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Private Equity Law

Advanced Fund Practice: Establishing Management Enterprises and General Partners of Private Funds Using Limited Partnership

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The amendment of China's *Partnership Enterprises Law* in 2006 makes it feasible for a fund manager to establish a private equity fund (hereinafter referred to as "**Private Equity Fund**" or "**Fund**") in the form of limited partnership in China, which has long been a common international practice. In recent years, thousands of Funds established in the form of limited partnership ("**LP-fund**") have been springing up all over the country, with assets under management of hundreds of billions renminbi. Funds in the form of limited partnership have already become mainstream in China. Over the next four or five years, as these LP-funds enter into middle or late phases of their investment period and many of their investee companies start to look for exit, the structure adopted by these LP-funds during its formation at the beginning will have a direct impact on whether such LP-funds and their fund managers can exit their investee companies at a low cost. This article will mainly focus on the creative use of limited partnership form to management enterprises or general partners of LP funds, and how it can help optimize the whole fund structure.

In practice, generally there are two ways of managing a Fund: (i) self-management mode, under which an internal management team will be established to manage the Fund directly (a corporate fund can be directly managed by their management personnel, and an LP-fund can be directly managed by its general partner acting as its management enterprise¹ or a separate fund management enterprise established by the management team); and (ii) entrusted management mode, under which a third-party fund management institution² will be engaged to manage the Fund and thus charge a specified amount of management fee in accordance with the entrustment management agreement. Most Funds on the market operate

¹ Under such circumstance, the general partner is always set up as an EIME.

² Under such circumstance, the management institution is always set up as an EIME.

under the self-management mode, while fewer Funds (such as Funds with no internal management team (e.g., government guidance fund) operate under the entrusted management mode. This article will mainly discuss the self-management mode, the more popular model on the market, although most of what is discussed in this article also applies to Funds operating under the entrustment-management model.

Under the self-management mode, a fund management enterprise independent from the general partner can be established according to the specific circumstances of the fund client³. As for the legal form of the general partner or the fund management enterprise, limited partnership is a form worth considering. At present, it is permissible under many local regulations to establish an equity investment management enterprise (“EIME”) in the form of a limited partnership (“LP-EIME”) in addition to a corporate form. Establishing the general partner/management enterprise in a corporate form have long been used and have an established practice, whereas establishing the general partner or management enterprise in the form of limited partnership are an emerging practice in recent years. It is more favorable for the general partner/management enterprise to operate under the limited partnership form compared to the corporate form with respect to the allocation of carry and implementation of tax planning for the purpose of reducing enterprise/ individual income tax at different levels. For funds with a relatively large fund scale, high amount of expected management fee or carry income, the advantages of using limited partnership for general partner or management enterprise could be quite significant.

The table below is a comparative summary based on relevant local regulations and practices in Beijing, Shanghai, Tianjin (Binhai New Area), Suzhou (Industrial Park), Shenzhen and Chongqing with respect to establishing LP-EIME. Please note that related policies and specific standards adopted by local authorities may vary from time to time and are subject to the then effective rules and written or non-written requirements of the relevant authorities. In addition, on November 23, 2011, the General Office of the National Development and Reform Committee (“NDRC”) issued the **Notice on Promoting the Healthy Development of Equity Investment Enterprises (Fa Gai Ban Cai Jin [2011] No. 2864)**, under which both the Funds and EIMEs are regulated, thus the extent to which such Notice will be implemented by local authorities may also have an impact on relevant analysis in the table below.

With a deep understanding of international fund formation practice and profound experience in setting up various types of funds all over China, our fund team has been on the forefront of creating various sophisticated and efficient Fund structures for our Fund clients in China and will continue to promote the growth and development of China’s fund industry. Should you have any questions, please feel free to contact us.

³ To establish an independent fund management enterprise from the general partner has long been a common international practice, which can isolate risks at a different level and in the long run also build an overall image of the fund management group to facilitate the management of its different funds.

Comparative Table of Policies on Establishing LP - EIME
in Beijing, Shanghai, Tianjin (Binhai New Area), Shenzhen, Suzhou(Industrial Park), and Chongqing

Domestic LP - EIME	Local Laws & Regulations	Establishment Requirements		Relevant Regulations on Name, Business Scope, and Registered Address of LP - EIME
		Sources of Information	Capital Contribution (Amount & Term)	
Beijing	Jing Jin Rong [2009] No.5 ⁱ	Inquiry with the Beijing AIC	<ul style="list-style-type: none"> ◆ Paid-in capital contribution of no less than RMB 30 million ◆ To be paid in one lump sum ◆ Capital verification is required 	<ul style="list-style-type: none"> ◆ Enterprises with reference to “fund” in their names shall satisfy all the requirements herein ◆ Enterprise with no reference to “fund” in their names shall be treated as a general investment management enterprise and be registered under the <i>PRC Partnership Enterprise Law</i>; a general investment management enterprise can also engage in the business of equity investment management
Shanghai	Hu Jin Rong Ban Tong [2011] No.10 ⁱⁱ	Inquiry with the Shanghai AIC and Shanghai Pudong New Area AIC	<ul style="list-style-type: none"> ◆ Paid-in capital contribution of no less than RMB 10 million ◆ To be paid in one lump sum 	<ul style="list-style-type: none"> ◆ Enterprise with “equity investment”, “equity investment management” in its business scope shall satisfy all the requirements herein, despite of their name ◆ Enterprises with a general business scope without “equity investment”, “equity investment management” shall not engage in the business of equity investment or equity investment management ◆ Only enterprises with “equity investment and/or equity investment management” in the business scope registered is eligible for preferential treatment of Pudong New Area District

Tianjin (Binhai New Area)	Jin Fa Gai Cai Jin [2011] No. 675 ⁱⁱⁱ	Notice No. 675 and Notice No. 18	<ul style="list-style-type: none"> ♦ Paid-in capital contribution of no less than RMB 2 million for the first installment ♦ Capital verification is required 	
	Jin Gong Shang Xu Zi [2011] No. 18 ^{iv}			
	Jin Bin Zheng Ban Fa [2011] No. 68 ^v	Notice No. 68; inquiry with Tianjin Binhai New Area AIC	<ul style="list-style-type: none"> ♦ Paid-in capital contribution of no less than RMB 10 million ♦ To be paid in a lump sum 	<ul style="list-style-type: none"> ♦ May be registered in the 6 Functional Areas in Tianjin Binhai New Area, namely, the Development Zone, Tariff-free Area, High Tech zone, Dongjiang Tariff-free Port Area, Sino-Singapore Tianjin Eco-city, Centre Business District
		Inquiry with Tianjin Development Zone AIC	<ul style="list-style-type: none"> ♦ Paid-in capital contribution of no less than RMB 10 million ♦ To be paid in a lump sum 	<ul style="list-style-type: none"> ♦ Only those enterprise with “equity investment management” or “fund management” in its name can be register with the same in its business scope ♦ Enterprises with a general business scope without “equity investment” or “equity investment management” shall not engage in the business of equity investment or equity investment management, respectively, and shall not raise a Fund in the role of GP
	Inquiry with Tianjin High Tech Zone AIC	<ul style="list-style-type: none"> ♦ Paid-in capital contribution of no less than RMB 2 million for the first installment ♦ To be paid in a lump sum 		

Suzhou (Industrial Park)	Su Yuan Guan [2010] No.48 ^{vi}	Inquiry with the Suzhou Industrial Park AIC	<ul style="list-style-type: none"> ◆ <u>Basic Requirement.</u> Committed capital contribution of no less than RMB 1 million, at least 20% to be paid in as first installment ◆ <u>Current Practice.</u> Committed capital contribution of no less than RMB 2 million for each LP with at least 20% to be paid in as the first installment evidenced by bank statement is required upon registration. However, the local AIC may reserve some flexibility on a case-by-case basis 	<ul style="list-style-type: none"> ◆ Need to satisfy all the requirements herein regardless of whether it contains “equity investment” or “equity investment management” in its business scope or name ◆ Enterprises established in satisfaction of the conditions herein may engage in the business of equity investment or equity investment management
Shenzhen	Shen Fu Jin Fa [2011] No.5 ^{vii}	Notice No. 5	Paid-in capital contribution of no less than RMB 5 million with respect to enterprise applying for development fund from the government	
		Inquiry with Shenzhen AIC	Paid-in capital contribution of no less than RMB 5 million	<ul style="list-style-type: none"> ◆ Need to contain “ entrusted to manage equity investment enterprises” in its business scope

Chongqing	Yu Fu Fa [2008] No. 110 ^{viii}	Notice No. 110	Paid-in capital contribution of no less than RMB 1 million	<ul style="list-style-type: none"> Business description in their names and their business scope may include as “equity investment” and “equity investment management” Can only be established in the form of limited partnership Record-filing with the Financial Office is required before carrying out its business and enjoy preferential treatment provided by local government
		Inquiry results with Chongqing AIC	<ul style="list-style-type: none"> Committed capital of no less than RMB 10 million Payment term may be agreed upon by the parties in partnership agreement 	<ul style="list-style-type: none"> To be established in accordance with Notice No. 110 and where Notice No.110 remain silent, the <i>PRC Partnership Enterprises Law</i> shall apply
		Inquiry with Chongqing Financial Office	<ul style="list-style-type: none"> Committed capital of no less than RMB 5 million Lump-sum payment is required to be provided for in partnership agreement 	<ul style="list-style-type: none"> Required to contain “equity investment management” in its name Record-filing with Financial Office is not a must Enterprises intending record-filing with the Financial Office may complete a pre-filing with the Financial Office, and the Financial office will assist the pre-filed enterprise in its AIC registrations

ⁱ Article 1 of the *Guiding Opinions on Promoting the Development of Equity Investment Funds* (Jing Jin Rong [2009] No.5).

ⁱⁱ Article 3 and Article 4 of the *Notice of Shanghai Financial Service Office, Shanghai Administration for Industry and Commerce, Shanghai Financial Bureau and Shanghai Local Taxation Bureau on Industrial and Commercial Registration of the Equity Investment Enterprises in Shanghai and Other Matters (revised)* (Hu Jin Rong Ban Tong [2011] No.10).

ⁱⁱⁱ Article 1, Article 2, Article 5, Article 10, Article 13, Article 28, Article 30, Article 31, Article 32, and Article 35 of the *Interim Measures for the Administration of the Equity Investment Enterprises and Equity Investment Management Institutions in Tianjin* (Jin Fa Gai Cai Jin [2011] No. 675).

^{iv} Article 3 and Article 4 of the *Notice on Issues Concerning the Industrial and Commercial Registration of the Equity Investment Enterprises and Equity Investment Management Institutions* (Jin Gong Shang Xu Zi [2011] No.18).

^v Article 4 of the *Notice of the General Office of Tianjin Bianhai New Area Government in Forwarding the Guiding Opinions in Putting into Effect the Interim Measures for the Administration of the Equity Investment Enterprises and Equity Investment Management Institutions in Tianjin from the Financial Service Bureau of Tianjin Bianhai New Area District* (Jin Bin Zheng Ban Fa [2011] No.68).

^{vi} Article 5, Article 6, Article 7, Article 11 of the *Guiding Opinions on Promoting the Development of Equity Investment Funds in Suzhou Industrial Park* (Su Yuan Guan [2010] No.48).

^{vii} Article 6 of the *Operational Procedures for Applying the Development Fund from the Government in Shenzhen* (Shen Fu Jin Fa [2011] No.5).

^{viii} Article 1 of the *Guiding Opinions of People’s Government of Chongqing on Encouraging the Development of Equity Investment Enterprises* (Yu Fu Fa [2008] No.110).

Important Announcement

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