

Intercompany loans between Chinese entities possible at last

November 10, 2015

The Supreme People's Court of China has issued new rules concerning the judicial interpretation of private lending disputes. The rules, known as "Provision 18", took effect on 1 September 2015. Provision 18 ensures that, subject to certain exceptions, private loan agreements between non-financial legal entities are recognised by all courts in China. This means that intercompany loans between Chinese group companies are now possible.

Provision 18 puts an end to the need of "shadow" lending practices in China where a bank is engaged to act as an intermediary. Under the old financing regulations, lending between Chinese non-financial legal entities was not permitted. This meant that courts in China generally denied validity to private loan agreements between non-financial legal entities. That has now changed. Provision 18 confirms that, subject to a limited number of exceptions, a private loan between non-financial legal entities entered into for production or business operation purposes will be regarded as valid by Chinese courts. However, a private loan agreement entered into by a lender (not being a financial institution) that carries out moneylending activities on such a scale that this activity has become its main source of income, is still likely to be declared null and void.

Provision 18 has also set fixed ranges for interest rates under private loans. As of September 2015, a private loan agreement with an annual interest rate of 24% or less will be regarded as valid by Chinese courts. If the annual interest rate exceeds 24%, but not more than 36%, the lender's claim to pay the part of the interest exceeding 24% will not be supported by Chinese courts. But if the borrower has paid the interest, the lender cannot be compelled to return it. If the annual interest rate in private loan agreements exceeds 36%, the excess interest will be deemed null and void, and a borrower may reclaim any excess amounts paid.

As a result of Provision 18, intercompany loans between Chinese companies are now allowed. Multinational groups with multiple subsidiaries in China can therefore use this additional means of funding in their intragroup financing strategy. Provision 18 also creates more flexibility for the funding of Sino-foreign joint ventures as the new regulations now allow loans from the Chinese joint venture partner to the joint venture company.
