Global Private M&A Guide - Limited External Content - People's Republic of China

| Contents |
| --- |
| To generate table of contents, right-click here and select **Update Field.** |

This is the **People's Republic of China** section. Select a topic from the menu and explore the questions within.

*This content was last reviewed around October 2023.*

# Quick reference guide

## Due diligence, pricing and closing

**Typical due diligence issues**

In the People's Republic of China (PRC, or China), regulatory noncompliance used to be very common but we see a growing trend of improvement. Regulatory noncompliance examples generally include the underpayment of social insurance for employees, violations of overtime policies and breaches of environmental laws. Often, these issues will mean additional costs for rectification and operations post-closing. In certain sectors, e.g., energy and resources, healthcare and telecommunications, noncompliance issues in business practices such as bribery can be prevalent. These issues may erode deal value and, in some situations, may lead to the buyer walking away. For buyers from certain countries, this may also trigger obligations to report to regulators in their home jurisdictions.

In some jurisdictions, asking the seller to clean up before closing will be the norm. However, this is not necessarily the case for every situation in China. Coming up with an appropriate solution requires detailed due diligence and a deep understanding of the local practice and practical risks involved. Seeking protection via a reduction in the purchase price or a holdback of the purchase price may also be advisable.

**Pricing and payment**

*Independent appraisal*

Where there is an onshore acquisition in China, and the target is a domestic Chinese entity, an independent appraisal will be required for tax filing purposes. In practice, the parties will often negotiate the price and work together to ensure the appraised value is aligned with the agreed price to the extent possible. Where the seller is a Chinese entity, it is common for the seller to ask for payment outside of China to minimize the Chinese taxes payable. They may also seek to create structures that could be exposed to tax and regulatory risks. From the buyer's perspective, accommodating such structures and weighing such accommodation against the risks involved is a balancing act.

*Payment*

Where the seller is a Chinese party and the buyer is a foreign party, the purchase price will need to be paid into a designated account in China opened in the seller's name.

Where the buyer is a Chinese party and the seller is a foreign party, the timeline for closing is typically longer as the Chinese buyer will need to present evidence of payment (or exemption) of Chinese capital gains tax, if any, before it can apply to its bank to remit the purchase price to the foreign seller. As such, it is common to request that the purchase price (or part thereof) be paid into an onshore escrow account upon signing the share purchase agreement.

In case of a direct acquisition of a Chinese company (shares or assets), a regulation issued by the Ministry of Commerce (MOFCOM) in 2009 (“**M&A Regulation**”) requires that the purchase price be paid in full within one year of closing. This makes the structuring of any deferred or earn-out payment challenging. However, with the Foreign Investment Law (FIL) having come into force as of 1 January 2020, the effectiveness of the regulation has been placed into question. There are generally no restrictions in the case of an indirect acquisition.

**Signing/closing**

*Share sale*

As government approval and/or registration is required for a direct transfer (onshore acquisition) of shares in a Chinese company to a foreign buyer, there is normally a gap between signing and closing.

On the other hand, where the Chinese company is owned by a special purpose vehicle (SPV) outside China, it is common for the deal to be transacted as an offshore transfer of shares in the SPV. Apart from a Chinese merger control filing (which may apply if thresholds are met) and/or a national security review filing (if applicable), the transfer of shares in the SPV is not subject to Chinese government approval or registration (except for a post-completion reporting of a change of beneficial owner) and a simultaneous sign and close is possible.

*Asset sale*

Unless the foreign buyer already has existing entities with the requisite business scope in China to acquire the assets, normally there will be a gap between signing and closing.

## Approvals/registrations

**Foreign investment restrictions**

China has a mandatory and suspensory foreign investment screening procedure, which means that transactions that meet the relevant criteria need to be notified to the relevant authority and cleared before they can be completed.

The foreign investment review regime is targeted at foreign investments in certain sectors. For further information, see the more detailed section on "Foreign investment restrictions".

**Antitrust/merger control**

Merger control in China is mandatory and suspensory. The thresholds for filing are based on the combined worldwide turnover and domestic turnover of the parties involved. It is generally recommended that notifications be made after transaction agreements have been signed and before implementation. For further information, see the more detailed section on "Antitrust/merger control".

**Other regulatory or government approvals**

If the target is state-owned, approval or recordal may be required from the State-Owned Assets Supervision and Administration Commission or its local counterpart. A public listing of the shares or assets in question at an authorized property rights exchange would also be required with limited exceptions to apply.

For acquisitions in certain sectors, such as telecommunications and the financial sector, approval from the relevant industry regulator is also required.

For targets that engage in infrastructure projects, approval by or recordal with the National Development and Reform Commission (NDRC) or its local counterpart is required.

## Employment

In case of share transfers, as there is no change of employment relationship, consent from employees or labor unions is not required. However, it will still be important to manage employee issues, as there are examples where employees may make additional demands (e.g., payment of severance or signing of new agreements) even though these demands are not supported by law.

In case of business transfers, employees will need to be terminated and rehired. Severance is either paid at the time of the termination/rehire or deferred by recognizing the previous years of service of the employees.

## Tax

Stamp duty of 0.05% of the consideration is payable by each party in the case of a share sale (a total of 0.1%). Stamp duty of 0.05% (real estates) and 0.03% (other assets) applies in the case of an asset sale. Stamp duty should be borne separately by the buyer and seller but they can contractually agree otherwise. By way of illustration, in respect of transfer of real estates, the buyer and seller are each separately liable to pay stamp duty at 0.05% on the contract value. In other words, a total of 0.1%.

For Chinese corporate sellers, capital gains will form part of their profits and will be subject to enterprise income tax (EIT) at the rate of 25%. For Chinese individuals, Chinese capital gains tax is 20%. For foreign sellers of shares, capital gains are subject to 10% withholding tax, unless reduced by a tax treaty.

**OECD's Two Pillar Solution**

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting has put forward a so-called Two-Pillar Solution to address the tax challenges arising from the digitalization of the economy. Pillar Two is intended to introduce a global minimum effective rate of tax of 15% for large businesses in each jurisdiction where they operate and will lead to fundamental changes in the international tax system. It is currently being implemented in a large number of jurisdictions.

Groups will need to consider how the Pillar Two rules could impact on the life cycle of M&A transactions from the pre-acquisition phase (including transaction planning (such as the choice of acquisition structure and financing) and due diligence of the target group), the acquisition phase (such as contractual risk allocation around Pillar Two) to the post-acquisition phase and the impact of Pillar Two on any post-acquisition integration.

## Post-acquisition integration

For information on post-acquisition integration matters, please see our [Post-acquisition Integration Handbook](https://www.bakermckenzie.com/en/insight/publications/resources/post-acquisition-integration-2023).

# Common deal structures

## What are the key private M&A deal structures?

A foreign investor wishing to acquire or increase its equity in a target company registered in the PRC would commonly do so in one of the following ways:

Direct acquisition, where the foreign investor buys all or part of the equity of the PRC target company or subscribes for an increase in capital of the target directly,

Offshore/indirect acquisition, where the foreign investor acquires or increases the equity of the PRC target company via the offshore purchase of or subscription for an increase in equity in the target's foreign parent(s),

Asset acquisition, where a foreign investor, using a new or existing foreign invested enterprise (FIE) as the acquiring vehicle, directly buys some or all of the business and assets of the PRC target company.

State-owned interests and special types of acquisition: The Law of the PRC on the State-Owned Assets of Enterprises, passed in October 2008, was a reminder of how significant state-owned enterprises (SOEs) are in the Chinese national economy. It remains the Chinese government's objective to spin-off SOEs in less sensitive sectors, particularly SOEs in poor financial shape. Since early 2003, foreign investors have been allowed to acquire domestic creditors' rights (debts) in the target SOE and thereby qualify for the opportunity to later convert such debts into equity in the company (similar to a convertible bond). The normal means of direct equity or asset acquisition applicable to regular companies outlined above will also apply, with certain special rules and restrictions. Such acquisitions could also raise other issues, such as state asset valuations and employee resettlement issues.

It is a mandatory requirement under PRC law that the transfer of state-owned assets and equities shall be conducted through a listing and bidding process at an authorized property rights exchange center. Apart from the above, for private deals, auction processes are seen in some M&A deals of relatively large sizes. Bid process letters are not commonly used in the transfer of state-owned assets and equities administered by exchange centers. In contrast, in auction deals led by private sellers, bid process letters are typically used, and both nonbinding indicative bid letters and binding letters at the final offer stage are commonly seen in China.

A scheme of arrangement is not applicable under PRC law.

Mergers: Western-style mergers between two or more companies are possible but are rarely seen in the PRC. Current PRC statutory mechanisms recognize two means of mergers: a merger by absorption and a merger by new establishment. A merger by absorption involves one company absorbing another, after which the absorbed company is dissolved and its registered capital and assets are merged into the surviving entity. In a merger by new establishment, both pre-merger companies are dissolved and a new company is established, holding an aggregate of the pre-merger companies' assets and registered capital. Generally, the post-merger entity would be a complete successor to the pre-merger entities, that is, it would assume all rights and liabilities of those pre-merger entities. However, creditors of the participating companies may opt to have their claims repaid in full before the completion of the merger.

Cross-border mergers are currently unavailable under PRC law, i.e., it is not possible to directly merge a foreign entity with a domestic company (including FIEs). For foreign investors, the only permissible forms of mergers in China are between FIEs and FIEs, or between FIEs and domestic companies.

Generally, share and equity acquisition are more common than asset acquisition since asset deals are usually more time-consuming and complicated to execute.

## Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Traditionally, foreign investors usually establish a presence in the PRC via one or more of the following legal forms:

Representative offices

Sino-foreign joint ventures (JVs)

Wholly foreign-owned enterprises (WFOEs)

Foreign-invested joint-stock limited companies (FISCs)

The latest option is the foreign-invested partnership (FIP). The more flexible FIP form is now starting to replace the foreign-invested venture capital enterprise (a form of a PRC vehicle used by some international investors to acquire Chinese targets), particularly with PRC investment funds aimed at foreign investors.

## What are the different types of limited liability companies?

A JV or a WFOE takes the form of a limited liability company (LLC) that does not issue shares but has "registered capital," which is registered with the business registry. FISCs (currently less common in China) are share-issuing companies similar in legal form to Western-style corporations. An FIP may take the form of a limited liability partnership, which is akin to its Western-style counterparts.

## Is there a restriction on shareholder numbers?

The maximum number of an LLC setup in the PRC is 50. For LLCs in certain regulated sectors (e.g., general aviation), foreign investment may be subject to ownership restriction. As a result, such companies need to have at least one Chinese shareholder and one foreign shareholder, and the foreign shareholder may only hold a minority stake depending on the business scope of the company.

## What are the key features of a share sale and purchase?

A direct acquisition will take place in the PRC and may be subject to PRC approval as well as registration information reporting requirements, which may be time-consuming and involve government discretion, i.e., the PRC authorities may withhold approval (if applicable) if they perceive problems with the transaction.

The foreign buyer in a direct share acquisition generally assumes all existing or contingent obligations and liabilities of and restrictions applicable to the PRC target company in proportion to its equity in the target, unless explicitly carved out or excluded before or during the transaction.

Offshore/indirect acquisition of shares: This option is available only if the PRC target companies have foreign investors. An offshore acquisition takes place in the offshore company's jurisdiction of incorporation and it is generally not subject to PRC jurisdiction and review, except in certain circumstances under the PRC's antitrust and national security review regimes and PRC tax disclosures. This could change under the FIL that affords the MOFCOM or its local counterparts authority to approve certain types of offshore acquisition whereby the actual control of a domestic enterprise is transferred to a foreign investor.

In addition, if the offshore company's ultimate shareholders are PRC nationals or entities, certain PRC filings should have been made with the State Administration of Foreign Exchange (SAFE) that should be carefully reviewed during due diligence.

The foreign buyer in an indirect share acquisition generally assumes all the existing or contingent obligations and liabilities of, and restrictions applicable to, the PRC target company via the target's parent company, unless explicitly carved out or excluded before or during the transaction.

## What are the key features of an asset sale and purchase?

In an asset deal, the buyer may need to set up a new entity with local registration authority to take over the transferred assets as well as the transferred employees (if the buyer does not have an existing suitable entity in China). In addition, permits and licenses are not automatically transferrable in an asset deal. The buyer's entity may need to apply  for the necessary permits and licenses in its own name before it can operate the acquired business and assets. Transfer of employees would entail termination of the contracts with the seller and execution of new contracts with the buying entity. In an asset transaction, any existing obligations and liabilities of the target or restrictions on it generally remain the target's sole responsibility.

# Preliminary documents

## Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Yes, it is becoming more and more common to prepare a letter of intent or term sheet for M&A deals in the PRC. While the letter of intent or term sheet is normally signed as a nonbinding document, it is customary to give binding effect on the following provisions: confidentiality, exclusivity for negotiation, governing law, dispute resolutions and the nonbinding effect clause itself.

## Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

**Exclusivity**: Exclusivity provisions are commonly included in letters of intent or term sheets, but there are many instances where letters of intent or term sheets do not contain exclusivity provisions.

**Break fee**: Break fee provisions are not common but are sometimes seen in the market.

**Confidentiality**: Confidentiality provisions are commonly included in letters of intent or term sheets.

## Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is common to negotiate separate confidentiality agreements and exclusivity agreements.

## Is there a duty or obligation to negotiate in good faith?

As a basic legal principle, the PRC Civil Code requires the contracting parties to act in good faith in the negotiation stage. According to Article 500 of the PRC Civil Code, a party shall be liable for damages suffered by the other party if it: (i) pretends to conclude a contract and negotiates in bad faith; (ii) deliberately conceals important facts relating to the conclusion of the contract or provides false information; or (iii) performs other acts that violate the principle of good faith.

# Agreeing to the acquisition agreement → Purchase price

## Is a purchase price adjustment common?

Frequency/market practice: Very common in offshore acquisitions or onshore acquisitions of FIEs, but not very common in onshore acquisitions of domestic companies mainly due to restrictions under PRC foreign exchange control rules.

## What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: Cash-free/debt-free is very common. Working capital is also fairly common. Net asset value is rarely seen.

## Is there a collar on the purchase price adjustment?

Frequency/market practice: Collars are rarely used. This may be required where public companies are involved.

## Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: This is usually prepared by the target company.

## Is the balance sheet audited (where applicable)?

Frequency/market practice: Rarely.

## Is an earn-out common?

Frequency/market practice: Fairly common and more common in private equity transactions where sellers continue to manage the target company after closing. It is less common where the seller is completely exiting. Earn-outs are commonly capped. There are potential difficulties in implementing earn-out provisions in onshore acquisitions given the requirement for foreign investors to pay the purchase price in full within one year under the M&A Regulation, as well as restrictions under PRC foreign exchange control rules.

## Is a deposit common?

Frequency/market practice: Rarely. Due to restrictions under PRC foreign exchange control rules, cross border deposit payments are difficult to implement in practice.

## Is an escrow common?

Frequency/market practice: Escrows are very commonly used by private equity investors and strategic buyers.

## Is a break fee common?

Frequency/market practice: Rarely.

# Agreeing to the acquisition agreement → Conditions precedent

## Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: Rarely. This is typically only available where there is a long period before the execution and completion or in the case of a foreign seller.

## Is the MAE general or specific?

Frequency/market practice: Both are seen.

## Is the MAE quantified?

Frequency/market practice: Both quantified MAE and non-quantified MAE are seen.

# Agreeing to the acquisition agreement → Covenants

## Is a noncompete common?

Frequency/market practice: Fairly common, but not from private equity sellers.

## Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: Blue pencil methods are more commonly used.

## Are nonsolicitation provisions (of employees) common?

Frequency/market practice: Fairly common (in conjunction with noncompete).

## Are nonsolicitation provisions (of customers) common?

Frequency/market practice: Fairly common (in conjunction with noncompete).

## Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: Fairly common (in conjunction with other pre-closing obligations).

## Is there broad access to books, records and management between signing and closing?

Frequency/market practice: Fairly common. We generally get this for private deals.

## Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: Fairly common. Updating schedules is common but limited to things like lists of contracts. Notification of possible breach is common. In the case of a material breach, there is a right to terminate.

# Agreeing to the acquisition agreement → Representations and warranties

## Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: Fairly common. Materiality qualifiers are commonly seen but often not quantified (other than specific warranties, e.g., contract value).

## How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: Knowledge qualifiers are growing. They are often limited to the actual knowledge and due enquiry of a specified list of senior management.

## Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: Fairly common.

## Is disclosure of the data room common?

Frequency/market practice: Rarely. Chinese sellers commonly require this but it is often not accepted by buyers. Chinese sellers may be reluctant to prepare specific disclosures.

# Agreeing to the acquisition agreement → Repetition of representations and warranties

## Is it common to repeat warranties at closing?

Frequency/market practice: Fairly common. Repetition at completion is common.

## Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: It is not very common to repeat warranties at all times between signing and closing.

## Is a bring-down certificate at closing common?

Frequency/market practice: Rarely. Bring-down certificates are not very common.

## What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: True and accurate in all material respects is common, but often carve-out for fundamental representations, which must be absolutely true.

## Is double materiality common (a materiality qualification in bring-down at closing and in representation(s))?

Frequency/market practice: Rarely. Double materiality is usually avoided.

# Agreeing to the acquisition agreement → Limitations on liability

## What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: The buyer will ask for 100% but it is possible to negotiate down. It ranges from 10% to 100%.

## Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: Both are seen regularly.

## What are the common exceptions to the cap?

Frequency/market practice: Key warranties are often excepted (e.g., title, capitalization and authority). Often tax and specific areas of concern, sometimes with specific higher caps. Separate caps can be negotiated.

## Is a deductible or basket common?

Frequency/market practice: Sometimes. It is becoming more accepted in the market.

## Is a de minimis common?

Frequency/market practice: Sometimes. It is becoming more accepted in the market.

## How long does seller liability survive?

Frequency/market practice: A general survival of 18-24 months is common. Tax is commonly longer than general warranties.

## Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: It is common to carve out fraud.

## Is warranty insurance common?

Frequency/market practice: Rarely used, but has been used in private equity exits.

# Agreeing to the acquisition agreement → Set-offs against claims

## Is a set-off against claims for tax benefits common?

Frequency/market practice: Rarely.

## Is a set-off against claims for insurance proceeds common?

Frequency/market practice: Fairly common for proceeds actually received.

## Is a set-off against claims for third-party recoveries common?

Frequency/market practice: Fairly common for amounts actually received.

# Agreeing to the acquisition agreement → Damages, knowledge

## Is there an obligation to mitigate damages?

Frequency/market practice: This is not usually express but is required by law.

## Is there an exclusion of consequential damages?

Frequency/market practice: Fairly common.

## Are provisions that there is no liability if the buyer has knowledge common, or does buyer knowledge have no effect?

Frequency/market practice: Rarely.

# Agreeing to the acquisition agreement → Dispute resolution

## Does local law allow for a choice of governing law?

Frequency/market practice: PRC law is mandatory for certain types of agreements (e.g., a purchase agreement of which both the seller and the buyer are Chinese entities, and JV contracts with Chinese entities). Otherwise, Hong Kong or English law is more common.

## What is the common governing law?

Frequency/market practice: PRC law is mandatory for certain types of agreements (e.g., a purchase agreement of which both the seller and the buyer are Chinese entities, and JV contracts with Chinese entities). Otherwise, Hong Kong or English law is more common.

## Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: Arbitration is more common. Hong Kong is predominately chosen but will typically carve out court or administrative action (e.g., injunction). Chinese arbitration (e.g., China International Economic and Trade Arbitration Commission) is becoming more accepted in the market.

# Agreeing to the acquisition agreement → Stamp duty and tax

## If stamp duty is payable, is it normally shared?

Frequency/market practice: An equity/share/asset purchase agreement is subject to stamp duty in the amount of 0.05% of the purchase price (for each party). It is common for stamp duty to be equally shared.

## Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: Rarely. This is becoming increasingly common.

Copyright © 2025 Baker & McKenzie. All rights reserved. **Ownership**: This documentation and content (Content) is a proprietary resource owned exclusively by Baker McKenzie (meaning Baker & McKenzie International and its member firms). The Content is protected under international copyright conventions. Use of this Content does not of itself create a contractual relationship, nor any attorney/client relationship, between Baker McKenzie and any person. **Non-reliance and exclusion:** All Content is for informational purposes only and may not reflect the most current legal and regulatory developments. All summaries of the laws, regulations and practice are subject to change. The Content is not offered as legal or professional advice for any specific matter. It is not intended to be a substitute for reference to (and compliance with) the detailed provisions of applicable laws, rules, regulations or forms. Legal advice should always be sought before taking any action or refraining from taking any action based on any Content. Baker McKenzie and the editors and the contributing authors do not guarantee the accuracy of the Content and expressly disclaim any and all liability to any person in respect of the consequences of anything done or permitted to be done or omitted to be done wholly or partly in reliance upon the whole or any part of the Content. The Content may contain links to external websites and external websites may link to the Content. Baker McKenzie is not responsible for the content or operation of any such external sites and disclaims all liability, howsoever occurring, in respect of the content or operation of any such external websites.  **Attorney** **Advertising**: This Content may qualify as “Attorney Advertising” requiring notice in some jurisdictions. To the extent that this Content may qualify as Attorney Advertising, PRIOR RESULTS DO NOT GUARANTEE A SIMILAR OUTCOME. **Reproduction**: Reproduction of reasonable portions of the Content is permitted provided that (i) such reproductions are made available free of charge and for non-commercial purposes, (ii) such reproductions are properly attributed to Baker McKenzie, (iii) the portion of the Content being reproduced is not altered or made available in a manner that modifies the Content or presents the Content being reproduced in a false light and (iv) notice is made to the disclaimers included on the Content. The permission to re-copy does not allow for incorporation of any substantial portion of the Content in any work or publication, whether in hard copy, electronic or any other form or for commercial purposes.