

## **Exit and Divestment from China– Options and Challenges**

**Authors:** Rachel Tao, Cheng Chen

The world is changing. While a number of European manufacturers shortly moved their capacity to China due to the European energy crisis, many foreign investors in China are considering or already implementing their exit strategy and divestment from China because of changed local market environment, trade war or local policies. A smart and effective strategy and a compliant, smooth and cost-saving implementation are keys to success in the interest of the foreign investors. Key issues, challenges and risks related to the exit and divestment must be identified properly in the first place.

### **1 Exit Options and Suggestions**

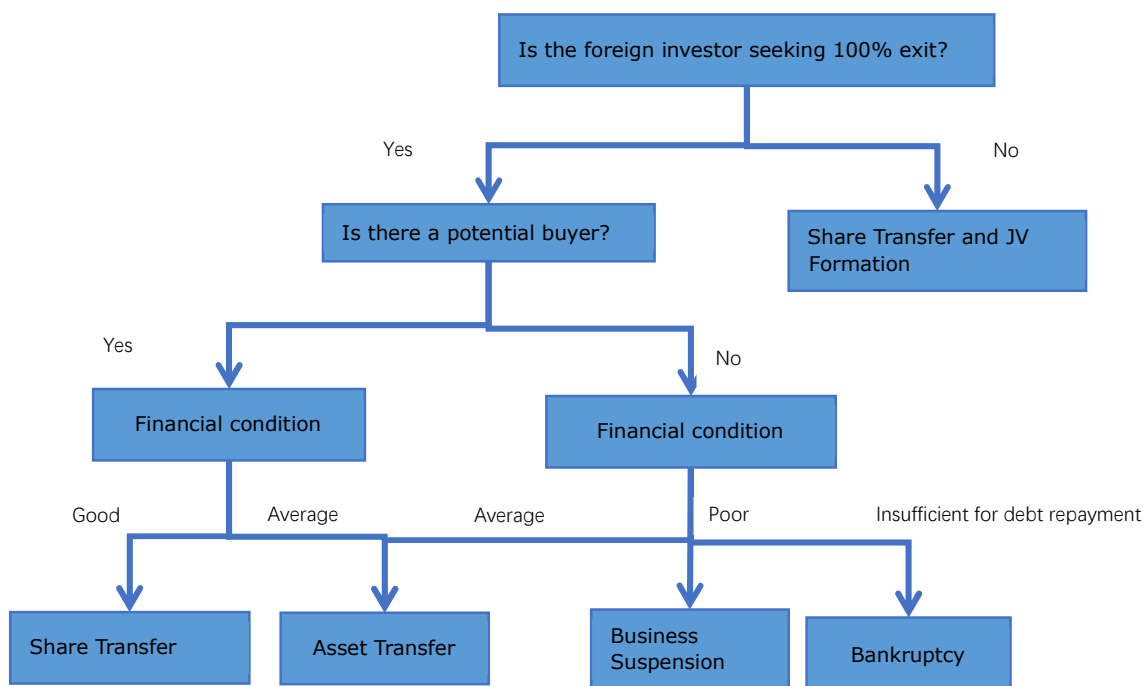
In China, foreign investors have the following options in general, should they decide to cease business operation: (1) Share Transfer (transferring shares or equity interests to a third party), (2) Asset Transfer (sell the company assets to a third party, and then initiate the dissolution process), and (3) Bankruptcy (apply to court to request for bankruptcy), or apply for (4) Business Suspension of maximum 3 years.

The final decision-making depends on many factors including:

- the strategy of the headquarter (to withdraw all or part of the investment, largely based on market prospectus);
- the financial condition and valuation of the company;
- availability of potential buyers;
- constitution of company assets.

#### **1.1 Exit from an WFOE**

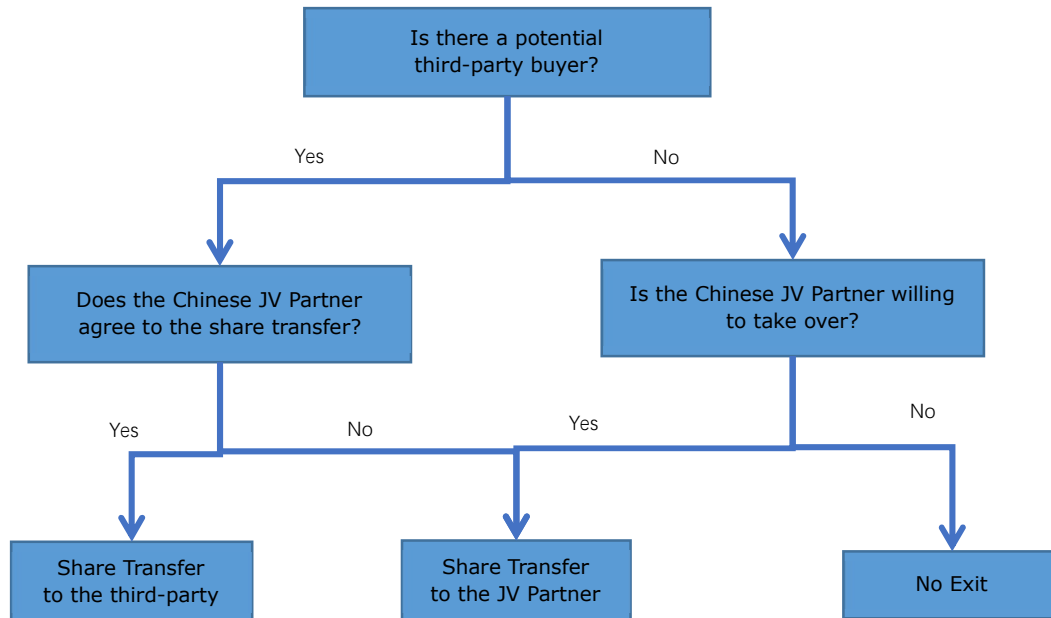
For divestment from a wholly foreign owned enterprises (an “WFOE”), we recommend the following valuation process:



#### **1.2 Exit from a JV**



For divestment from a joint venture (a “JV”), negotiation with the Chinese JV partner based on the joint venture contracts shall be the first step. Under standard terms of JV Contracts and Articles of Association, we recommend the following valuation process:



## **2 Key Issues and Challenges**

### **2.1 Transfer of Real Estate**

Where 100% of the shares or equity interests in a company is being sold, and such company possesses real estate, such Share Transfer will be qualified as “transfer of real estate” by the tax authority. Should the fair market value of the real estate be correctly included into the purchase price of the shares and the seller(s) pay land appreciation tax in addition to the regular stamp tax and enterprise income tax, such Share Transfer shall be valid and legitimate. Otherwise, such Share Transfer could be qualified as tax evasion.

### **2.2 Bankruptcy**

Should the company find itself unable to repay its debts as they become due, and its assets are insufficient for the settlement of all debts or where it is clearly insolvent, it may apply to the court to request for bankruptcy. However, if all remaining open and due debts are administrative penalties imposed by the regulatory authorities, the company is not qualified for bankruptcy. In other words, dissolution would still be possible under such circumstances.

Should the company decide to cease business operation by Bankruptcy, it must plan its debt repayment schedule at least more than one year prior to the bankruptcy filing for the following reasons: unreasonable debt repayment rendered within one year could be revoked; any debt repayment within six months could be revoked.

### **2.3 Business Suspension**



The concept of Business Suspension was formally introduced by the *Administrative Regulation on the Registration of Market Entities in March 2022*. A company may choose to suspend its business operation for at most 3 years by filing with the AMR. Should the foreign investor decide not to dissolve the company after the Business Suspension, the company shall continue to operate.

During the suspension period, the company may register another address for receipt of documents, and there is no statutory limitation on the choice of the address. This enables the company to terminate its lease so as to significantly reduce its costs during the suspension period.

Business Suspension is an appropriate option to overcome temporary difficulties and short-term crisis.

### **3 Process**

#### **3.1 Share Transfer**

The main process of Share Transfer includes:

- Preliminary agreement on terms and conditions (LOI, Term Sheet, or MoU)
- Due diligence and merger filing (if needed)
- Contractual negotiation
- AMR registration
- Closing
- SAFE registration
- Tax registration

The divestment will be completed upon the closing of the share transfer and respective AMR (Administration for Market Regulation) and SAFE (Administration of Foreign Exchange) registration.

#### **3.2 Asset Transfer**

The main process of Asset Transfer could be divided into two phases, the asset transfer phase and the dissolution phase. The asset transfer phase is similar to that of Share Transfer, except that normally Asset Transfer does not require transfer registration with AMR, unless the transferred assets include real estate.

The most time-consuming part lies in the dissolution phase, which includes:

- Establishment of liquidation committee and public announcement
- Disposing remaining debts and assets and issuing liquidation report
- Tax clearance and deregistration
- Bank accounts cancellation and SAFE deregistration
- AMR deregistration

In practice, the dissolution phase could be shortened or prolonged by certain factors including:

- Eligibility for Summary Procedure. The Summary Procedure could shorten the whole dissolution process by 25 days. The concept of Summary Procedure is introduced for companies that have not incurred any debt or obligation, or have no outstanding debt or obligation. However, the application of Summary Procedure excludes the companies with records of abnormal operation, under share pledge or negative list management.



- Branches. Branches should be deregistered before initiation of dissolution process, otherwise the company would be prevented from the application of Summary Procedure as well as AMR deregistration.
- Employment. Termination of employment must be planned ahead (suggested at least one year ahead) and carefully, as labor disputes could prolonged the dissolution process by months.

#### **4 Key Takeaways**

Well planned and structured exit will enable the foreign investor to not only retrieve as much as investment as possible, but also avoid hidden risks and liabilities therein.

When foreign investors come to the idea of dissolving their Chinese subsidiaries, running a due diligence overall review by external counsels so as to understand the conditions of the Chinese subsidiaries is strongly recommended, which serve as the basis for an appropriate strategy and an effective implementation plan.

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In case you have questions or for further information, please contact the authors of this newsletter:



**Rachel Tao**

Associate (PRC)

Kellerhals Carrard, China

**T** +86 139 1814 4842

**E** rachel.tao@kellerhals-carrard.ch



**Cheng Chen**

Head of China Desk, Of Counsel

Kellerhals Carrard, China

**T** +86 139 1741 3490

**E** cheng.chen@kellerhals-carrard.ch



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### Contact:

Shanghai:  
West Yan An Rd. 726, Huamin Empire Plaza, 5F, 200050 Shanghai, China  
上海市长宁区延安西路 726 号 | 华敏翰尊国际 5 层 | 200050  
+86 21 5237 0950 - 8888  
[www.kellerhals-carrard.ch](http://www.kellerhals-carrard.ch)

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