Introduction of Joint Venture (JV)

A Joint Venture is a business arrangement in which the participants create a new business entity or official contractual relationship and share investment and operation expenses, management responsibilities, and profits and losses.
The Chinese authorities encourage foreign investors to use this form of company in order to obtain exposure to advanced technology and new management skills. In return, foreign investors can enjoy low labour costs, low production costs and a potentially large Chinese market share. Joint Ventures are sometimes the only way to register in China if a certain business activity is still controlled by the government. e.g. Restaurants, Bars, Building and Construction, Car Production, Cosmetics etc. There are 2 types of Joint Venture:

1- EJV (Equity Joint Venture)

Equity joint ventures are the second most common manner in which foreign companies enter the China market and the preferred manner for cooperation where the Chinese government and Chinese businesses are concerned. Joint ventures are usually established to exploit the market knowledge, preferential market treatment, and manufacturing capability of the Chinese side along with the technology, manufacturing know-how, and marketing experience of the foreign partner.
Normally operation of a joint venture is limited to a fixed period of time from thirty to fifty years. In some cases an unlimited period of operation can be approved, especially when the transfer of advanced technology is involved. Profit and risk sharing in a joint venture are proportionate to the equity of each partner in the joint venture, except in cases of a breach of the joint venture contract.
Share holdings in a joint venture are usually non-negotiable and cannot be transferred without approval from the Chinese government. Investors are restricted from withdrawing registered capital during the live of the joint venture contract. Regulations surrounding the transfer of shares with only the approval of the board of directors and without approval from government authorities will probably evolve over time as the size and number of international joint ventures grow.
There are specific requirements for the management structure of a joint venture but either party can hold the position as chairman of the board of directors. A minimum of 25% of the capital must be contributed by the foreign partner(s). There is no minimum investment for the Chinese partner(s).
It is preferable that foreign exchange accounts are balanced in order to remit profits abroad so that the repatriated foreign exchange is offset by exports from the joint venture. With the elimination of foreign exchange certificates and the further opening of the China market, this requirement is becoming more and more relaxed.
The permissible debt to equity ratio of a joint venture is regulated depending on the size of the joint venture. In situations where the sum of debt and equity is less than US$ 3 million, equity must constitute 70% of the total investment. In joint ventures where the sum of the debt and equity is more than US$ 3 million but less than US$ 10 million, equity must constitute at least half of the total investment. In cases where the sum of the debt and equity is more than US$ 10 million but less than US$ 30 million, 40% of the total investment must be in the form of equity. When the total investment exceeds US$ 30 million, at least a third of the sum of the debt and equity must be equity.
Equity can include cash, buildings, equipment, materials, intellectual property rights, and land-use rights but cannot include labor. The value of any equipment, materials, intellectual property rights, or land-use rights must be approved by government authorities before the joint venture can be approved.

After a joint venture is registered, the entity is considered a Chinese legal entity and must abide by all Chinese laws. As a Chinese legal entity, a joint venture is free to hire Chinese nationals without the interference from government employment industries as long as they abide by Chinese labor law. Joint ventures are also able to purchase land and build their own buildings, privileges prevented to representative offices.

2- CJV (Cooperative Joint Venture)

In a Sino-Foreign Cooperative Venture (also known as Contractual Joint Venture), the parties involved may operate as separate legal entities and bear liabilities independently rather than as a single entity. A cooperative venture may also be registered as a limited liability entity resembling an equity joint venture in operation, structure, and status as a Chinese legal entity.
There is no minimum foreign contribution required to initiate a cooperative venture, allowing a foreign company to take part in an enterprise where they preferred to remain a minor shareholder. The contributions made by the investors are not required to be expressed in a monetary value and can include excluded in the equity joint venture process can be contributed such as labor, resources, and services. Profits in a cooperative venture are divided according to the terms of the cooperative venture contract rather than by investment share, allowing a more flexible schedule for return on investment in cases where one investor provides cash while the other party's investment is primarily in kind.
Greater flexibility in the structuring of a cooperative venture is also permissible including the structure of the organization, management, and assets. There is no term for unlimited terms in cooperative ventures, but also no provisions for the term of the duration. The term of the cooperative venture contract may be renewed subject to the consent of the parties involved and approval from the examination and approval authorities. The foreign investor is permitted to withdraw their registered capital or a portion thereof from the cooperative venture during the duration of the cooperative venture contract.
Because of the unique privileges and added features offered to the foreign party in a cooperative venture, trade unions must be allowed to represent the employees in employment matters to protect the interests of the employees.

KEY ISSUES REGARDING A JOINT VENTURE

Nature of JV Project

(A) The principal differences between an EJV and a CJV can be simply summarised as follows:
- For an EJV:
    1. Each party must make cash or permitted contributions in proportion to its subscribed percentage of the EJV's registered capital.
    2. Profit must be distributed strictly in accordance with the parties' respective percentage shareholding of the registered capital of the EJV.
    3. Upon dissolution of the EJV at the expiry of the term of operation, the EJV's net assets are to be distributed to each party in accordance with its respective shareholding of the EJV's registered capital.
- For a CJV:
    1. A party (typically, but not always, the Chinese party) may contribute non-cash intangibles in the form of "cooperative conditions". Such "cooperative conditions" may consist of market access rights, rights to use buildings or office space owned or leased by the party that are not subject to clear valuation. In exchange for such

"cooperative conditions", the party is entitled to participate in the distributable earnings of the CJV.
2. Profit sharing in a CJV need not be made strictly in accordance with the parties' respective percentage shareholding of the registered capital of the CJV but can be made in accordance with the agreement of the parties (e.g. the Chinese party may be entitled to a fixed profit share with the balance to be distributed to the foreign party, or the parties may agree on a multi-tiered profit-sharing arrangement that permits the foreign party to recover an amount equal to its capital investment on a priority basis, following which the profit split will be changed, etc.).
3. Upon dissolution of the CJV at the expiry of the term of operation, the CJV's net assets may be transferred to the Chinese party without compensation (thus operating in many respects as a BOT project) so long as the foreign party has been able to recoup its capital contribution during the term of the CJV. Such recoupment typically is funded by excess cash flow generated by accelerated depreciation of the CJV's assets. Such arrangement requires approval of relevant finance and tax authorities in China. Note that this capital recoupment is separate and distinct from possible priority rights to receive after-tax net profit distributions as outlined in the bullet point above.

Capitalisation of JV

(A) The concepts of authorised and issued capital are not used in connection with Sino-foreign joint ventures. Instead, the concepts of "registered capital" and "total investment" are employed. Under applicable PRC law, registered capital is defined as the total amount of capital contributions subscribed to by the parties and registered with the Chinese authorities. Thus, the term "registered capital" refers to the parties' equity in the venture. The concept of "total investment", on the other hand, includes both registered capital and external borrowings.
(B) Pursuant to regulations promulgated by the SAIC, certain minimum equity requirements are imposed on joint ventures. These are:
Minimum Equity

Total Investment	(% of Total Investment)
<= US$3 Million	70%
US$3 - US$10 Million	50% or US$2.1 Million (whichever is higher)
US$10 - 30 Million	40% or US$5 Million (whichever is higher)
>US$30 Million	33.3% or US$12 Million (whichever is higher)

PRC laws governing joint ventures require that the foreign party contribute no less than 25% of the registered capital.
(C) The capital to be injected by the parties constituting their capital contribution may take a variety of forms including cash, machinery, equipment and intangible property, such as proprietary technology, trademarks and other industrial property rights. Pursuant to a circular promulgated by SAFE and effective as of 1 April 2003, subject to SAFE's approval, a foreign party may also use the assets obtained by way of early recoupment of investment, liquidation, share transferring, capital reduction etc. from FIEs it has previously invested in. In addition, the Chinese side may contribute the right to use a site and count this as part of its contribution.
There are, however, certain restrictions on in kind contribution by a party. For example, the technology contributed as registered capital by a party generally should not exceed 20% of the total registered capital (but this can be increased with approval for certain encouraged projects) or 50% of an individual investor's capital contribution. The issue of the appropriate

valuation of in kind contribution can often be a major stumbling block in joint venture negotiations.
Once the joint venture contract is approved, the parties must inject their subscribed registered capital amounts within the time limits set out in the contract. If paid in one lump sum, the registered capital contributions must be made within six (6) months of the issuance of the business license for the joint venture. If the subscribed registered capital is to be injected in instalments, the first instalments, which must not be less than 15% of the total subscribed registered capital, must be made within three (3) months following issuance of the business license. The balance is to be contributed in accordance with a schedule agreed by the parties, provided that the parties must complete all such contributions within the following time limits (calculated from date of issuance of the business license) depending on the total amount of registered capital of the joint venture company:

Registered Capital (US$M)	Contribution Time Limit
<=0.5	1 year
>0.5 but <=1.0	1.5 years
>1.0 but <=3.0	2 years
>3.0 but <=10.0	3 years
>10.0	subject to approval with reference to actual condition

(D) Chinese law permits joint ventures to borrow funds from either Chinese or foreign banks in excess of the parties' capital contributions. Shareholder loans from the foreign party are also permitted. (Chinese partners likely will not have a sufficiently broad scope of business to permit them to provide shareholders loans.) All such loans should be registered with SAFE and should not exceed the difference between the registered capital amount and the total investment amount.

Transfers of Equity Interests in Joint Ventures

If a party proposes to transfer all or part of its interest in the registered capital of the joint venture company to a third party, then each other party has a pre-emptive right to purchase the equity interest proposed to be transferred. As an equity transfer also requires amendment of the joint venture contract and articles of association, which in turns requires the signature of each party, each party in effect holds absolute consent rights to any transfer generally. All transfers of registered capital additionally require a unanimous approval of the joint venture company board of directors and approval by the original government authority which approved the joint venture contract and articles of association.

Off-shore Structures

(A) Offshore Structures
The entity to be used by the foreign investor as the offshore investment holding company ("OHC") for its investment in the EJV will be determined by a number of factors. One of the main considerations driving choice of OHC is tax-efficiency. In this respect the foreign party needs to ascertain whether there is a double tax treaty ("DTT") covering the types of revenue streams that are likely to be coming out of the EJV as between the PRC and the jurisdiction where the OHC is established. DTTs generally cover loan interest, dividends and distributions, income taxes, royalties and capital gains. The tax treatment of dividends tend to be less important in terms of determining the location of the OHC because, at present,

China exempts dividends by FIEs to their foreign shareholders from withholding and other taxes (although this could change as the post-WTO levelling of the playing field progresses, as Chinese parties do not benefit from such an exemption). There are proprietary software programs for determining the most tax-efficient jurisdiction under the applicable DTTs, based on a specific set of input parameters which you provide.
Based on past experience, popular DTTs for investment in China are the PRC-Mauritius DTT (but note the provisions on capital gains do not apply to FIEs whose principal assets comprise real estate assets), PRC-Netherlands and PRC-Malaysia. If you are using a Labuan company, note that certain countries have objected to Labuan companies getting Malaysian DTT benefits in the country of investment because it is a tax haven within Malaysia, although China does not appear to have done so to date.
A number of industries in China, notably the telecommunications, fund management, banking, venture capital and many others require foreign investors to meet certain qualification requirements which may preclude using a special purpose vehicle ("SPV") as the OHC. This needs to be considered on an industry-by-industry, case by case basis. It may be possible, in some cases, such as under the Foreign Invested Venture Investment Enterprise Administrative Regulations to use an affiliated entity to satisfy the qualification requirements where there is an express legal basis for doing so, whilst investing through an SPV located in a tax-efficient jurisdiction.
Another possibility to consider, when establishing an EJV in "special industries" with foreign investor qualification requirements, is whether the industry regulator would accept the use of an SPV backed up by a parent company guarantee of the SPV's obligations in relation to the EJV or similar arrangement, based on an agreement negotiated with the regulator. Again there are no hard and fast rules as to what may or may not be possible as it depends on the position taken by the regulator. You should make telephone enquires to confirm.
Tax structuring of the foreign party's investment in an FIE does not, however, stop at the OHC level, as you also need to consider (where applicable) the tax implications of repatriating funds from the OHC to the foreign party's home jurisdiction, and the DTTs (if any) between OHC jurisdiction and the foreign investor's home jurisdiction.
(B) Tax Havens as OHCs
Many foreign investors tend to favour the use of tax haven jurisdictions, typically the British Virgin Islands ("BVI"), the Cayman Islands and so forth as OHCs for China investments. From the foreign investor perspective the main advantage is low or zero rates of tax on funds once they reach the tax haven or on disposals of shares in OHCs located in the tax haven. On the other hand, tax havens do not have any DTTs to reduce the tax withheld at the China end, so the tax required to be withheld in China before a remittance of funds out by EJV (other than for dividends) by way of payment of loan interest, royalties etc. will be the maximum applicable rate under Chinese law and policy at the time, thus giving a substantially reduced amount on arrival at the tax haven.
The location of OHCs, as can be seen from the above, is not always straightforward and is a decision that will be determined by a large number of variables on a case-by-case basis. Often foreign investors will make the decision based on internal policies or on the basis of advice from their own in-house or external tax advisers.

Miscellaneous

(A) Under PRC law, joint venture companies have a fixed term of operation. Currently, the most common term of operation approved is fifty (50) years. This term can be extended with the consent of all parties and approval of the relevant government authorities. In some instances, particularly in BOT-like CJVs, the term of operation agreed by the Chinese party and approved by the relevant government authorities will be much shorter.
(B) Depending on the nature of the operations of the proposed joint venture company, certain additional government approvals, permits or licenses may be required, e.g.,

sanitation certificates, environmental permits, production approvals, export licenses, value-added telecom services operating licenses, etc. Certain other legal and practical considerations relating to the establishment of a Sino-foreign joint venture company are set out in the notes at the end of the template Joint Venture Contract.