

Client Alert

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Offshore Deposit of Foreign Exchange Income from Export Trade

Introduction

With an aim of expanding offshore funding sources of domestic entities and encouraging outbound investment by domestic entities, the State Administration of Foreign Exchange (“SAFE”) published the *Provisional Measures regarding Administration of Offshore Deposit of Incomes of Export Trade of Goods* (《货物贸易出口收入存放境外管理暂行办法》) (the “**Provisional Measures**”) in August 2010, which were implemented as a pilot scheme in four cities and provinces from October 1, 2010.

On December 31, 2010, SAFE further published the *Circular on Issues regarding Administration of Depositing Incomes under Export Trade of Goods Offshore* (《国家外汇管理局关于实施货物贸易出口收入存放境外管理有关问题的通知》) (the “**Circular**”). According to the Circular, effective from January 1, 2011, the Provisional Measures are implemented on a nationwide basis, and any eligible domestic entity may apply to SAFE to deposit into offshore accounts their foreign exchange income derived from export trades of goods. For the purpose of this Alert, domestic entity includes both Chinese-funded entities and foreign-funded entities.

In light of the above regulatory developments, we provide in this Alert a brief introduction to the Provisional Measures.

What are the resources that may be deposited offshore?

A domestic entity may deposit the following kinds of income in offshore accounts:

- (a) export trade income, including advance payments;
- (b) interest accrued on export trade income;
- (b) income related to trade financing;
- (c) export insurance proceeds; and
- (d) subject to SAFE approval, income derived from offshore contracting projects, transportation, etc.

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What are the permissible uses of foreign exchange deposited offshore?

The foreign exchange deposited offshore may be used by a domestic entity for the following purposes:

- (a) payments for import trades, including advance payments;
- (b) offshore expenses, such as offshore contracting projects, commission, transportation and insurance expenses;
- (c) capital account items, including making outbound investment, extending loans to foreign parties and repaying foreign debt borrowed by the domestic entity; and
- (d) repatriation foreign exchange in offshore accounts to onshore current items foreign exchange account.

Note that, item (c) (capital account items) above is also subject to the following requirements.

- (i) **Outbound Investment** A domestic entity may apply for approval from the Ministry of Commerce (“**MoC**”) of China to engage in outbound investment activities, such as establishing an offshore entity or acquiring equity interest in an offshore entity. Before the Provisional Measures were implemented, a domestic entity was only permitted to remit foreign exchange outside of China for outbound investment if it had first completed its registration with SAFE. Now, however, when approved by the MoC, a domestic entity may use its foreign exchange in offshore deposits for outbound investment before it completes its registration with SAFE. The domestic entity still must complete the registration with SAFE, but it has twenty working days from the time of making the payment to do so.

For expenses incurred during the preparatory stage of outbound investment, such as bidding fees and office rentals, a domestic entity must still obtain a quota from and complete its registration with SAFE before the domestic entity may use the foreign exchange in its offshore account to make the relevant payments. The amount of the payments made must stay within the SAFE approved quota.

- (ii) **Extension of Loans** After obtaining a quota verified by SAFE and completing SAFE registration, a domestic entity may use foreign exchange deposited in its offshore account to provide financing to its offshore subsidiary or an offshore entity in which it owns a stake, within the SAFE approved quota.

- (iii) **Repayment of Foreign Debt** Subject to prior SAFE verification, a domestic entity may use the foreign exchange deposited in its offshore account to repay principal *and or or* interest under any loan borrowed from a foreign party.

How to open overseas account(s) to deposit foreign exchange income from export trade?

In order to open an overseas account to deposit foreign exchange income from export trade, a domestic entity must have its qualifications verified by a local SAFE and register the account with that local SAFE. To pass the qualification stage, the domestic entity must comply with various requirements under the Provisional Measures, including, among others, no violation of any foreign exchange control regulations in the previous two consecutive years before application.

A Chinese group company may authorize one member company to handle the account opening process at SAFE. Once the offshore account is opened, all member companies in the group may deposit export trade income into the account. Please note that each member company that plans to deposit foreign exchange income into the first account opened must pass qualification verification with the local SAFE where its place of business operation is located.

A domestic entity (including a group company) is generally allowed to open no more than five offshore accounts and must complete SAFE registration before opening each new account. However, once the initial account is opened, the account opening registration process is relatively easier for the subsequent accounts. Foreign exchange may be transferred between different offshore accounts opened in the name of the same domestic entity. But the domestic entity may not remit foreign exchange from its onshore foreign exchange accounts to its offshore accounts unless SAFE grants a special approval for the transaction.

How does SAFE control foreign exchange deposited offshore?

SAFE controls foreign exchange deposited offshore by the following measures.

- (a) The total amount of the offshore deposit must be registered with SAFE. Any increase in that amount must be verified by SAFE.
- (b) SAFE ensures enforcement of this requirement by having the offshore account bank execute an agreement to report the account information (账户收支信息报送协议). A copy of this agreement

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is one of the required application documents for registering the offshore account with SAFE. One mandatory clause in the agreement states that the offshore account bank agrees to provide account statements to SAFE within ten working days after the end of each month by courier.

- (c) The offshore account bank is required to be an affiliate of an onshore bank (including Chinese- and foreign-funded banks), by means of which, SAFE can “control” the offshore account bank by leveraging its authority over the onshore affiliate.
- (d) The domestic entity must report the payments and receipts from its offshore accounts to SAFE at least on a monthly basis in the form prescribed by SAFE.
- (e) The domestic entity must retain for five years all transaction documents and other evidence related to the foreign exchange deposited offshore so that SAFE may inspect them.

Conclusion

Although the PRC government hopes its implementation of the Provisional Measures will help to alleviate the pressure that it is facing from its high foreign exchange reserve rate, the recent trend of RMB appreciation may prevent this hope from being realized. It is true that the Provisional Measures will encourage outbound investment with their simplified SAFE procedures, but the domestic entities, while they have the right to do so, may look to convert the foreign currency income into RMB in order to take advantage of the expected appreciation of the RMB against most foreign currencies.

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