with preferential export credit interest rates.

ESTABLISHING RISK PREVENTION MECHANISM FOR KEY PROJECTS

NDRC and China Export & Credit Insurance Corporation ("CECIC") issued the *Circular Concerning the Relevant Issues on Establishing Risk Prevention Mechanism for Key Outbound Investment Projects* (the "Insurance Circular") on 25 January 2005, which provides that NDRC and CECIC will jointly establish a risk prevention mechanism for key outbound investment projects. According to the state development plan on outbound investment and the state arrangements on risk fund of export and credit insurance, CECIC will provide the state-encouraged key outbound investment projects with services of investment consultancy, risk assessment, risk control, investment insurance and other risk prevention services.

STRENGTHENING FINANCING SUPPORT TO KEY PROJECTS

NDRC and China Development Bank ("CDB") issued the *Circular Concerning the Relevant Issues on Further Enhancing Financing Support to Key Outbound Investment Projects* on 25 September 2005, which provides that plans for providing financing support to key outbound investment projects shall be formulated on an annual basis. In addition, CDB shall specially arrange, out of its annual equity loans, a certain amount of loan fund to support the capital increase of the state-encouraged key outbound investment projects.

State Administration of Foreign Exchange

On 6 March 1989 and 26 June 1990, SAFE promulgated the *Administration Measures on Foreign Exchange for Outbound Investment* (the "SAFE Administration Measures") and *Implementation Rules for the Administration Measures on Foreign Exchange for Outbound Investment* respectively, which regulate outbound investment activities by way of new establishment or acquisition of shares by the PRC-registered companies, enterprises and other business organisations (excluding foreign-invested enterprises).

Subsequently, SAFE gradually relaxed the administration on foreign exchange for outbound investment and modified some provisions of the SAFE Administration Measures by promulgating the regulatory documents set out below.

SIMPLIFYING THE REVIEW AND APPROVAL PROCEDURES

The SAFE Administration Measures provide that SAFE shall assess the foreign exchange risks, including political risks, business risks and financial risks, of enterprises conducting outbound investment. In accordance with the relevant provisions of the *Decision of the State Council on Cancelling the First Batch of Items subject to Administrative Approval* (Guo Fa [2002] No.24), the review of foreign exchange risks in respect of outbound investment was cancelled. As a result, foreign exchange risks shall be borne by enterprise investors themselves. At the same time, SAFE reduced the procedures for reviewing the sources of foreign exchange funds from 11 to 7 items, with foreign aid projects, the projects wholly invested in kind and the state strategic investment projects exempted from such review.

CANCELLING DEPOSITS FOR REMITTANCE OF PROFIT

SAFE promulgated the *Circular Concerning the Relevant Issues on Sorting out the Deposits for Remittance of Profits Generated by Outbound Investments* on 12 November 2002, which provides that SAFE shall not require deposits for remittance of profits generated from outbound investment. As of 1 October 2002, fourteen provinces and cities including Zhejiang, Jiangsu, Shanghai, Shandong and Guangdong were approved to implement trial reform for foreign exchange administration of outbound investments (the "Trial Reform"). Starting from the Trial Reform, SAFE no longer requires the investors remit back to China the profits generated from outbound investment. Such profits may be used for capital increase or offshore reinvestment.

CANCELLING FOREIGN EXCHANGE QUOTA RESTRICTIONS

In accordance with the SAFE Administration Measures, domestic investors should use their own foreign currency for outbound investments. Due to the Trial Reform, apart from their own foreign currency, approved enterprises can also use foreign currency loan, policy loan and purchased foreign currency to make outbound investment. However, purchase of foreign currency is subject to foreign exchange quotas, which were USD 3 billion in 2003 and USD 5 billion in 2005. Since 2005, the Trial Reform was introduced throughout the country. With the effect that, as of 1 July 2006, SAFE no longer proposes any foreign exchange quota for outbound investment and therefore, demand for foreign exchange intended for outbound investment by domestic investors can be fully satisfied.

ALLOWING DOMESTIC INVESTORS TO REMIT FOREIGN EXCHANGE ABROAD IN ADVANCE

As of 1 July 2006, domestic investors may, upon SAFE's approval when necessary, remit abroad the initial expenses relating to their outbound investment in advance.

REGULATING ADMINISTRATION OF FOREIGN EXCHANGE FOR OUTBOUND INVESTMENT IN SECURITIES BY FUND MANAGEMENT COMPANY

On 30 August 2006, SAFE promulgated the *Circular on Relevant Issues concerning Administration of Foreign Exchange on Outbound Investment in Securities* by *Fund Management Company* (the "Securities Circular"). The Securities Circular clarifies the work flow and verification flow of fund management companys' outbound investment in securities. Where a fund management company engages in outbound investment in securities, it shall obtain the qualification of foreign exchange business together with a foreign exchange quota for outbound investment in securities. In addition, carrying out such business shall comply with relevant regulations issued by China Securities Regulatory Commission ("CSRC"). The Securities Circular stipulates the foreign exchange accounts and pay-in and pay-out scope of the accounts in the business of a fund management company's outbound investment in securities, including self-owned foreign exchange accounts, foreign exchange accounts for outbound investment in securities, domestic custody accounts and offshore settlement accounts. The Securities Circular also touches on relevant issues such as source identification and transfer of foreign exchange for outbound investment.

Ministry of Finance

On 1 July 1996, MOF promulgated the *Interim Measures for the Financial Management of Outbound Investment*, which regulates the financial management for outbound investment.

China Securities Regulatory Commission

On 18 June 2007, CSRC promulgated the *Tentative Measures for the Administration of Qualified Domestic Institutional Investors Conducting Outbound Securities Investment* (the "QDII Measures"). The QDII Measures permit that upon CSRC's approval, qualified domestic institutional investors ("QDII") may raise funds within PRC territory. QDII may use the raised funds to make investment in the form of asset portfolios in foreign securities. The QDII Measures specifies qualifications and relevant reviewing and approving procedures for obtaining the qualification of QDII and provides for regulations on the issues such as fund raising, asset custody, investment operation, information disclosure, etc.

China Insurance Regulatory Commission

On 28 June 2007, China Insurance Regulatory Commission ("CIRC"), the People's Bank of China ("PBOC") and SAFE, jointly promulgated the *Tentative Measures for the Administration of Outbound Investments of Insurance Funds* (the "Insurance Funds Measures"). The Insurance Fund Measures permit insurance companies, insurance group companies, insurance holding companies or other insurance institutions lawfully incorporated within PRC territory, to use self-owned or purchased foreign exchange to make outbound investment by engaging domestic or foreign professional investment management institutions which satisfy CIRC's requirements. The Insurance Fund Measures set out the qualifications for appointment of principals, trustees and custodians:

- principals shall have the corresponding capabilities of management, risk assessment and investment performance appraisal;
- trustees shall have the capabilities of risk management and investment management, and particularly have certain specialities and operational experiences; and
- custodians shall establish a system for segregation of custodian assets and have certain custodian experiences and global custodian network resources.

The total amount of outbound investment of an insurance company shall not exceed 15% of the total assets of the company for the preceding year. The investment scope includes monetary products, fixed-income products and products such as stock and equity interests. According to the CIRC Measures, CIRC, PBOC and SAFE conduct synergetic supervision on such investment according to their respective powers and duties.

On 31 July 2006, CIRC promulgated *Administration Measures on the Establishment of Outbound Insurance Institutions by Insurance Companies* (the "Insurance Companies Measures") and *Administration Measures on Investment by Non-insurance Institutions in Outbound Insurance Enterprises* (the "Non-insurance Institutions Measures").

The Insurance Companies Measures permit domestic commercial insurance companies either to establish offshore branches or sub-branches, offshore insurance institutions, insurance intermediaries or to acquire offshore insurance companies and insurance intermediaries. The requirements an insurance company shall satisfy for establishing an offshore entity of insurance business include:

- operating for over two years;
- with total assets and foreign exchange at the end of previous year respectively no less than RMB 5 billion and USD 15 million (or equivalent value of other freely convertible currencies);
- within its solvency ability, internal control regime and risk management system in conformity with relevant provisions of CIRC.

The Non-insurance Institutions Measures permit a PRC-registered enterprise not in the business of an insurance company and an insurance assets management company either to establish an offshore insurance company, an insurance agency, an insurance brokerage institution and an insurance surveyor & loss adjustment institution, or to acquire 20% or more of equity interests in an offshore insurance enterprise. A non-insurance institution that invests in an offshore insurance enterprise shall have legitimate source of foreign exchange, operate stably and in satisfying financial conditions, and shall obtain approvals from CIRC prior to the investment.

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MOFCOM's New Regulation for Overseas Investment by Chinese Enterprises Takes Effect

1 Introduction and Background
1 Approval Processes
3 Documentation Requirements
3 Prospective Impact

MOFCOM's New Regulation for Overseas Investment by Chinese Enterprises Takes Effect

Introduction and Background

The Ministry of Commerce of the People's Republic of China (**MOFCOM**) released a new regulation relating to overseas investment by Chinese enterprises, the 'Administrative Measures for Overseas Investment' (the **Measures**) on 16 March 2009 which became effective on 1 May 2009. The stated purpose of the Measures is to promote and regulate overseas investment by Chinese enterprises. The Measures create three categories of review for overseas investment based on the size of the proposed investment, with varying approval processes and documentation requirements for each category.

The Measures will replace the previous MOFCOM regulation on outbound investment ('the Provisions on the Review and Approval of Overseas Investment to Establish Enterprises', released on 1 October 2004 (the **2004 Regulation**)). This Client Alert will highlight key issues in the Measures of interest to both Chinese enterprises considering such overseas investment and their proposed investment targets.

Under the current regulatory structure, overseas investment requires the approval of MOFCOM and the National Development and Reform Commission (**NDRC**). As compared to the 2004 Regulation, the Measures delegate more power to MOFCOM's provincial branches and significantly speed up the application process for certain small investments. The Measures also set out increased documentation requirements and enhance MOFCOM's role in the approval process for larger investments. Some commentators have noted that NDRC may soon amend its regulation on overseas investment so as to be more consistent with the Measures.

Approval Processes

MOFCOM's primary focus in reviewing applications for overseas investment is the potential impact on China's bilateral relationship, national economic security and competition. The Measures state that an application will be rejected if the proposed overseas investment may endanger Chinese sovereignty, security and public interest; violate any Chinese laws and regulations; impair relations between China and other countries (or regions); breach any international treaty to which China is a party; or involve the export of any technology or goods which are prohibited. In reviewing an application, MOFCOM will not evaluate the economic and technical feasibility of a proposed investment, which will be the responsibility of the applicant.

The Measures create three tracks for review of proposed investments. The approval process and documentation requirements vary among the three categories.

NATIONAL LEVEL MOFCOM APPROVAL

MOFCOM approval at the national level is required for overseas investment projects:

- in countries without diplomatic relations with China;
- in specific countries or regions (the list of these countries and regions has not yet been published);
- involving investment by a Chinese party of USD 100 million or more;
- involving interests in multiple countries (or regions); or
- involving the establishment of Special Purpose Vehicles (**SPVs**[1]).

Review of applications that meet any of the above criteria shall conclude within 30 working days of submission of complete application documentation. In its review MOFCOM is required to solicit the opinion of the Chinese Embassy in the target country as to the security conditions in the target country and any impact the proposed investment might have on bilateral political and economic relations. The Chinese Embassy must provide its opinion within 10 working days from receipt of the request. MOFCOM is also required to solicit the opinion of relevant domestic commercial chambers when reviewing an overseas investment relating to the development of mineral resources. Such consultation time is not included in the time limitations set out above and may prolong the process.

PROVINCIAL LEVEL MOFCOM APPROVAL

MOFCOM's provincial departments shall be responsible for reviewing overseas investment projects:

- involving investment by a Chinese party of USD 10 million or more, but less than USD 100 million;
- in the energy or mineral industries; or
- that need to attract other Chinese investors.

The review shall conclude within 20 working days of submission of complete application documentation. When reviewing proposed investments in the energy or mineral industries, MOFCOM's provincial department shall solicit the opinion of the Chinese Embassy as well. For other overseas investment, the provincial department may also solicit such opinion but is not required to do so.

APPROVAL OF SMALL OVERSEAS INVESTMENTS

Review of proposed overseas investments of less than USD 10 million (which do not fall into any of the other categories above) should be completed within three working days. MOFCOM will review applications from enterprises directly controlled by central government and the provincial departments will review applications from local enterprises.

1 Special Purpose Vehicles refer to those overseas enterprises directly or indirectly controlled by domestic companies for the purpose of listing their domestic interest on overseas stock markets.

Documentation Requirements

Applications for all investments (other than small investments of less than USD 10 million), must include the following materials:

- an application (including the overseas enterprise's name, registered capital, amount of investment, business scope, operation period, explanation to the source of invested funds, specific content of investment, shareholding structure, investment environment analysis and evaluation, and the statement that the proposed overseas investment does not meet any of the rejection criteria);
- copies of business licenses of the domestic enterprises;
- articles of association and relevant agreements or contracts of the overseas enterprises;
- approval or filing documents issued by relevant authorities;
- Preliminary Report on Overseas Merger and Acquisition in respect of the overseas investment by means of merger and acquisition; and
- other documents as required by competent authorities.

For small overseas investments, the Chinese investors only need to file a printed Application Form through MOFCOM's 'Management System for Overseas Investment'.

When a proposed investment is approved, MOFCOM or its local department will issue a written approval decision with a certificate. The investment must be made within two years or the approval certificate will automatically lapse.

If an overseas investment is not approved, MOFCOM or the provincial authority shall notify the applicant in writing and explain the reasons for rejection at which time the applicant may apply for reconsideration or bring a lawsuit in the court to challenge the rejection decision.

Prospective Impact

MOFCOM estimates that after the Measures come into effect, 85% of applications will be handled by provincial departments and that most overseas investments could obtain approval within three working days. It is anticipated that changes implemented through the Measures will speed up the approval process and encourage overseas investment by smaller companies that may previously have found the approval process burdensome. Large investments, however, and investments in the fields of finance (to which the Measures are not applicable), energy and mineral resources as well as the establishment of SPVs will still be strictly controlled by the central government authorities. Applications for these types of investments will require additional documentation, possibly lengthening the approval process.

Overseas investment is also subject to approval or filing requirements with other authorities such as NDRC, the State Administration of Foreign Exchange and the State-owned Assets Supervision and Administration Commission. Investors may still face additional or overlapping requirements with other administrative regulations. It is also unclear how any proposed changes to NDRC regulation could interact with the Measures.

As with any new regulatory scheme, the full impact of the Measures will only be understood as the Measures are tested and as the application process is fully implemented.

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Gateway to the Global Market

A Primer of Corporate Tax Systems of Major Economies

1 China Tax Regime for Outbound Investment

4 Introduction to US Corporate Tax System

8 Introduction to UK Corporate Tax System

10 Introduction to German Corporate Tax System

13 Introduction to Spain Corporate Tax System

16 Introduction to Italy Corporate Tax System

18 Introduction to Belgium Corporate Tax System

FRAMEWORK OF ENTERPRISE INCOME TAX

On 1 January 2008, the new PRC Enterprise Income Tax Law ("EIT Law") became effective. Previously, China had two sets of EIT laws and regulations, one applicable to domestic enterprises and the other to foreign-invested enterprises ("FIEs") and foreign enterprises. The two regimes were unified in 2008.

PRC Resident Enterprises and non-PRC Resident Enterprises

The EIT Law introduced for the first time the concept of PRC resident enterprises. A PRC tax resident enterprise refers to an enterprise that is legally established in China in accordance with the laws of the PRC, or an enterprise that is legally established in a foreign country but has a place of effective management located within the PRC. A place of effective management refers to an establishment that exercises, in substance, overall management and control over the production and business, personnel, accounting, and assets of an enterprise. A non-PRC resident enterprise refers to an enterprise that is legally established outside the PRC and has a "place of effective management" located outside the PRC but has an establishment in China or has PRC-sourced income.

A PRC resident enterprise pays EIT on its worldwide income, i.e., income derived from sources both inside and outside the PRC. A non-PRC resident enterprise that has an establishment in the PRC pays EIT on income that is derived from sources inside the PRC, as well as on income which, although derived from sources outside the PRC, is effectively connected with such establishment. If a non-PRC resident enterprise has no establishment in the PRC, or has an establishment in the PRC but has derived income not effectively connected with such establishment, it pays EIT only on PRC-sourced income.

Tax Base and Tax Rate

The taxable income of an enterprise is defined as the amount remaining from the enterprise's gross income in a year, after non-taxable income, tax-exempt income, and various expenses and losses have been deducted. Losses incurred by an enterprise may be carried forward for a period of five years. No carry back is permitted. Reasonable expenditures that have actually been incurred and are related to the generation of income are deductible.

The enterprise income tax rate is 25%. Qualified small- and low-profit enterprises enjoy a reduced rate of 20%. The withholding tax rate is 10% under PRC domestic tax law and is reduced for certain types of income under certain tax treaties or arrangements.

TAXATION OF INVESTMENT INCOME OF A RESIDENT ENTERPRISE

Taxation of Dividends, Interest, Royalties and Capital Gains

Subject to certain limited exceptions, investment income of a resident enterprise, such as dividends, interest, royalties and capital gains, is included in the taxable income of the resident enterprise and subject to tax at the normal income tax rate of the resident enterprise.

Dividends paid by one resident enterprise to another resident enterprise are exempted from enterprise income tax in the hands of the recipient enterprise, provided that the dividends are not paid by a listed company whose shares the recipient enterprise has held for less than 12 consecutive months.

Foreign Tax Credit

An enterprise receiving non-PRC sourced income may claim a foreign tax credit in the current period for the foreign taxes paid on such income. Where a resident enterprise receives dividends from a foreign enterprise that the resident enterprise directly or indirectly controls, the resident enterprise may receive a foreign tax credit for the foreign income taxes paid by the foreign subsidiary and borne by the dividends that were paid to the resident enterprise. Control means direct or indirect share ownership of at least 20%.

In determining the amount of the foreign tax credit to claim, a taxpayer is subject to a foreign tax credit limitation, which prevents the taxpayer from using the credit to reduce its tax liability on PRC-sourced income. The maximum amount of the credit that a taxpayer may claim is the amount of the PRC tax otherwise payable computed according to PRC tax law in respect of the foreign-sourced income, and any excess amount, which cannot be credited in the current period, can be carried forward to offset against tax payable within the following five years. The foreign tax credit limitation is calculated on a country-by-country basis, regardless of the nature of the income. In other words, different types of income derived from one country are consolidated to determine the tax payable and the maximum credit.

CONTROLLED FOREIGN CORPORATION RULES

A resident enterprise that is the shareholder of a controlled foreign corporation ("CFC") must treat its proportionate share of the CFC's profits, whether distributed or not, as dividends and include these in its taxable income for the current tax period.

Definition of a CFC

A CFC refers to a foreign enterprise:

- established in a country (or region) where the actual tax rate is lower than 50 percent of China's standard enterprise income tax rate;
- whose profits are not distributed or are partially distributed due to reasons other than reasonable business needs; and
- "controlled" by resident enterprises or by resident enterprises and Chinese individual residents (collectively, "PRC Resident Shareholders").

Control means effective control in terms of shares, capital, operation or purchases and sales. A foreign enterprise is considered to be controlled by PRC Resident Shareholders if, on any day during a taxable year, one PRC Resident Shareholder holds directly or indirectly at least 10% of the voting shares of the foreign enterprise and PRC Resident Shareholders collectively hold at least 50% of the shares of the foreign enterprise.

Deemed Dividends

Profits of a CFC that are deemed to be distributed to a corporate PRC Resident Shareholder are calculated as follows:

Taxable income of PRC Resident Shareholder = Deemed dividend distributions × Number of days on which the PRC Resident Shareholder held shares of the CFC/ Number of days in the CFC's tax year × Shareholding percentage

Actual distributions of a CFC's profits previously taxed as deemed dividends to a PRC Resident Enterprise will not be subject to PRC enterprise income tax again.

Exceptions

There are three situations where a PRC Resident Shareholder will not be deemed to have received dividends:

- The foreign subsidiary is established in a country or region that is designated by the State Administration of Taxation ("SAT") as non-low tax jurisdictions;
- The income of the foreign subsidiary is derived from active business operations; or
- The foreign subsidiary's profits for the relevant year are no more than RMB 5 million.

The current white list of countries includes the US, the UK, France, Germany, Japan, Italy, Canada, Australia, India, South Africa, New Zealand, Norway, etc.

GENERAL ANTI-AVOIDANCE RULES

The EIT Law introduced general anti-avoidance rules. A local tax bureau may, upon the approval of the SAT, launch an anti-avoidance investigation into an enterprise if the enterprise is found to be engaged in any of the following activities:

- Abusing tax incentives
- Abusing tax treaties
- Abusing corporation forms and structures
- Avoiding taxes by using tax havens
- Participating in other tax arrangements that do not have a reasonable business purpose

In determining whether an enterprise is engaged in a tax-avoidance arrangement, tax authorities are required to use the principle of substance over form and consider the following factors in the aggregate:

- The form and the substance of the arrangement
- When the arrangement is set up and how long it is in place
- How the arrangement is executed
- The connection between each step or part of the arrangement
- Changes of the financial status of each party involved in the arrangement
- Tax consequences of the arrangement

Tax authorities may re-characterize transactions based on the true economic substance of these transactions and disregard the tax consequences that would have arisen from the tax-avoidance arrangement. In particular, enterprises without any economic substance, including those established in tax havens for the purpose of tax-avoidance, may be disregarded. Additionally, tax authorities may require the party that plans the tax-avoidance arrangement to submit materials relevant to the arrangement.

Introduction to US Corporate Tax System

Income is taxed both by the US federal government and also certain states and localities in the US. The Internal Revenue Service (IRS) is responsible for collecting federal income tax revenues and enforcing federal income tax laws.

In addition to the federal income tax, each of the 50 states and the District of Columbia impose some or a11 of the following: individual income tax, corporate income tax, sales tax, real estate transfer tax, gross margin tax and franchise tax.

Most states' corporate income tax provisions conform to federal income tax law and such taxes are generally imposed at a lower rate than federal income tax. However, the taxes imposed by states and localities can vary greatly and may play an important role in determining how an investment should be structured.

GENERAL CONCEPTS

US persons and residents are generally taxable on their worldwide income (subject to any available credit for foreign tax paid on foreign source income); non-US persons and non-residents are generally taxable only on their US source income.

Gross income includes all income from whatever source derived, including, unless a provision of the 1986 IRC provides non-recognition, capital gains such as those arising on the sale or exchange of property.

The 1986 IRC differentiates between types of income (such as capital gains and dividends). For non-corporate taxpayers, the highest tax rate on long term capital gains (15%) and certain qualifying dividends (15%) is significantly lower then the top individual income tax rate (35%).

For corporations, the rate of tax on all kinds of income is the same (35%) . However, the distinction is still important because capital losses may only be used to offset capital gains, not ordinary income.

US federal income tax is imposed both on individuals and on certain legal entities, such as corporations. Some entities enjoy special tax regimes. Other entities, such as partnerships, are not generally subject to direct taxation. Instead, items of income and loss flow through to the owners and are taxed only in their hands (flow-through treatment). Whether a business entity is subject to direct taxation or flow-through treatment depends on how the entity is classified.

CLASSIFICATION OF ENTITIES

Generally, a US business entity will have one of the following default classifications:

- A "C" corporation. All US corporations are "C" corporations by default.
- A partnership. These are non-corporate business entities with more than one owner.
- A disregarded entity. These are non-corporate business entities with one owner, such as single member limited liability companies (LLCs).

Non-US entities

Non-US business entities generally have the following default classifications:

- A partnership, if the entity has two or more members and at least one member does not have limited liability;
- A corporation, if all members have limited liability
- A disregarded entity, if the entity has a single owner that does not enjoy limited liability.

INBOUND INVESTMENT

Non-US businesses can invest in the US in one of two ways:

- Directly, by carrying on a trade or business in the US through a branch or permanent establishment. An investment made through a flow-through entity as an LLC that is disregarded for US tax purposes or a partnership, is treated for these purposes s if the non-US business directly invested in the US.
- Indirectly, through a legal entity (whether a US or non-US entity) that is classified as a corporation (a blocker).

Direct investment

Non-US business entities carrying on a trade or business in the US generally are subject to US federal income taxation on a net basis at the same rate as for domestic corporations (35%) on income and capital gains that are effectively connected with the conduct of that trade or business (ECI) (see "ECI" below).

If a tax treaty applies, non-US business entities carrying on business in the US through a permanent establishment are taxed on income attributable to that permanent establishment, rather than on ECI.

In addition, non-US businesses operating through a branch pay branch profits tax (BPT) of 30% (unless reduced by a treaty) on their "dividend equivalent amount" for the taxable year (see "BPT" below). This typically gives rise to an effective rate of US federal income tax on the profits of the branch of 54.5% (35% rate plus 30% of the dividend equivalent amount).

- ECI.

  The 1986 IRC does not provide a definition of "effectively connected" or of what it means to be engaged in the conduct of a trade or business within the US.

  However, in practice a non-US business entity would derive ECI if it derives certain categories of US-source income (and in some cases, non-US source income) in with respect to business activities it conducts in the US. As a general matter, the non-US business will determine its ECI in the same manner as a US corporation determines its gross income and deductions. In addition, certain gains on real property transactions are automatically treated as ECI.

  Investing in an entity classified as a corporation is not in itself sufficient to count as conducting a trade or business within the US (see "Indirect investment" below).

- Real property

  Gains from the disposition (for example, by sale) of a US real property interest are automatically treated as ECI under the Non-US Investment in Real Property Tax Act of 1980 rules (FIRPTA rules).

  For this purpose, a real property interest includes any interest (other than solely as a creditor) in any domestic corporation unless the taxpayer establishes that such corporation was at no time during the five-year period ending on the date of disposition a US real property holding corporation (that is, a corporation whose fair market value equals or exceeds 50% of the sum of the fair market values of its US and non-US real property interests and trade and business assets) .

  In practice this means that, among other things, non-US persons are liable to US federal income tax on gains on the sale of stock in companies that are, or have in the preceding five years been, US real property holding companies. In addition, a series of withholding rules apply to dispositions by non-US persons of US real property interests. The FIRPTA rules do not apply to sales of shares in non-US entities, provided they are treated as corporations for US federal income tax purposes.

  US income tax treaties do not provide any relief from the FIRPTA rules. In practice this means that a FIRPTA analysis is required to determine whether gain from a US real property interest would be subject to US federal tax.

- BPT

  In addition to tax on ECI, non-US businesses are subject to BPT if they are engaged in a trade or business in the US.

  The purpose of BPT is to place non-US businesses operating in the US through branches in the same position as non-US businesses operating through US subsidiaries.

  Non-US businesses operating through subsidiaries would pay tax at both the corporate and the shareholder level (that is, tax on profits in the subsidiary and withholding tax on dividends paid to shareholders). In effect, BPT imposes a tax charge on a notional dividend paid by the branch to its "parent".

  Non-US businesses operating through a branch pay tax of 30% (unless reduced by a treaty) on their "dividend equivalent amount" for the taxable year. For the purposes of BPT, a branch would constitute any business operations of the non-US business that occur in the US and that are not conducted by a US corporation. Usually, the dividend equivalent amount is the non-US corporation's effectively connected earnings and profit (usually its earnings and profits that are ECI) .

  This is adjusted upwards or downwards according to increases or decreases in US net equity (usually the non-US corporation's net US trade or business assets).

  Gain realized on the disposition of an interest in a current or former US real property holding company (but not other US real property interests) is excluded from effectively connected earnings and profits, and is therefore not subject to BPT.

Generally, the imposition of the BPT on a non-US business increases its effective rate of US federal income tax on its US income to 54.5% (35% rate plus 30% of the dividend equivalent amount), unless the rate of BPT is reduced by treaty.

Indirect investment

Rather than conducting operations in the US directly, a non-US business may choose to make an indirect investment by conducting operations through a US corporation.

Dividends (distributions of current and accumulated earnings and profits) and interest paid to non-US persons by a US corporation are generally subject to a 30% withholding tax, unless the income is attributable to a trade or business in the US or an exception applies. However, US income tax treaties usually reduce or eliminate this tax.

In practice, this means that payments of interest and dividends by US corporations to its non-US parent can generally either be made free of withholding tax or subject to withholding tax at a rate below 30%. However, the parent will need to provide the subsidiary with a beneficial owner withholding certificate that claims a reduced rate of tax pursuant to an applicable income tax treaty (for example, IRS Form W-8BEN).

- Exceptions for distributions

  To the extent a distribution is not treated as a dividend, the withholding agent (generally the distributing US corporation or its paying agent) can elect to not withhold tax on such portion of the distribution.

  A distribution is not treated as a dividend to the extent that it exceeds the available earnings and profits of the distributing corporation:

  » To the extent the distribution exceeds available earnings and profits; it is treated as a return of capital, which reduces the recipient's basis in the shares of the distributing corporation (but not below zero).

  » To the extent the distribution exceeds any remaining basis in the shares of the distributing corporation, it is deemed to be gain from the sale of shares in the distributing corporation.

- Exceptions for interest

  Payments of interest (and original issue discount) by US persons that qualify as portfolio interest are not subject to the 30% withholding tax.

  Portfolio interest is interest (or original issue discount) that is received by a non-US person that:

  » Holds less than 10% of the equity interests of the US payer.

  » Is not a CFC that is related to the payer.

  » Is not a bank receiving interest on a loan made in the ordinary course of its business (other than interest on an obligation of the US).

  Contingent interest is generally not portfolio interest.

  In addition, interest on deposits and interests on obligations with a term of 183 days or less is not subject to the 30% withholding tax.

CORPORATE TAX RATES

The "standard" rate of corporation tax in the UK is 28% and applies to both resident and non-resident companies. "Small companies" pay a rate of 21%. Marginal relief is applied to profits between the various rates to ease the transition between the small companies' rate and the main rate.

A UK resident company pays corporation tax on its worldwide profits, which are adjusted for tax purposes. Profit includes capital gains and trading income. A company qualifies as a UK resident if it is incorporated in the UK or if its central management and control is in the UK. Any foreign income on which a company pays tax abroad is liable to tax in the UK. However, any overseas tax paid can usually be credited against a company's tax liability.

TAX ON DIVIDENDS (RECEIVED OR PAID)

There is no withholding tax on payments of dividends by a UK company.

A UK company is not taxed on (income) dividends received from another UK resident company. UK companies are currently subject to corporation tax on overseas source dividends, with credit given for any withholding tax (and for any underlying tax paid in the foreign jurisdiction, provided the UK recipient controls at least 10% of the voting rights in the company that pays the dividend). The UK Govt proposes to replace the tax with credit system with a dividend exemption, though it is unclear when this change will occur.

Dividends received by UK individual residents from either a UK company or (in certain circumstances) a non-UK company carry a tax credit equal to one-ninth of the net dividend, which equates to 10% of the dividend plus the tax credit.

SUBSTANTIAL SHAREHOLDING EXEMPTION

The SSE exempts companies from corporation tax on a gain made on the disposal of a substantial shareholding in another company. There are numerous conditions, but in broad terms it applies where the corporate seller has held a substantial shareholding (generally, at least a 10% interest) for a 12 month period prior to the sale, and the seller and the company whose shares are being sold are trading companies.

GROUPS

The UK does not permit group companies to be taxed on a consolidated basis but has grouping rules which achieve a degree of effective consolidation. A group consists in most cases of a parent company and its subsidiaries which may in turn have subsidiaries. The exact test for whether a group exists depends on the type of group, but the common factor is that 75% of issued share capital (and economic ownership) is required to be beneficially held directly or indirectly by the parent.

- Group relief for trading losses - trading losses can be surrendered from one UK resident group company (and, in certain limited circumstances, from a non-UK company resident in another EU member state) to another UK resident group company. Losses can also be surrendered by or to a UK permanent establishment of a non-UK group company.
- Group relief for capital gains - it is possible to make an election for a gain on a disposal made by one group member to be treated as a gain on a disposal by another group member. Alternatively, capital assets may be transferred between group members on a no gain/no loss basis (irrespective of the actual amount paid).

TAX CREDITS FOR RESEARCH AND DEVELOPMENT

R&D tax reliefs are available for companies investing in R&D. The nature of the relief is either an enhanced deductible expense, or, in certain circumstances, the ability to surrender losses to the UK Revenue in return for payments from the UK Revenue (so called R&D tax credits).

CAPITAL ALLOWANCES AND INTANGIBLES

The UK has a range of allowances that allow the costs of certain capital assets and intangibles to be written off against taxable profits.

INTERNATIONAL

The UK has a range of measures which impact international groups. For example, the UK has extensive transfer pricing rules and CFC rules. Also, withholding tax (at 20%) is applied to payments of UK source royalties or interest when paid to non-UK recipients. However, the UK has also concluded over 100 tax treaties for the avoidance of double taxation (most follow the OECD model). An important feature of many treaties is a reduced rate for withholding tax on the payment of dividends, interest and royalties when received/paid by UK companies. UK companies can also take advantage of various EC directives (such as the Interest and Royalties Directive, the Mergers Directive, and the Parent-Subsidiary Directive).

CORPORATE INCOME TAX

Tax liability

Corporations are subject to unlimited corporate income taxation if they have their registered office or their place of management in Germany. Corporations which are not resident in Germany can be subject to a limited corporate income tax. This means that only income from German sources and certain types of income are subject to German taxation (e.g. if they maintain a permanent establishment located in Germany).

Partnerships qualify as tax-transparent entities for income tax purposes. Consequently, they are not subject to corporate income tax. Instead, each partner is taxed on its own. If the partner is a corporate entity, the income derived from the partnership is subject to corporate income tax.

Tax base and tax rate

The tax base for corporate income tax is the income of the corporation. The corporate income tax rate amounts to 15%. The same tax rate applies to corporations which are subject to the limited tax liability. Furthermore, the solidarity surcharge at a rate of 5.5% is levied on the corporate income tax payable.

Dividends and capital gains

Dividends and capital gains from the sale of shares in a German or a foreign corporation received by a corporation taxable in Germany are tax-exempt. However, 5% of such dividends or capital gains will be deemed as non-deductible business expenses. Therefore, 95% of the dividends and capital gains received by a corporation from another corporation are tax-exempt.

Dividends paid to a foreign corporate shareholder are subject to a withholding tax at the rate of 25% (plus 5.5% solidarity surcharge). If certain substance requirements are met, the withholding tax rate amounts to 15% (plus 5.5% solidarity surcharge).

Deduction of interest expense

As of 1 January 2008 new, very complex thin capitalization rules came into effect. Pursuant the so-called “interest barrier rules” interest expense is only deductible without limitation up to the interest revenue of the same fiscal year. If the interest expenses exceed the interest revenue the excess is only deductible up to 30% of the tax EBITDA. The interest barrier rules are not applicable

- if the amount of interest expenses exceeding the interest income of the relevant year is less than 1 mil. Euro;
- if the relevant corporation is not part of a group of companies in consolidated financial statements;
- if the company is part of a group of companies and its equity/asset ratio is not lower than the ratio for the entire group.

In case of shareholder loans tighter rules apply.

Change of control rules

The transfer of more than 25% of the shares in a corporation to a single transferee (or related parties thereof) within a period of 5 years leads to a loss of a corresponding percentage of the tax loss carry forwards. If more than 50% of the shares are transferred, all existing tax loss carry forwards cease to exist. Also indirect share transfers are covered. Further, there are no exemptions of intra-group reorganizations.

TRADE TAX

In addition to corporate income tax, each permanent establishment of a business located in Germany is subject to trade tax. This income is levied by the local authorities.

Trade tax is levied on business income calculated essentially on the basis of profits as determined for corporate income tax purposes. However, in order to tax the general ability of the enterprise to generate profits, certain adjustments are made. For example, generally 25% of all interest payments deducted for income tax purposes must be added back to the tax base for trade tax purposes. The 95% tax-exemption for dividends and capital gains received by a corporation from another corporation is, in general, also applicable for trade tax purposes. However, the dividend exemption requires a direct minimum shareholding of 15%, held continuously from the beginning of the relevant fiscal year.

The applicable trade tax rate varies from municipality to municipality; the average rate is currently approx. 13%.

OTHER TAXES

If a corporation owning real estate is involved in a transaction, the corporation can be subject to real estate transfer tax. Real estate transfer tax is levied at a rate of 3.5% on the agreed consideration for the real estate.

Real property tax is imposed upon all real property in Germany. Real property tax is levied on a specific tax value (Einheitswert). The annual real property tax burden presently ranges from about 0.5% to 2% of the specific tax value.

INTERNATIONAL TAXATION

In addition to domestic tax law, German taxation may be affected by double taxation treaties. Germany has an extensive double taxation treaty network of approx. 90 bilateral income taxation treaties. In general, the double taxation treaties follow the structure and principles of the OECD model treaty.

In case of the applicability of a double taxation treaty the withholding tax rate for dividends might be reduced. However, a foreign corporation is not entitled to a complete or a partial relief from withholding tax to the extent it is owned by individuals/entities who would not be entitled to the refund or exemption if they generated the income directly and

- if there are no economic or other valid reasons for the interposition of the foreign company or
- if the foreign company does not generate more than 10 % of its total gross earnings in the relevant fiscal year from its own economic activities or
- if the foreign company does not participate in general economic business through a business organization appropriate to its business purpose.

CORPORATE INCOME TAX

The taxable base for CIT purposes is the profit according to commercial accounts, which is determined according to Spanish accounting rules, subject to certain tax adjustments set out by CIT legislation.

Net operating losses from previous tax years may be off-set against the tax base within a period of 15 years as from its tax year of generation.

The general tax rate for CIT purpose is 30%. Small companies (turnover of the previous tax below €8.000.000) benefit from a reduced rate of 25% that applies on the first €120.202,41 of profit. The excess is taxed at the general tax rate.

CIT is payable within the first twenty-five calendar days following the six month period after the end of the relevant tax period.

Capital gains are taxed as business profits at the general corporate income tax rate (30%).

The Capital gains derived from the transfer of a participation in an operating non-resident company may be exempt if the requirements summarised below are fulfilled during the whole shareholding period: (i) a direct or indirect participation of at least 5% in a non – resident company has been held for one year prior to its transfer and (ii) the non – resident company is subject to a tax comparable to Spanish CIT. This requirement is deemed to be met if the non – resident company is resident in a jurisdiction with which Spain has signed a tax treaty.

Thin capitalisation rules are provided by the Spanish corporate income tax rules. These rules apply when the direct or indirect net interest – bearing borrowing from non-resident Spanish but related parties (excluding banks), exceed, on average during the tax period, a 3:1 debt equity rate.

However, thin capitalisation rules do not apply to debt owed to non – resident related entities that are resident in an EU member state, unless located in a country qualifying as a tax haven for Spanish tax purposes.

The interest which exceeds this equity rate will be regarded as dividends.

Spanish corporate income tax legislation provides for new transfer pricing rules since December 2006. According to them, transactions between related parties must follow the arm´s – length principle. Documentation requirements concerning to set up of prices and conditions for relates parties transactions are provided for these purposes. Penalties may be charged if such documentation requirements are not fulfilled.

The methodologies to determine the market price of a related transaction are consistent with OECD transfer pricing guidelines.

CROSS-BORDER PAYMENTS

Dividends

According to the Convention[1], the dividends paid by a Spanish subsidiary to a Chinese resident company may be taxed in Spain but if the recipient is the beneficial owner of the dividends the tax so charged shall no exceed 10% of the gross amount of the dividends (in front of the general withholding tax on dividends of 18%).

Royalties

According to the Convention, the royalties payments made by Spanish companies, may be taxed in Spain, but the tax so charged shall not exceed 10% of the gross amount of the royalties (in front of the 24% withholding tax rate, fixed by the Spanish domestic legislation).

Interest

According to the Convention, the interest paid by the Spanish company to the Chinese entity may be taxed in Spain but the tax so charged shall not exceed 10% of the gross amount of the interest (and not the withholding tax rate of 18% established by Spanish domestic legislation).

SUBSIDIARY VS. BRANCH

The incorporation of either a branch or a subsidiary is subject to 1% capital duty.

Upon the incorporation of a subsidiary, the tax base is the nominal amount of the subsidiary´s share premium, being the taxpayer the incorporated subsidiary.

Upon the incorporation of a branch, the tax base is the funds assigned to the branch, being the taxpayer the head office. However, the incorporation of a branch may be not subject to capital duty if the head office of the Spanish branch is resident in an EU member state.

A Spanish branch office of a foreign company is considered a permanent establishment in Spain. The branch office is subject to Non Resident Income Tax.

The taxable profits of a local branch are determined in accordance with similar rules, to those applicable to Spanish entities. The tax base is based on the commercial profit and the application of some tax adjustments.

However, there are certain limitations to the tax deductibility of a branch´s expenses.

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1 There are 65 tax treaties in force in Spain as of April, 2009 and one of these is the Convention between the government of spain and the government of the people´s republic of china for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital which follows the OECD Model Convention and entry in force in 20 May 1992(“Convention”)

OTHER TAXES

The main local taxes are the following:

- "Tax on economic activities": annual tax levied on the development of economic activities within the Spanish territory. CIT taxpayers with a turnover below €1 million are exempt.
- "Tax on real estate": annual real estate property tax levied on the ownership of real estate.
- "Tax on urban land appreciation": tax levied on the increase in value of land classified as urban land. It becomes due when a property transfer takes place. The tax base is based on the cadastral value and the holding period of the urban land.
- "Tax on construction and installation projects": tax levied on those constructions done in a municipality for which a licence is required.

Also, the supplies of goods and services performed by entrepreneurs or corporate in Spain (without the Canary Islands) and the importation of goods are subject to Spanish Value Added Tax ("VAT"), which general tax rate is 16%.

CORPORATE INCOME TAX

General information

Corporations are subject to Italian corporate tax - IRES ("Imposta sul reddito delle società"), which is currently applied at the rate of 27.5%. The rules deriving from IRES regime provide that the income is based on the profits or losses resulting from the Profits and Losses Account (P&L), increased or decreased in compliance with the specific provisions contained basically in the Italian Income Tax Code ("Presidential Decree n. 917/1986"). Corporations which are not fiscally resident in Italy are subject to a corporate income tax only for incomes produced in Italy.

Italian partnerships are qualified as tax-transparent entities for income tax purposes. It means that they are not subject to corporate taxation since each stockholder is taxed on its own in relation to the taxable income produced by the transparent entity. Should the stockholder be a corporate entity, the income deriving from the partnership is subject to IRES through the abovementioned tax rate equal to 27.5%.

Dividends

Dividends paid to an Italian resident corporation are 95% exempt and only the residual 5% is included in the taxable income subject to IRES with the rate of 27.5% in the fiscal year of collection, with an effective tax charge equal to 1.375% (27.5% of the 5% subject to taxation).

Under the current law, dividends paid from Italian corporations to companies that are resident in a European Union ("EU") member state or in a state belonging to the European Economic Area and included in a specific list of jurisdictions, are subject to withholding tax at the same rate of 1.375%.

Participation exemption (PEX)

The difference between the selling price of shares, decreased by the expenses of sale, and the purchase costs of the shares themselves is part of the taxable income subject to IRES.

According to the Participation Exemption (PEX) rules, upon fulfilment of the specific conditions - basically: participation transferred is held since the first day of the twelfth months preceding the month when the participation is sold (minimum holding period) and it was accounted as a financial asset in the first balance sheet closed after the purchase - the 95% of positive difference will be exempt from IRES.

Deduction of interest expense

As of 1 January 2008 a new regime applicable to corporations came into effect.

It provides that interest expenses may be deducted to the extent of interest income. Any excess of interest expenses over interest income ("net interest expense") is deductible up to an amount not exceeding the 30% of borrower's gross accounting profit or EBITDA ("limitation amount").

The excess of net interest expense over the limitation amount can be carried forward and be deducted in future years, to the extent of the limitation amount available in those years.

Specific tax provisions which rule the deduction of interest expenses are instead established for banks, financing and insurance companies due to the activity carried on by these entities.

Tax Consolidation

National tax consolidation regime is adopted in Italy. As in other countries, it is provided that the head entity of the group is responsible for all or most of the group's tax obligations such as paying IRES and lodging group tax return. Benefits deriving from tax consolidation may include inter alia the compensation of the losses of a company in the group company in order to reduce profits of other companies of the group.

A separate set of rules may be applied to worldwide tax consolidation of foreign affiliates.

REGIONAL TAXES

Corporations are also subject to a regional tax on productive activities called Irap ("Imposta regionale sulle attività produttive") which is applied through to a 3.9% nominal tax rate.

The taxable income is the value of the net production - basically deriving from the difference between the ordinary proceeds and costs of the company - connected with the activity carried on in the Italian territory, determined in relation to the type of activity.

INDIRECT TAX - VALUE ADDED TAX (VAT)

Value Added Tax (VAT) rules are very similar in all the EU countries, with the consequence that Italian disposals on the matter do not differ significantly from those in force in the main European countries and they generally comply with EU directives.

A commercial activity is subject to the Italian VAT, if three requirements are met (objective, subjective and territorial), as stated by the VAT tax law (Presidential Decree 633/1972).

INTERNATIONAL TAXATION

Italy signed treaties for the prevention of double taxation with approximately 80 countries.

The said treaties generally follow the structure and principles provided by the OECD model treaty. Under these treaties, corporations of foreign countries may be taxed at a reduced rate or may be exempt from Italian taxes on certain items of income they receive from sources within Italy.

These reduced rates and exemptions may vary among countries and specific items of income.

Introduction to Belgium Corporate Tax System

Belgium offers great flexibility and an interesting tax framework, combined with an impressive treaty network (around 100 tax treaties).

The description below, which is not exhaustive, provides for general information on Belgian corporate income tax as well as a brief introduction to selected tax incentives available in Belgium.

THE CORPORATE INCOME TAX – GENERAL RULES

Corporate tax framework

Resident taxpayers are subject to corporate income tax on their worldwide net income, including distributed dividends at the standard rate of 33.99%.

Branches of foreign companies are taxed at the same rate of 33.99% on their Belgian source income. Generally speaking the same tax rules apply to Belgian companies and to Belgian branches of foreign companies.

Dividends received from Belgian or foreign companies are included in the profits of the recipient company. Subject to conditions, a deduction amounting to 95% of the received dividends applies.

Interest received is treated as ordinary income. Interest paid is tax deductible if computed on an arm's length basis. Under certain conditions, a notional interest deduction is also granted to companies as a percentage of the equity (see below).

Capital gains on shares are exempt provided that the "taxation requirement" (see below) is met.

Dividend and interest payments are typically subject to a Belgian withholding tax ranging from 15% to 25%. Reduced rates (including a 0% rate) are available either under domestic law or double tax treaties provisions. The 0% withholding tax rate applies to qualifying dividend paid to a company resident in a treaty-country (e.g. in the region: China, Hong Kong, Korea, Japan, Philippines, Singapore, Thailand, etc.).

Several rules are contained in the Belgian income tax code that may be used to correct the taxable basis of a Belgian company when the tax authorities determine that a transaction carried by such company is not in line with the market conditions (arm's length principle).

The participation exemption (capital gains on shares and dividend received deduction)

The participation exemption entails an exemption of capital gains on shares ("the capital gain exemption") and the opportunity to offset 95% dividend income from the taxable basis ("the dividend received deduction").

The application of the Belgian participation exemption regime requires a number of conditions to be met. The so-called "taxation requirement" must be satisfied to benefit both from the dividend received deduction on dividends and from the capital gain exemption. Companies established in tax haven, benefiting from derogative corporate tax treatment and intermediary companies are, generally, not meeting the taxation condition. The taxation condition is supposed to be met for EU based companies subject to common rules of corporate income tax in their country of residence.

The following additional requirements apply to the **dividend** received deduction:

- Minimum participation of 10%; or minimum acquisition price of EUR 1.200.000;
- Minimum holding period: the shares should be held in full ownership for an uninterrupted period of 1 year; and
- The share qualify as financial fixed assets: the exemption only applies to financial fixed assets as defined under Belgian GAAP. Shares booked in the short-term investment account ("geldbeleggingen"/"placements de trésorerie") do not qualify for the exemption.

There are a number of exceptions to these rules.

Losses

As a rule, tax losses may be carried forward without time limit by the entity that incurred the losses. Some exceptions apply in case of re-organizations.

Capital losses on shares are however not deductible for Belgian tax purposes, except subsequent to the liquidation of the underlying company. In this latter case the capital loss may be deducted up to the amount of paid-up capital.

Deductibility of expenses

Expenses or charges are tax-deductible provided that they are incurred in order to acquire or maintain taxable income and have been determined on an arm's length basis.

Interest payable on loans made by Belgian companies to acquire Belgian or foreign shareholdings should be fully deductible.

Thin capitalisation rules (7:1) however apply for interest payment made to low taxed vehicles.

TAX INCENTIVES

The Notional Interest Deduction

The notional interest deduction (hereafter "**NID**") enables corporate taxpayers to benefit from a tax deduction corresponding to an amount of deemed interest on their equity. It balances the traditional advantage offered by debt financing (i.e. deduction of the interests paid).

The regime applies to all Belgian or foreign resident companies, whose profits are subject to the common corporate income tax regime in Belgium.

The NID is calculated on the basis of the average (adjusted) accounting equity shown in the balance sheet of the non-consolidated annual accounts for the preceding financial year.

The rate of the notional interest deduction is determined every year on the basis of the average interest rate for 10-year Belgian government linear bonds, i.e. the 10-year OLO rate, for the calendar year preceding the relevant financial year. It is capped, by law, at 6.5%

In the absence of sufficient profit, the notional interest deduction may be carried forward for seven years. Special rules apply in the event of a change of control or if the company does not comply with the arm's length requirement.

The regime offers plenty of interesting opportunities for intra-group financing, cash pooling, central procurement, etc. and actually reduces the effective tax rate in Belgium.

The Belgian patent box regime

Belgium recently introduced a patent box regime providing for an 80% reduction of the taxable income generated by qualifying patent, i.e patent and extended patent certificates. The measure applies to income arising from licensing fees, income from improvements made in respect of acquired or licensed patents and income deriving from utilising the patent for an entity's own production (but not to income derived from the disposal of a patent).

There is no cap applicable on the amount that can benefit from the regime but the deduction cannot be carried forward.

Other incentives for investments

Other federal or regional tax incentives are available for R&D activities, for highly qualified expatriate, accelerated depreciation for investment in capital goods, etc.

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China Outbound Investment
May 2009

Buying a U.S. Business

An Overview

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12 U.S. Public Company Acquisitions

The current global economic conditions provide unprecedented opportunities for Chinese companies to secure or enhance a presence in the U.S. market and to acquire technology and know-how through M&A activity. Chinese companies with global aspirations that are poised to capitalize on these opportunities may prove to be particularly well placed to lead as no global businesses can excel without a presence in the U.S., just as they cannot excel without a presence in China.

The structure, complexity and timing of an acquisition of a U.S. business by a Chinese acquirer will depend upon a number of additional factors, including:

- the type of business to be acquired;
- the regulatory framework within which the target business operates;
- whether the acquirer is acquiring control or merely making a strategic or minority investment;
- whether the target business is publicly or privately held;
- whether the acquisition is a purchase of assets or shares or a merger;
- whether the acquirer is acquiring a parent company or a division, segment or subsidiary of a company; and
- the form of consideration.

In addition, acquiring a U.S. business may involve legal and regulatory issues at both the state and federal level. U.S. companies are generally formed under state law, and as such, governance and other corporate issues will be determined at the state level. Purely contractual matters are also typically governed by state law. The issuance of sale of securities, however, is largely regulated at the federal level, with some state involvement. As a result, the acquisition process for a company formed in Texas may vary somewhat from the process of acquiring a Delaware entity.

The first section of this paper addresses general considerations in buying a U.S. business many of which apply to both publicly-held and private businesses and the second section addresses the considerations unique to buying a publicly-held U.S. business. Each of the topics discussed in this paper involve complex issues and are only summarized very briefly below. Accordingly, this material is not a comprehensive treatment of the subject matter and is not intended to provide legal advice.

Deal Structures

The three principal methods of buying a U.S. business are:

- an asset acquisition;
- a share acquisition; and
- a merger or consolidation transaction.

Each principal method is discussed briefly below.

ASSET ACQUISITION

In an asset acquisition, the acquirer purchases all or a portion of the assets of a company or of a division, segment or subsidiary of a company and generally assumes only those liabilities it specifically agrees to assume. In most cases, the liabilities of the seller's business do not automatically transfer to an acquirer of the assets. Accordingly, an asset acquisition structure can provide flexibility to an acquirer that desires to acquire only certain identified assets or to limit its exposure to certain known or unknown liabilities. It is possible, however, for an acquirer to be held responsible for a seller's liabilities in certain limited circumstances, particularly in respect of environmental, products liability and tax matters, and for pension obligations if employees are transferred. Accordingly, a purchase investigation of the seller's business and obtaining appropriate contractual protections remain important in the context of an asset acquisition. Acquisition structures can be put in place, however, to help shield an acquirer's other assets from future claims. Approval of the board of directors of the acquirer and the board of directors (and in certain cases approval of the shareholders) of the seller may be legally required (or expected if not legally required) for an acquisition of assets.

In an asset acquisition, instruments transferring title must be prepared for each asset or category of assets and such transfer may trigger certain taxes, although generally there are no stamp duties in the U.S. Any such taxes on the transfer may be apportioned between the parties by contract. In addition, depending upon the nature of the assets acquired, the seller may be required to obtain consent from third-party contractual counterparties in order to effect the transfer and this process can vary greatly in terms of timing and complexity. Representations and warranties and indemnification from the seller (or seller's parent or principal shareholders) in the purchase agreement can provide meaningful protection to the acquirer after the closing.

SHARE ACQUISITION

In a share acquisition where the shares of the target are closely held, an acquirer customarily enters into one or a series of share purchase agreements with the target's shareholders While an agreement with all of the target's shareholders is preferable, if only a controlling majority of the target's shareholders agree to sell, the acquirer can nevertheless buy these shares in a first-step transaction and then eliminate the minority shareholders by merging the target and the acquiring subsidiary in a second-step merger transaction. But as described further below, this process is not ideal as it creates appraisal rights and may lead to litigation by minority shareholders. Generally, in a share acquisition, all assets, liabilities and employees of the target business will remain with the target after its shares are transferred, but the acquirer can include contractual indemnity provisions to protect against liabilities that arise after closing. No instruments of transfer are necessary for the transfer of specific underlying assets and, generally, no transfer or sales taxes are imposed. The process of obtaining third-party consents is typically a much less involved process in share acquisitions although there may be contracts with change of control provisions which require the consent of the counterparty.

An acquirer generally seeks representations and warranties and indemnification from the target's parent company, if any, or from the target's principal selling shareholders.

MERGER OR CONSOLIDATION

A merger is the combination of two or more corporations into one of such corporations, and a consolidation is the combination of two or more corporations into a new corporation. These transaction structures are governed by state corporate law and based on statutory rules that can vary from state to state. The surviving corporation (in the case of a merger) or the new corporation (in the case of a consolidation) has all the rights, properties and liabilities of the constituent corporations. Upon effectiveness of the merger or consolidation, the legal existence of the non-surviving corporation(s) ceases, and former shareholders of such corporation(s) receive cash, shares of the new or surviving corporations, other securities or some other form of consideration for their shares. Mergers and consolidations generally require approval of the shareholders (the approval threshold required varies from state to state) and the boards of directors of both constituent corporations, and shareholders of the constituent corporations who do not support the transaction often have appraisal rights. Appraisal rights entitle a shareholder to receive "fair" value for the share in a merger or consolidation transaction which they can claim through a statutory procedure that may involve going to court.

Form of Consideration

Payment for an acquired business can be in the form of cash, shares, promissory notes or other debt instruments, or a combination of the foregoing. An acquisition effected by the exchange of securities of the acquiring corporation for shares of the target might require registration of the acquirer's securities with the U.S. Securities and Exchange Commission (the "SEC") if the target is widely held or if the target's shareholders insist on receiving securities that are readily marketable. Registration of securities with the SEC entails detailed disclosures about the issuer of the securities and, compared with cash consideration, can result in additional expense and longer periods between deal announcement and closing. The issuance of securities in mergers in which shareholders are asked to vote or otherwise make an election to receive new securities can also require registration with the SEC.

Payment in the form of securities is also more likely to require corporate formalities, such as approval of the acquirer's shareholders. The amount of consideration paid in an acquisition need not be fixed but may vary based upon events determined or occurring after the closing. For example, if the purchase price is based, in part, on the net asset value of the target, the parties frequently agree to adjust the purchase price based upon a closing date balance sheet prepared after closing by accountants and according to accounting methods acceptable to the parties.

Acquisition Vehicle

Prior to making a U.S. acquisition, a Chinese acquirer should evaluate the ongoing structure of its U.S. operations and its U.S. growth strategy. There are several reasons why many foreign acquirers hold their U.S. operations through holding companies. For example, a holding company structure may be more appropriate when more than one U.S. acquisition is contemplated and subsequent acquisitions should not be subsidiaries of earlier acquired U.S. companies. In addition, if inter-company loans are used to finance the U.S. acquisition or ongoing operations, interest on such loans can be paid to a number of countries free of U.S. withholding taxes. Many U.S. holding companies are incorporated in Delaware due to a relatively favorable corporate tax regime, a flexible corporate law regime, a well developed body of corporate case law and a knowledgeable and expedient judiciary.

Choosing a Structure

There are a number of factors to consider in selecting an appropriate deal structure including: general strategic, business or financial issues affecting the acquirer or seller; a particular desire or need to segregate assets or allocate liabilities; the role of shareholders and the need for consents and approvals; and the application of certain regulations to the deal. The most significant consideration in structuring an acquisition is often taxation status, as discussed in greater detail below.

Whether or not (and to what extent) any of these factors will play a role in determining the ultimate structure will depend on the particular context of the parties to the transaction and the dynamics of the deal. In many cases, the acquirer and seller have differing (and often opposing) interests to consider and resolve to get a deal done.

TAX CONSIDERATIONS

The tax consequences of structuring a transaction as an asset versus share acquisition can vary considerably for both the acquirer and the seller and can play a large role in the negotiation of any deal. Generally, an asset acquisition offers two main advantages over a share acquisition for a Chinese investor: (i) a step-up in basis of the acquired assets to fair market value and (ii) additional post-acquisition flexibility for organizational tax planning. These tax advantages, however, come at potential cost to the seller. If the seller is a corporation, it can be exposed to two levels of tax on the transaction: first, at the corporate level, as the assets are sold and, second, at the shareholder level, if the sale proceeds are distributed to the shareholders. Depending on the seller, the seller's tax considerations may mandate a share acquisition. Note though that in today's economic environment there may actually be a basis decrease as a result of an asset sale because the value of assets may actually be below their tax basis and the seller may have a loss.

In a share acquisition, the sellers pay only one level of tax on the gain on sale. In the case of an individual, its capital gain is currently taxed at a preferential rate of 15% for assets held for more than one year as opposed to a maximum federal rate of 35% on ordinary income. Conversely, the buyer will generally not be able to fully depreciate the target's underlying assets to the extent of the purchase price (and thereby reduce its taxable income on a going-forward basis) since the buyer's historic tax basis to the assets will carry over in the acquisition. Certain other elements of the target's tax history would also carry over unaffected by the acquisition. However, the use of certain attributes such as the excess of basis over fair market value and net operating losses may be limited following an acquisition.

In certain circumstances, an acquirer may be able to obtain some of the benefits of an asset acquisition even though shares of the target have been purchased by making one of two elections of section 338 of the Internal Revenue Code of 1986, as amended (the "Code"). These elections are the functional equivalent to an asset purchase and may be desirable depending on the tax characteristics of the acquirer and seller.

The Chinese acquirer should also consider what measure of its income is subject to tax in the United States and in which manner after the acquisition of the target. Its taxation will depend on various factors, including, but not limited to, the entity that is chosen to make the acquisition, which investments are held by or through the United States target and the applicable tax rules in China.

Regulatory Approvals

ANTITRUST APPROVAL

The Hart-Scott Rodino Antitrust Improvements Act of 1976 (the "HSR Act") generally requires pre-notification to U.S. antitrust regulatory authorities. In general, there are two thresholds that must be satisfied before a transaction is reportable under the HSR Act — the "size of the persons" test and the "size of the transaction" test. An acquisition is reportable if it involves: (i) a person on one side of the transaction with $130.3 million or more in annual net sales or total assets and a person on the other side of the transaction with $13.0 million or more in annual net sales or total assets (the "size of persons" threshold); and (ii) the acquisition of voting securities or assets of the seller, or any combination of the seller's assets or voting securities, valued at more than $65.2 million (the "size of the transaction" threshold). Transactions valued at more than $260.7 million are reportable regardless of the size of the persons involved in the transaction. Certain exemptions may apply to the transactions including specific exemptions applicable when a non-U.S. company is involved in the acquisition. The HSR Act imposes a 30-day waiting period after notification by the acquirer and the target before the acquisition may be effected (plus 30 days from completion of submission of additional information, if requested). In the context of a cash tender offer, the waiting period is 15 days after notification by the acquirer (plus ten days from completion of submission of additional information, if requested). If the requested information is submitted promptly, antitrust clearance should not slow down the acquisition unless there is a real antitrust issue. As a practical matter, the HSR Act will not impede an acquisition of a U.S. company by a Chinese acquirer where the acquirer does not have other significant business in the United States. In that situation, the statutory waiting periods probably will be accelerated.

EXON-FLORIO

The Exon-Florio foreign investment law empowers the President of the United States to halt or rescind acquisitions by foreign acquirers of U.S. companies where the acquisition would threaten to impair the national security[1]. The President delegated this authority to the Committee on Foreign Investment in the United States ("CFIUS"). Acquisitions subject to Exon-Florio include any form of transaction in which the foreign acquirer achieves functional control over the U.S. target, whether by acquisition of shares or assets or by contractual arrangements, such as joint ventures, in which the U.S. target contributes an existing identifiable business in the United States.

1 See Section 721 of Title VII of the Defense Production Act 1950, as amended, commonly known as Exon-Florio (50 U.S.C. §2170), and the National Industrial Security Program established by Executive Order 12829 of January 6, 1993, Exec. Order No. 12,829, 58 Fed. Reg. 3479 (1993), *as amended*, 58 Fed. Reg. 65,863 (1993).

Parties to prospective transactions that might have national security implications typically submit joint voluntary notifications to CFIUS in advance of the closing of such transactions. Although these notifications are generally voluntary, failure to notify CFIUS may be cause for rescission of a completed transaction if CFIUS concludes that the national security is impaired. Notifications are mandatory for "foreign government controlled transactions," which are transactions subject to CFIUS review that "could result in control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign governments," including sovereign wealth funds.

Although CFIUS clears most reviewed transactions at the end of a 30-day review period, CFIUS will extend the 30-day period by an additional 45 days for (i) a transaction which threatens to impair national security and that threat has not been mitigated prior to the conclusion of the initial 30-day period, (ii) any "foreign government-controlled transaction" and (iii) any transaction that would result in foreign control of critical infrastructure. CFIUS may impose mitigation measures on the parties as a condition to approve the transaction, such as entering into a national security agreement with a CFIUS agency or providing a letter of assurance to CFIUS. If the transaction is not cleared by CFIUS by the end of that 45-day investigation period, CFIUS may decide to submit the transaction to the President, who has 15 days to determine whether to permit or prohibit the acquisition. Parties are encouraged to confer with CFIUS in advance of a formal notification, so that CFIUS can understand the transaction and provide guidance as to the information it will need to conduct the examination.

CFIUS identifies "national security considerations" (i.e., facts and circumstances that have potential national security implications) to assess whether a transactions poses a potential "national security risk" (i.e., whether the foreign acquirer that exercises control over the U.S. target as a result of the transaction might take action that threatens to impair U.S. national security). In conducting its analysis of whether a transaction poses a national security risk, CFIUS conducts a two-pronged test: (i) whether the nature of the U.S. business being acquired creates susceptibility to impairment of U.S. national security (i.e., whether there is a "vulnerability") and (ii) whether the foreign acquirer has the capability or intention to exploit or cause harm (i.e., whether there is a "threat"). "National security risk" is a function of the interaction between threat and vulnerability.

In December 2008, the U.S. Treasury Department, chair of CFIUS, published the "Guidance Concerning the National Security Review" (the "Guidance"), which provides a detailed description of the types of transactions CFIUS has reviewed that have presented national security considerations. Although the Guidance does not purport to identify the types of transactions that pose national security risks, it does help potential foreign investors to better assess the national security risk of a proposed transaction based on the characteristics of the U.S. target and the nature of the foreign investor. Chinese companies (whether or not state owned enterprises) that are interested in acquiring U.S. businesses may use the Guidance to help them select acquisition targets and better manage the CFIUS review process.

OTHER APPROVALS

In addition to the antitrust and foreign investment filings described above, additional filings, hearings and/or clearances may be required if the target's business is in an industry section which is subject to additional regulatory supervision (such as defense, banking, insurance, telecommunications and broadcasting, energy, and transportation and shipping).

Practical Tips for Chinese Acquirers Relating to Exon-Florio Reviews

- Be prepared for intensive CFIUS examination if the target is in industries such as defense, energy and natural resources, aerospace, transportation, telecommunications, and advanced technology.
- Be prepared for intensive CFIUS examination if the target has contracts with governmental agencies or conducts activities subject to U.S. export controls are also more likely to raise CFIUS concerns.
- Demonstrate, if the Chinese acquirer is controlled by, or otherwise connected with, the Chinese government, that it is independent of the government in terms of management and investment decisions (e.g., having independent directors, having investment policies based solely on commercial grounds, avoiding government subsidized acquisition financing, etc.).
- Engage legal advisors to develop a comprehensive legal and political strategy to address potential CFIUS concerns, to anticipate and address potential opposition at federal or state levels, and to identify and nurture potential allies.
- Consult with CFIUS as early as possible regarding the proposed transaction and be prepared to adjust the structure of the transaction based on such consultations.
- Particularly if the transaction is likely to be controversial, engage public relations advisors and explain as early as possible to the relevant audience in the U.S. the purpose of the acquisition, the acquirer's investment objectives, institutional and financing arrangements, relevant financial information, and plans for the U.S. business after acquisition.

The Acquisition Process — Documenting the Deal

Corporate acquisitions of any size, even straightforward ones, involve considerable legal documentation and negotiation. The major tasks for the acquirer, its lawyers and its accountants are:

- reaching agreement with a financial adviser, if one is to be used;
- negotiating the basic terms of the acquisition and formalizing them in a letter of intent (although a formal letter of intent is not always utilized);
- conducting a due diligence investigation of the business to be acquired;
- negotiating and drafting the definitive purchase agreement;
- negotiating and drafting supporting documents;
- seeking necessary approvals;
- preparing for closing; and
- conducting the closing.

FINANCIAL ADVISORS

In reaching agreement with a financial advisor, the issues of most interest to an acquirer are typically the compensation and indemnification provisions, although there may be little room to negotiate on the financial advisor's standard indemnification terms. The employment of an investment bank is a particularly good idea if the acquirer is entering the U.S. market for the first time, the available targets are not known, the acquirer needs advice on price, or the target itself is represented by an investment bank.

LETTER OF INTENT

Once a target company has been identified and approached and the parties have agreed in principle to the essential terms of the transaction, they typically execute a non-binding letter of intent. The letter of intent is usually not binding as to the ultimate consummation of the acquisition, but customarily sets out the proposed principal terms of the transaction and the parties' agreement to negotiate in good faith a definitive agreement to give effect to these terms (typically accompanied by a binding agreement to a period of exclusivity) as well as a binding agreement to maintain confidentiality. A letter of intent is not an essential step in a U.S. acquisition and, unless exclusivity is important to the acquirer, letters of intent are often skipped in favor of moving directly to the definitive documentation. In such a case, the parties typically sign a separate confidentiality agreement at this stage to allow the acquirer's purchase investigation to begin.

PURCHASE INVESTIGATION

Once a letter of intent or confidentiality agreement is signed, the acquirer often conducts a legal and financial investigation (a so-called "due-diligence" investigation) of the target's business. In connection with such an investigation, the acquirer asks the seller to provide it with information about the target's business (including detailed information about its operations, real property, personal property (including patents, trademarks and other intellectual property), environmental matters, employee benefit plans, financial condition, litigation, and tax filings), and to provide it with copies of the relevant material documents (including corporate and organizational records, insurance policies, supply contracts, employment and labor contracts, employee benefit plans, leases, debt agreements, licenses, tax returns and informational filings and, if applicable, SEC filings). The acquirer, its lawyers and its accountants review these documents and information, as well as any other information they can obtain about the company or business, to determine if there are any legal, financial or other problems with the company or business and to learn as much about the target company as possible. If the target is a public company with recent financial statements certified by reputable accountants, the purchase investigation may be limited to available public information and if any additional purchase investigation is agreed to at all, it is likely to be short.

The acquirer's ability to conduct a purchase investigation and/or to obtain detailed representations and warranties and indemnification will depend, at least in part, on the nature of the seller and whether there is competition for the target. If the seller or its investment bankers are auctioning the business, a "data room" is typically set up by the seller and an acquirer's opportunity to conduct its investigation of the target beyond a controlled review of the data room may be limited in practice. In the U.S. many data rooms are "virtual" with all relevant information being accessible by potential acquirers remotely through on-line computer access.

PURCHASE AGREEMENT

The purchase agreement sets out the basic terms of the transaction (i.e., what is to be sold and the price to be paid). Particularly in an asset sale, it should specifically and carefully describe the assets to be transferred and the liabilities to be assumed and should also set forth how the purchase price will be allocated among the assets. This allocation will determine, in part, both the taxation of the seller in the transaction and the taxation of the acquired business after the transaction.

Typically, the seller makes extensive representations and warranties to the acquirer, including with respect to (i) the due incorporation and valid existence of the target company, (ii) the seller's authority to enter into the transaction, (iii) the capitalization of the target company, (iv) the accuracy and completeness of the financial statements and other documents given to the acquirer by the seller, (v) contingent and other liabilities, (vi) the target company's title to its assets, (vii) due payment of its taxes, (viii) absence of litigation and governmental investigations, (ix) environmental matters, (x) compliance with pension and related employee benefit matters, (xi) necessity for consents to the transaction, (xii) absence of defaults under existing agreements, (xiii) intellectual property matters, and (xiv) absence of burdensome provisions in existing agreements. Other warranties may be required, depending on the nature of the target's business and other facts unique to the transaction. The exact scope of these representations is typically subject to considerable negotiation. Unless the acquirer is paying for the acquired business with its own shares, its representations and warranties are typically minimal.

The purchase agreement also typically sets out various covenants of the seller and the acquirer. One of the most important covenants made by the seller concerns the operation of the acquired business during the period between the signing of the purchase agreement and the closing. In addition, the purchase agreement sets out conditions to the obligations of the parties to complete the transaction. Depending upon the ownership structure of the target, the purchase agreement may also contain non-compete provisions restricting key owners from competing with the target business in the future. In a U.S. deal, acquirers customarily make their obligation to proceed with the acquisition contingent on the truth and accuracy of the seller's representations and warranties, the performance of the seller's covenants, the absence of litigation and other material proceedings, and the absence of material adverse changes in the seller's financial condition or business.

The acquirer may seek to make its obligation to complete the acquisition contingent upon satisfactory completion of its purchase investigation. Sellers are often very resistant to such a provision as it can be viewed as providing the acquirer with an option on the deal and creates real uncertainty for the seller on the terms of the transaction and whether or not closing will actually occur. While retaining flexibility for itself, the acquirer seeks to commit the seller to the transaction as firmly as possible. Because the parties' obligations to complete the transaction may be contingent on obtaining necessary approvals and consents, it may be difficult or impossible to commit the seller completely.

ANCILLARY DOCUMENTATION

Other documents required to complete an acquisition can be extensive, and may include employment agreements with key employees; non-competition agreements with principals leaving the business; transition services agreements to address potential business separation issues; a merger agreement if the purchase of shares will be followed by a merger of the acquired corporation with the acquirer or a subsidiary of the acquirer; deeds, assignments and other transfer documents in the case of an asset sale; certificates of the seller regarding important representations and warranties; consents of major suppliers, governmental agencies, major creditors, landlords and others; resolutions of the boards of directors of the corporations and their shareholders; a "cold comfort" letter from the accountants of the seller regarding their investigation of the target business; an escrow agreement if any of the purchase price is placed in escrow; receipts for money paid at the closing; and promissory notes representing a portion of the purchase price.

With respect to the acquisition of a U.S. public company, additional documentation required may include tender offer documents, proxy statements, registration statements, and other materials that might need to be filed with the SEC and/or submitted to the target's shareholders. Certain special considerations relating to the acquisition of public companies are summarized below.

U.S. Public Company Acquisitions

Acquisitions of U.S. public companies are customarily effected through either a negotiated merger or a tender offer made directly to the target's shareholders.

MERGERS

To effect a merger, the two companies negotiate a merger agreement. On the effective date of the merger, the target's shares are automatically converted into the right to receive the consideration specified in the merger agreement (whether cash, shares of the acquiring company, a combination of cash and shares or another form of consideration). Such a merger will usually require the approval of the shareholders of the target company and, depending on the structure of the transaction, and whether the acquirer is issuing a considerable amount of shares in the acquisition, may sometimes require the approval of the shareholders of the acquirer as well. Under SEC rules, information (in the form of a "proxy statement") must be sent to shareholders before seeking such approval and must be filed in advance with the SEC. The proxy statement is usually the subject of a lengthy review process by the SEC's staff. Generally, the SEC's proxy review process will occur concurrently with the process for other regulatory clearances. If securities of the acquirer will be issued as consideration in the merger, a registration statement generally (which would generally be combined with the proxy statement) also must be filed with and reviewed by the SEC. Assuming no other regulatory constraints, it can be expected to take about 90 to 120 days from the date of signing to close the merger. This straightforward arrangement is usually the structure of choice for negotiated combinations in which the consideration to be paid to the target's shareholders consists of shares or other securities of the acquirer. An acquisition through merger can be structured in a variety of different ways depending on a number of factors including tax, legal and regulatory considerations.

TENDER AND EXCHANGE OFFERS

As an alternative, the acquiring company may gain control of the target by making a tender offer for some or all of the target's shares followed by a "squeeze-out" merger of the non-tendering shareholders, usually at the same price. If the transaction is supported by the target, the parties will negotiate and enter into a merger agreement, as discussed above, which will govern the tender offer process and the second step merger as described below. The consideration payable in either step can be cash, shares of the acquiring company or other consideration. A tender offer for a consideration other than cash is referred to as an exchange offer. If cash will be used as all of the consideration, the use of a tender offer can have a significant advantage in speed over the merger structure described above. A cash tender offer does not require prior review by the SEC and, barring regulatory constraints or unforeseen circumstances, the tender offer can be closed as early as 20 business days (the statutory minimum offer period) after being commenced. At that time, the acquirer usually purchases enough shares in the target to assure its ability to approve a subsequent second-step merger, thereby obtaining ownership of 100% of the target's shares. If the acquirer can acquire more than 90% of the outstanding shares of the target in the tender offer, it will usually have the power under the applicable state's laws to approve the second-step merger immediately and without a shareholders' meeting. Thus, the entire acquisition can be consummated in about five or six weeks. If the acquirer proposes to use shares or other securities as consideration in an exchange offer, there will be timing implications for the transaction. Securities issued in an exchange offer have to be registered with the SEC before the transaction can be consummated. Since the SEC registration process can take 60 to 90 days, an exchange offer has only a modest timing advantage, if any, over the merger structure described above.

Tender offers for US companies (and non-U.S. companies with U.S. based shareholders) are regulated under US securities laws and regulations. These laws and regulations seek to ensure public disclosure of material information to the target, its shareholders and the marketplace during tender offers, as well as to impose procedural and substantive requirements on tender offers to ensure that shareholders receive fair treatment. The offer normally consists of a bid by an individual or group to buy shares of a company — usually at a price above the current market price. Those accepting the offer are said to tender their shares for purchase. The entity making the offer obligates itself to purchase all or a specified portion of the tendered shares if certain specified conditions are met.

A clear disadvantage of exchange offers as compared to mergers is that the bidder typically would need to acquire at least 80% of the target's share in the exchange offer in order to assure that the exchange offer is not taxable to the target's shareholders. Even then, a second-step merger would be needed to eliminate the shareholders who, inevitably, fail to tender their shares. A merger, in contrast, typically requires a simple majority vote to be approved and, once approved, is binding on all shareholders, subject to any appraisal or "dissenters'" rights that may be available. Since the exchange offer provides added complexity and little or no advantage in speed, a straightforward merger transaction is still the preferred method in most negotiated transactions where shares or other securities are used as consideration.

Although a discussion of hostile takeovers is beyond the scope of this article, if an acquirer fails to open negotiations with target management or their discussions fail to reach agreement on a transaction, several means are available to increase pressure on target management to consider a bona fide acquisition proposal. While such "hostile" actions will likely strain relations between an acquirer and its intended target, the fiduciary duties of target's management generally preclude it from ignoring entirely a proposal that can increase value for its shareholders. These methods include "proxy fights", "bear hugs" and litigation.

The tender offer materials which will be distributed to all of the target's shareholders must include certain disclosures about the transaction, the target and the bidder as required by the SEC's tender offer form, the Schedule TO. Much less information is required to be disclosed about the bidder in a cash tender offer than would be required in a sale of securities by the bidder through an exchange offer. Generally, the information disclosed about the bidder in cash offers is limited to the names and five-year employment histories of the officers and directors of the bidder, as well as those of any person or entity controlling the bidder, a brief description of the bidder and its business and certain financial information. Information must also be disclosed about the source of financing for the offer. If the tender offer is being financed other than out of the bidder's available cash resources, detailed information is required about the financing arrangements, including detailed summaries of loans and other borrowing arrangements. In addition, a description of the history of negotiations between the target and the bidder, and any other parties that may have been involved, is an important part of the tender offer disclosure as well.

The U.S. tender and exchange offer rules are complex and to minimize the risk of non-compliance, a Chinese acquirer considering a possible takeover of a U.S. public company should consult with U.S. legal counsel in advance of any acquisition. It should also be noted that the U.S. system of tender offer regulation applies to all tender offers made "directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise" and can apply to offers to acquire shares from U.S. shareholders of non-U.S. companies.

PUBLIC MINORITIES

Acquisitions may be made cheaper by leaving a public minority in place, but the bargain may be illusory for a number of reasons. A public minority may make the economies that are the main purpose of the acquisition difficult or impossible to achieve. The public minority imposes fiduciary duties upon a majority shareholder that may hinder its exercise of control, and the presence of a public minority gives management an excuse not to do what the majority shareholder wants. With a public minority in place the target may also have continuing SEC disclosure and other obligations and must continue to comply with the Sarbanes-Oxley regulatory regime. In addition, the costs of buying out the minority later on may be high. For these reasons, certain deals that left public minorities in place, have provided for the ultimate purchase of the minority shareholdings at prices determined pursuant to preset formulae which take into account share value appreciation. The continued presence of minority shareholders makes it significantly more difficult for an acquirer to combine and restructure its and the target's businesses, assets and liabilities in an optimal way, because of potential claims by the minority shareholders of conflict of interest (including breach of fiduciary duty or usurpation of corporate opportunity).

DEAL PROTECTION

Competition is always a possibility in acquisitions of public companies. This is because the target's shareholders will either vote against a negotiated merger if a better offer has been announced or, in a tender or exchange offer context, refuse to tender their shares. There is inevitably a delay between disclosure of the negotiated deal and its consummation, which provides time and a free education to competing bidders — two crucial ingredients to their potential success. An acquirer can adopt several strategies to improve its ability to enforce its negotiated acquisition agreement with the target, including entering into contractual "lock-ups" of the target shares with large shareholders. There is no perfect strategy and, as a general rule, the tighter the lockup, the less likely it is to be enforceable. There are, however, myriad techniques that acquirers can employ to minimize the risk in this regard and to provide the acquirer with some compensation if a topping bidder emerges.

PUBLIC DISCLOSURES AND PRESS ANNOUNCEMENTS

There is generally no affirmative duty to disclose merger discussions except to the extent that a party to the negotiations has an obligation to report under applicable SEC rules and regulations, or where the parties become concerned about the possibility of insider trading occurring as a result of the non-disclosure of the material information. Both targets and acquirers typically maintain a "no comment" stance with the press until they are prepared to truthfully announce the status of negotiations. This will be of great importance to the target's board as the board of a U.S. public company may be liable to it's shareholders for misleading investors about the existence or non-existence of discussions regarding mergers or other extraordinary events. If the confidentiality of a transaction can be maintained, the bidder gains the tactical advantage of keeping potential rival bidders uninformed until the bidder is prepared to launch a cash tender offer or offer securities to the target's shareholders. Once an agreement with respect to a merger or other business combination is reached, press releases announcing the essential terms of the agreement will typically be made by both parties.

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Recent Changes to US Foreign Investment Rules

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Recent Changes to US Foreign Investment Rules: Implications for Chinese Investors

The current unprecedented economic downturn has depressed the value of assets worldwide to a historically low level. Although a number of Chinese companies have taken advantage of this opportunity and aggressively acquired assets in other countries, few have made acquisitions in the United States in recent years. One of the reasons for the lack of U.S.-focused M&A activities by Chinese companies is the regulatory obstacle posed by the Committee on Foreign Investment in the United States ("CFIUS"), an inter-agency government body authorized to review on national security grounds any foreign acquisitions that could result in control of a U.S. business by a foreign person. Acquisitions that are found to threaten to impair the national security of the United States may be forced to mitigate the national security concerns by restructuring or other measures, or acquisitions may be blocked if acceptable mitigation measures cannot be implemented. Such regulatory hurdles were cited as the primary reasons for the withdrawal by the China National Offshore Oil Corporation of its takeover bid for Unocal Corporation in 2005 and the failed attempt by Huawei Technologies and its U.S. partner, Bain Capital, to acquire 3Com Corporation in 2008. The CFIUS review process has been criticized for its lack of predictability (e.g., the term "national security" is not defined in the statutes and regulations) and the potential for abuse rooted in economic protectionism by U.S. companies and their congressional allies.

The CFIUS review process has been reshaped substantially in recent years by new legislation enacted in 2007 and by new regulations published in 2008. Furthermore, in December 2008, the U.S. Treasury Department, which chairs CFIUS, published "Guidance Concerning the National Security Review" (the "Guidance"), which provides a detailed description of the types of transactions CFIUS has reviewed that have presented national security considerations. Although the Guidance does not purport to identify the types of transactions that pose national security risks, it does help potential foreign investors to assess the national security risk of a proposed transaction based on the characteristics of the U.S. target and the nature of the foreign investor. Chinese companies (whether or not state owned enterprises) that are interested in acquiring U.S. businesses may use the Guidance to help them select acquisition targets that are less likely to pose a U.S. national security risk and better manage the CFIUS review process.

The CFIUS Review Process

Foreign acquisitions of control of U.S. companies that involve national security issues are reviewed under the Exon-Florio Amendment to the Defense Production Act of 1950 ("Exon-Florio"), which was amended by the Foreign Investment and National Security Act of 2007 ("FINSA"). Exon-Florio authorizes the President to investigate proposed transactions to evaluate their impact on U.S. national security. The President delegated this authority to CFIUS. In November 2008, new regulations implementing FINSA (the "2008 Rules") were issued indicating that foreign investments in the United States will be subject to a more expansive and intensive examination process by CFIUS. The 2008 Rules set especially important standards with respect to the determination of "control," the exclusion of certain transactions, the treatment of government-owned acquirers, the use of mitigation agreements, and the application of Exon-Florio to privatization of infrastructure and to sovereign wealth funds ("SWFs").

THE DETERMNATION OF "CONTROL"

CFIUS screens those foreign investments that would result in "control" by a foreign person over an existing U.S. business. "Control" is defined as the "power, direct or indirect, whether or not exercised... to determine, direct or decide important matters affecting an entity," and can be exercised not only through sharehioldings and board seats but also through other direct or indirect arrangements (e.g., contracts). The test of control will be functional and CFIUS will consider all relevant facts and circumstances rather than applying a bright line test.

The 2008 Rules contain a non-exhaustive illustrative list of important matters for use in determining "control". Certain types of negative power, generally used to protect minority shareholders' rights, will not be automatically deemed to constitute control. Instead, the determination of control through minority rights will be determined based on whether those rights "protect the investment-backed expectations of minority shareholders and do not affect strategic decisions on business policy or day-to-day management of an entity or other important matters affecting an entity." The 2008 Rules indicate that CFIUS will focus on a person's power in relation to existing business rather than the transaction form and, specifically, in the context of private equity investments, the 2008 Rules contain examples of structures that create ownership interests but not control. Traditionally, practitioners considered the 10% interest threshold as the dividing line between control and no control; however, the 2008 Rules made it clear that a foreign person taking less than a 10% interest in the voting shares of a U.S. business with national security considerations would still need to establish that its investment is "solely for the purpose of passive investment."

THE EXCLUSION OF CERTAIN TRANSACTIONS

It is worth noting that asset acquisitions are not subject to CFIUS's review if the assets being acquired do not constitute a U.S. business. In addition, investments that start a business rather than acquire an existing business are not reviewed by CFIUS. A long-term lease may be subject to CFIUS review only if a foreign lessee makes substantially all business decisions concerning the operation of a leased U.S. business. Finally, lending arrangements are not subject to CFIUS's review unless the foreign person acquires financial or governance rights characteristic of an equity investment. CFIUS is likely to review, however, lending transactions where imminent or actual default, or other similar circumstances, gives a foreign person control over collateral that constitutes a U.S. business.

THE TREATMENT OF GOVERNMENT-OWNED ACQUIRERS

Under the 2008 Rules, there is a heightened level of scrutiny for "foreign government controlled transactions" which are transactions subject to CFIUS review that "could result in control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign government," including sovereign wealth funds ("SWFs"). In many circumstances, CFIUS will extend the review of such transactions for 45 days beyond the 30-day initial period of review.

A CFIUS examination ordinarily entails a 30-day review of the proposed acquisition, at the end of which period most reviewed acquisitions are cleared. If there are national security concerns that cannot be resolved within the 30-day period, the transaction is subject to a further 45-day investigation. CFIUS may impose mitigation measures on the parties as a condition to approve the transaction, such as entering into a national security agreement with a CFIUS agency or providing a letter of assurance to CFIUS. If the transaction is not cleared by CFIUS by the end of that 45-day investigation period, CFIUS may decide to submit the transaction to the President, who has 15 days to determine whether to permit or prohibit the acquisition. In most cases, CFIUS will extend the 30-day period by an additional 45 days for (i) a transaction which threatens to impair national security if that threat has not been mitigated prior to the conclusion of the initial 30-day period, (ii) any "foreign government-controlled transaction," and (iii) any transaction that would result in foreign control of critical infrastructure. Parties are encouraged to confer with CFIUS in advance of a formal notification, so that CFIUS can understand the transaction and provide guidance as to the information it will need to conduct the examination.

THE USE OF MITIGATION AGREEMENTS

The 2008 Rules emphasize the use of mitigation agreements, which will be an increasingly common condition of CFIUS clearance. These agreements between the US Government and the parties to the transaction are intended to ameliorate concerns about the national security risks of a proposed transaction. Under the

2008 Rules, CFIUS has authority to impose civil penalties up to $250,000 or the transaction's value, whichever is greater, for each intentional or grossly negligent breach of an agreement to mitigate national security risks. In addition, a mitigation agreement may provide for liquidated or actual damages for any breach. The 2008 Rules also provide for civil penalties of up to $250,000 for intentionally submitting a material misstatement or omission in a notice or making a false certification to CFIUS.

THE PRIVATIZATION OF INFRASTRUCTURE AND INVESTMENTS BY SOVEREIGN WEALTH FUNDS

In addition to addressing the scope and process of CFIUS examinations, the 2008 Rules address, explicitly or implicitly, two areas of growing significance to Chinese and other foreign investors in the United States: (i) the privatization of U.S. infrastructure, and (ii) the activity of SWFs. Foreign investors have played a key role in a number of transactions through which turnpikes, bridges, and other infrastructure have been placed in private hands, typically through long-term leases. As indicated above, the 2008 Rules expressly state that long-term leases may be considered transactions that transfer control, but only where the lessee "makes substantially all business decisions concerning the operation of a leased entity, as if it were the owner." An example provided in the 2008 Rules notes that, where a foreign person "signs a concession agreement to operate a toll road business" in the United States "for 99 years," but where the US owner retains authority to perform "safety and security functions" and to terminate the lease if the foreign person fails to fulfill its operational obligations under the lease, then the lease would not constitute a transaction transferring control. This provision provides to parties to infrastructure privatization transactions a road map on how to draft long-term leases that will fall outside the scope of CFIUS examination.

The 2008 Rules make no mention of SWFs. Some observers, including some members of the U.S. Congress, had urged that the 2008 Rules address SWFs directly, given their growing importance in international investment flows and their potential for extending foreign government control into U.S. energy, infrastructure, telecommunications, and other sensitive sectors. In announcing the proposed regulations in April 2008, however, the U.S. Treasury Department commented that CFIUS has examined SWF transactions for many years and that CFIUS intends to treat SWFs as it does any other investor controlled by a foreign government. For parties to SWF transactions, therefore, the 2008 Rules appear to promise no better treatment, and no worse, than that accorded to other investments by Chinese and foreign government instrumentalities.

The Guidance

In the Guidance, CFIUS identifies "national security considerations" (i.e., facts and circumstances that have potential national security implications) by which CFIUS assesses whether a transactions poses a potential "national security risk" (i.e., whether the foreign acquirer that exercises control over the U.S. target as a result of the transaction might take action that threatens to impair U.S. national security). In conducting its analysis of whether a transaction poses a national security risk, CFIUS conducts a two-pronged test: (i) whether the nature of the U.S. business being acquired creates susceptibility to impairment of U.S. national security (i.e., whether there is a "vulnerability"); and (ii) whether the foreign acquirer has the capability or intention to exploit or cause harm (i.e., whether there is a "threat"). "National security risk" is a function of the interaction between threat and vulnerability. The Guidance sets forth illustrative, but not comprehensive, descriptions of transactions reviewed by CFIUS that have presented national security considerations under each prong of the two-pronged test.

THE NATURE OF THE U.S. BUSINESS BEING ACQUIRED

Transactions that have presented national security considerations because of the nature of the U.S. business being acquired usually involve a U.S. business that provides goods or services that directly or indirectly contribute to U.S. national security, including:

- Government contractors: U.S. businesses that provide products and services, either as prime contractors or as subcontractors or suppliers to prime contractors, to agencies of the U.S. federal government and state and local authorities.
  - » This category often includes U.S. businesses in the defense, security, and national-security-related law enforcement sectors, and cover such industry segments as weapons and munitions manufacturing, aerospace, and radar systems.
  - » This category also includes U.S. businesses that supply goods and services that affect the national security functions of U.S. government agencies or create vulnerability to sabotage or espionage, such as information technology, telecommunications, energy, natural resources, and certain industrial products.
- Non-contractors: U.S. businesses that have no contracts with government, but whose products or services have implications for U.S. national security, including:
  - » U.S. businesses in the energy sector at various stages of the value chain: the exploitation of natural resources, the transportation of these resources (e.g., by pipeline); the conversion of these resources to power; and the provision of power to customers.
  - » U.S. businesses that affect the nation's transportation system, including maritime shipping and port terminal operations, and aviation maintenance, repair, and overhaul.
  - » Transactions involving U.S. businesses that could significantly and directly affect the U.S. financial system.

- Critical infrastructure: U.S businesses that involve infrastructure that may constitute United States critical infrastructure. CFIUS determines whether a transaction involves critical infrastructure on a case-by-case basis, depending on the importance of the particular assets involved in the transaction.
- Advanced technology: U.S. businesses that provide certain types of advanced technologies that may be useful in defending, or in seeking to impair, U.S. national security. Many of these U.S. businesses are engaged in the design and production of semiconductors and other equipment or components that have both commercial and military applications. Others are engaged in the production or supply of goods and services involving cryptography, data protection, Internet security and network intrusion detection, and they may or may not have contracts with U.S. government agencies.
- Export control: U.S. businesses that are engaged in the research and development, production, or sale of technology, goods, or software that are subject to U.S. export controls.

THE IDENTITY OF THE FOREIGN ACQUIRER

With regard to the characteristics of the foreign person seeking to make an acquisition, CFIUS considers the following factors, among others:

- the record of the person's country, with respect to non-proliferation and other national security matters;
- the record and intentions of such person regarding actions that could impair U.S national security (such as an intent to terminate U.S. government contracts); and
- whether the foreign person is foreign government-controlled. Foreign government-controlled transactions may include transactions resulting in control of a U.S. business by, among others, foreign government agencies, state-owned enterprises, government pension funds, and SWFs.

That a transaction is a foreign government-controlled transaction does not, in itself, mean that it poses a national security risk. In reviewing foreign government-controlled transactions, CFIUS considers, among all other relevant facts and circumstances, the following mitigating factors:

- the extent to which the basic investment management policies of the acquirer require investment decisions to be based solely on commercial grounds;
- the degree to which, in practice, the acquirer's management and investment decisions are exercised independently from the controlling government, including whether governance structures are in place to ensure independence;
- the degree of transparency and disclosure of the purpose, investment objectives, institutional arrangements, and financial information of the acquirer; and
- the degree to which the acquirer complies with applicable regulatory and disclosure requirements of the countries in which it invests.

Practical Implications

The Guidance emphasizes that it does not purport to describe all national security considerations that CFIUS may identify and analyze in reviewing a transaction, and it should not be interpreted to suggest that the U.S. government encourages or discourages the types of transactions described above. However, because the types of transactions described in the Guidance were drawn from CFIUS's extensive experience in reviewing foreign investment transactions, it does offer some insight into the Committee's thinking and specific examples of transactions that are more likely to present national security considerations.

Chinese investors who are interested in making acquisitions in the U.S. may consider the following practical tips from the Guidance:

- anticipate that targets that are in such industries as defense, energy and natural resources, aerospace, transportation, telecommunications, infrastructure, or advanced technology are more likely to present U.S. national security considerations;
- anticipate that targets that have contracts with governmental agencies or conduct activities subject to U.S. export controls are also more likely to present U.S. national security considerations;
- demonstrate, if the Chinese acquirer is controlled by, or otherwise connected with, the Chinese government or a Chinese governmental instrumentality, that the acquirer is independent of the government in terms of management and investment decisions (e.g., having independent directors, having investment policies based solely on commercial grounds, avoiding government subsidized acquisition financing);
- engage legal advisors to develop a comprehensive legal and political strategy to address potential CFIUS concerns, to anticipate and address potential opposition at federal or state levels, and to identify and nurture potential allies;
- consult with CFIUS as early as possible regarding the proposed transaction and be prepared to adjust the structure of the transaction based on such consultations; and
- particularly if the transaction is likely to be controversial, engage public relations advisors and explain as early as possible to the relevant audience in the U.S. the purpose of the acquisition, the acquirer's investment objectives, institutional and financing arrangements, relevant financial information, and plans for the U.S. business after the completion of the acquisition.

The Future

The 2008 Rules and the Guidance should provide Chinese and other foreign investors with more clarity regarding the CFIUS process and the concerns that will need to be addressed to complete certain U.S. acquisitions. The new regulations also reflect a desire for increased openness and transparency with respect to foreign investment activity in the United States, designed to promote economic growth, productivity, and competitiveness while protecting U.S. national security. The real impact of the 2008 Rules and the Guidance, however, will depend, in large part, on how they are applied in practice and over time. The CFIUS process is also likely to be affected by the continuing global credit crisis and by the new political administration in charge of U.S. foreign investment policy.

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Beyond Borders
China Outbound Investment
May 2009

EU Competition Rules

Executive Summary

Chinese enterprises evaluating investment targets or considering entering into commercial agreements within the European Union should be aware of the two level review process for these types of transactions. An acquisition may be subject to robust review of competition law issues by both the European Commission and member states' national authorities. This summary provides a general framework of merger control review within the European Union by addressing the practices and procedures for review of various types of transactions including mergers and acquisitions, joint ventures and minority investments and commercial agreements. Attachment 1.1 sets out the turnover thresholds for merger control review by the European Commission and Attachment 1.2 contains a suggested form of "condition" regarding merger control for inclusion in Sale and Purchase Agreements.

Mergers and Acquisitions

The transaction might be subject to the EC merger control rules.

Legal Comment	• Applies to large transactions meeting certain turnover thresholds (*see attachment 1.1 for further details*) • If applicable, consent from the EC Commission is required prior to completion • Clearly not applicable if Target's EU-wide turnover is below Euro 100 million
Practice	• Determining the issue is not simply the Purchaser's concern. This is particularly true if it is a transaction involving a company listed on a public exchange, because the interface of the rules often prevent any public offer being completed without EU merger consent being obtained first • Should always be addressed as it has significant contractual and timing consequences • Sending a sales memorandum and Accounts of the parties to External Counsel as soon as possible will usually allow the issue to be settled early
Procedure	• If applicable, particular conditions to completion are necessary (*see attachment 1.2 for further details*) • The implications mean External Counsel should be contacted before a MOU is signed • If applicable, substantive competition analysis is necessary and swiftly identifying the appropriate person at the clients' structure will facilitate this task • Sending to External Counsel any relevant background reports on the target, including acquisition memoranda, will facilitate the legal analysis. The earlier this is done, the better, as relevant questions can be asked of the client in time

If not subject to EC merger control, the transaction might be subject to national merger control rules.

Legal Comment	• Most EC countries have merger control regimes which apply if certain turnover thresholds are met • Most EC countries have national merger control regimes and most are mandatory, meaning that consent is required to be given prior to completion
Practice	• If assets are not being acquired in a territory, but market share will be increased in that country, national merger control might still apply • Determining the issue is not simply the Purchaser's concern because if consent cannot be obtained, or if it can only be obtained subject to conditions, then this affects the validity of the transaction • Should always be addressed as it has significant contractual and timing consequences • Sending a sales memorandum and Accounts of the parties to External Counsel as soon as possible will usually allow the issue to be settled early
Procedure	• Country specific information is required, usually in relation to turnover and market share. Contact External Counsel • If applicable, substantive competition analysis is necessary and swiftly identifying the appropriate person at the clients' structure will facilitate this task • Sending to External Counsel any relevant background reports on the project, including acquisition/project memoranda, will facilitate the competition analysis. The earlier this is done, the better as relevant questions can be asked of the client in time

Agreements ancillary to the acquisition (e.g. supply, distribution, agency, tolling manufacturing) might be regarded as anti-competitive at the EC or national level.

Legal Comment	• EC competition law rules need not be considered if the combined market share of the parties on the relevant market does not exceed 15%, or 10% if the parties are competitors and there are no "hardcore" restrictions (e.g. price fixing) contained in the ancillary agreements • National competition law rules sometimes include safe harbour provisions, e.g. under UK competition law, with the exception cartels, there is a safe harbour if the parties' combined share of the relevant market does not exceed 25%
Practice	• It is rare that such ancillary agreements would be regarded as anti-competitive, but the consequences of breach of competition law rules are serious and so the issue must be addressed • Be particularly sensitive to restrictions in such agreements on the commercial freedom of a party, such as supply commitments, exclusive grant of IP rights and non-compete clauses
Procedure	• The center of the attention is on the transaction, but you should also inform External Counsel of any ancillary agreements • Defining the relevant product and geographic market, and thus market share, is a complex task which should be undertaken by External Counsel

The transaction might be subject to EC merger control rules.

Legal Comment	• A number of tests must be satisfied, but the question need not be addressed if the combined world-wide turnover of all the parties to the JV does not exceed Euro 2,500 million (see attachment 1.1 for further details) • If applicable, consent from the EC Commission is required prior to completion • The acquisition of a minority shareholding is subject to merger control rules as long as it confers control to the purchaser • Should always be addressed as it has significant contractual and timing consequences
Practice	• EC merger control rules are much more likely to apply in joint ventures than under a straight acquisition scenario because there are more parties to enable the turnover thresholds to be satisfied • Can apply to the smallest of JVs if the parents are sufficiently large • Sending a sales memorandum and Accounts of the parties to External Counsel as soon as possible will facilitate early settlement of the issue
Procedure	• If applicable, particular conditions to completion are necessary • External Counsel should be contacted even before a MOU is signed • If applicable, substantive competition analysis is necessary and identifying the appropriate person at the clients' structure will facilitate this task • Sending to External Counsel any relevant background reports on the project, including acquisition/project memoranda, will facilitate the competition analysis. The earlier this is done, the better, as relevant questions can be asked in time • The issue must be addressed as early as possible because difficult questions of fact and law commonly arise

If not subject to EC merger control, the transaction might be subject to national merger control rules.

Legal Comment	• Most EC countries have merger controls which apply if certain turnover thresholds are met • Most EC countries have national merger controls and most are mandatory meaning that consent is required to be given prior to completion • In certain EU countries the acquisition of a non-controlling minority stake as low as 25% is sufficient to trigger the application of the respective national merger law rules • Should always be addressed as it has significant contractual and timing consequences
Practice	• Sending a sales memorandum and Accounts of the parties to External Counsel as soon as possible will usually allow the issue to be settled early
Procedure	• If applicable, substantive competition analysis is necessary and identifying the appropriate person at the clients' structure will facilitate this task • Sending to External Counsel any relevant background reports on the project, including acquisition/project memoranda, will facilitate the competition analysis. The earlier this is done, the better, as relevant questions can be asked in time

If not a merger, the transaction might be regarded as anti-competitive at the EC or national level.

Legal Comment	• The more restrictions on the commercial freedom of the parties, the more such a conclusion is likely • EC competition law rules need not be considered if the combined market share of the parties on the relevant market does not exceed 15%, or 10% if the parties are competitors • EU countries' competition law rules sometimes include safe harbour provisions, e.g. UK competition law need not be considered, except for cartels, if the parties' combined share of the relevant market does not exceed 25%
Practice	• Where the Parents are competitors, competition law may well apply, even to small JVs • Look out for restrictions in such agreements on the commercial freedom of a party
Procedure	• JVs commonly raise the most complex issues, usually as to whether the law applies. Consequently, you should be sensitive to the likelihood that examination of a JV under competition law rules by External Counsel can be a larger task than you might consider

Commercial Agreements

Any agreement which restricts the commercial freedom of a party might be subject to competition law at the EC or national level.

Legal Comment	• If competition law applies, applying for consent may be necessary or appropriate • There is no exhaustive list, but agreements commonly raising issues are: distribution, supply, IP licences, R&D and co-operation / collaboration agreements • The more restrictions on the commercial freedom of a party, the more such a conclusion is likely • 'Hardcore restraints' are prohibited. They include: price fixing, market sharing, restrictions on cross supplies between distributors in a selective distribution system and restrictions on the sale of spare parts • Non-compete clauses which exceed 3 years may well raise competition issues • Post term non-compete clauses are rarely permitted • EC competition law rules need not be considered if the combined market share of the parties on the relevant market does not exceed 15%, or 10% if the parties are competitors, unless there are 'hardcore restraints' as mentioned above • At both the EC and national level there are a number of recognised exemptions (e.g. Vertical Restraints, R&D and Technology Transfer)
Practice	• Rarely is prior consent necessary, but the question of whether obtaining consent, potentially informal, is appropriate is a sensitive issue for clients and so it must be addressed as early as possible • Analysis might conclude that amendments need to be made to the documentation • If application for consent is appropriate, the parties need to understand and agree how the process is to be handled
Procedure	• Contact External Counsel as early as possible, as often a preliminary view will enable a conclusion on the basis of competition rules to be drawn

Attachment 1.1 — The EC Merger Regulation

INTRODUCTION

The Merger Regulation turnover thresholds:

Either test one or test two must be satisfied, namely:

Test 1

- combined world-wide turnover of the parties exceeds EURO 5,000 million, and
- EU wide turnover of each of at least two parties exceeds EURO 250 million,

unless more than two-thirds of the EU wide turnover of each of the parties arises in the same Member State.

Test 2

- combined world-wide turnover of the parties exceeds EURO 2,500 million ,
- EU wide turnover of each of at least two of the parties exceeds EURO 100 million,
- in each of at least three Member States the combined turnover of the parties exceeds EURO 100 million, and
- in each of the three Member States above, the turnover of each of at least two parties exceeds EURO 25 million,

unless more than two-thirds of the EU wide turnover of each of the parties arises in the same Member State.

For an Acquisition:

The parties are (1) the purchaser and the entire group to which the purchaser belongs, and (2) the Target and all legal entities owned by the Target which are being transferred (in brief, the Target is everything being transferred, and thus excludes the seller and its group).

For Joint Ventures:

The parties are each of the parents of the Joint Venture and the entire group to which each of the parents is affiliated.

Attachment 1.2 — EC Merger Regulation CONDITION

INTRODUCTION

Below is a suggested insert 'condition' clause for a Sale & Purchase agreement of a company or business. It is important to note that:

- it is drafted from the point of view of being 'friendly' to the Purchaser
- if there is a potential substantive competition law issue a considerably more complex clause may be required,
- External Counsel should always be consulted prior to it being put in a draft document.

CONDITIONS

Conditions

It shall be a condition to Completion that on or prior to Completion the following shall have occurred:

a. subject to sub-clause (b), either:
   i. following notification of the Merger (which in this clause X shall mean the arrangements to be effected by this Agreement, and any matters arising therefrom) to the European Commission in accordance with Council Regulation (EC) No. 139/2004 (in this clause X, the "Regulation"), a decision shall have been received by the Purchaser from the European Commission that the Merger falls within Article 6.1(a) or Article 6.1(b) of the Regulation; or
   ii. following initiation of proceedings in relation to the Merger under Article 6.1(c) of the Regulation, the European Commission shall have issued a decision in relation to the Merger pursuant to Article 8.1 of the Regulation (the "Clearance") provided that if the European Commission attaches conditions or obligations to the Clearance pursuant to Article 8.2, those conditions or obligations are satisfactory to the Purchaser; or
   iii. the Merger shall have been deemed compatible with the Common Market in accordance with Article 10(6) of the Regulation;

b. following a decision by the European Commission taken pursuant to Article 9(3)(b) of the Regulation, or having been deemed to have been taken pursuant to Article 9(5) of the Regulation, to refer part of, or parts of the Merger to the competent authorities of [relevant member State] with a view to the application of that member State's competition law rules, decisions having been taken by all such competent authorities to which part of, or parts of, the Merger have been referred to permit the Merger provided that if any conditions or obligations are attached to any such decision those conditions or obligations shall be satisfactory to the Purchaser.

Fulfilment of conditions

- Any notifications and filings made under this Clause X shall be the responsibility of the Purchaser who shall have sole and final discretion as to the form and content of such notifications or filings. The Vendor shall co-operate with the Purchaser and endeavour to enable the conditions to Completion referred to in clause X.1 to be satisfied as early as practicable and neither the Vendor nor the Purchaser shall take any affirmative action which might impede the satisfying of such conditions. Such co-operation shall include, but without limitation, all or any of the following in relation to the Merger: the furnishing to the Purchaser of information in order to enable the Purchaser to prepare the notification of the Merger to the Merger Task Force; the preparation of the notification; agreeing that the notification is submitted on behalf of, inter alia, the Vendor; responding to requests for information made by the European Commission; attending (and, if appropriate, requesting) hearings with the European Commission; and offering conditions and/or accepting obligations considered satisfactory to the Purchaser to enable the European Commission to issue a Clearance.

Notification of other parties

Upon either party becoming aware that the Conditions have been fulfilled, delayed in fulfilment or become incapable of fulfilment, that party shall immediately notify the other party (-ies) and shall supply to the other party(-ies) written evidence (if available) of the fulfilment of the Conditions or (as the case may be) an explanation for the delay or non-fulfilment.

If Conditions not fulfilled or waived

If the Conditions are not fulfilled on or before [•] (*date*) or such later date (before [[•]]) as the parties may agree in writing, all rights and obligations of the parties under this Agreement (except under Clauses [•] (*Confidentiality*), [•] (*Announcements*), [•] (*Costs and Expenses*), [•] (*Choice of Governing Law*) and [•] (*Jurisdiction*)) shall terminate and neither party shall have any claim against the other, but without prejudice to the accrued rights and obligations of the parties in respect of any breaches of this Agreement before that termination.

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