Analysis of Regulations and Laws Related to Equity Finance

Xiaogang Gu*
Henan Institute of Economics and Trade, Zhengzhou, Henan, China
**Corresponding Author.*

Abstract: This paper focuses on the analysis of Regulations and laws related to equity finance. It begins by introducing equity finance as a new fiscal model emerging due to the challenges faced by the traditional land finance model. The model offers local State Institutions a new way to obtain revenue and promote economic transformation but also comes with its own set of challenges. The paper then details the regulations support for equity finance at the municipal, national, and local levels, including measures such as adjusting investment Regulations, issuing tax announcements, and implementing trial measures. It further elaborates on the legal provisions governing equity finance, especially in the context of state-owned financial enterprises and local fiscal funds. Finally, it discusses the current situation and challenges of equity finance, highlighting its benefits in reducing dependence on land finance, alleviating revenue-expenditure contradictions, and resolving debt risks, while also noting the reasons for its temporary inability to replace traditional finance and the problems it currently faces.

Keywords: Analysis; Regulations; Laws; Equity Finance

1. Equity Finance: The Rise of a New Fiscal Model

Equity finance, as an emerging fiscal model, is gradually becoming the focus of attention from all sectors in the context of the current decline in land finance revenue. With the slowdown of the urbanization process and the continuous downturn of the real estate market, the traditional land finance model is facing huge challenges. The reduction in land transfer revenue has made local State Institutions urgently need to find new sources of fiscal revenue growth to fill the fiscal funding gap.

The proposal of equity finance provides a new idea for local State Institutions. By holding and operating enterprise equity, the State Institutions can realize the preservation and appreciation of state-owned capital and obtain stable fiscal revenue.[1] This model can not only relieve the fiscal pressure of local State Institutions but also promote the transformation and upgrading of the economy. For example, some local State Institutions set up State Institutions-guided funds to attract social capital to participate in the investment of high-tech industries with core competitiveness. In this process, the State Institutions participates in the development of enterprises in the form of equity. After the enterprises grow and develop, they exit in an orderly manner through the capital market to realize the reinvestment of funds. This virtuous cycle model injects new vitality into the development of the local economy.

At the same time, equity finance also faces some challenges. Problems such as how to improve the return rate of state-owned assets, how to select appropriate investment targets, and how to balance the relationship between the market and the State Institutions need further exploration and solution. However, it is undeniable that as a new fiscal model, equity finance has great development potential and broad prospects.

2. Policy Support for Equity Finance

2.1 Example of Municipal Regulations

The General Office of Weifang Municipal People's State Institutions issued an opinion on adjusting and optimizing the equity investment policy of municipal fiscal funds. In terms of expanding the scope of equity investment implementation, actively expand the scope and scale of municipal fiscal fund equity investment.[2] For fiscal funds invested in market entities, if they meet the conditions for equity investment, they shall, in principle, be supported by means of equity investment. For subsidy and reward funds for state-owned enterprises, they shall be encouraged to be converted into registered capital in an orderly manner within the scope permitted by Regulations. Appropriately divide the amount of equity investment funds. In principle, for special funds invested in market entities, those of 5 million yuan and above shall be converted into equity investment implementation; those between 1 million yuan and 5 million yuan shall be encouraged to implement equity investment; and those of 1 million yuan and below may continue to be supported in accordance with the current method. The investment period of fiscal fund equity investment generally does not exceed 10 years.

In terms of optimizing the equity investment management mechanism, improve the coordinated management mechanism between equity investment and budget preparation. When compiling the budget, the business competent department shall integrate the special funds invested in market entities and may arrange no less than 10% annually for equity investment, clarify the equity investment amount, support scope and conditions, etc., and form a reserve pool of fiscal fund equity investment projects in relevant industrial fields. Adjust and optimize the equity investment decision-making mechanism. The decision-making of fiscal fund equity investment shall refer to the practice of the municipal guiding fund. In principle, the entrusted management institution shall conduct due diligence investigation and make market-oriented decisions; or an investment decision-making committee may be jointly formed by the entrusted management institution and the business competent department, and the business competent department shall moderately participate in the investment decision-making. For each equity investment, the entrusted management institution shall make a follow-up investment of not less than 10% of the investment scale of the fiscal fund. Explore a more flexible equity investment selection mechanism and encourage market entities to independently select equity investment methods under the guidance of the business competent department.

In terms of giving play to the amplification effect of the linkage between finance and finance, establish a linkage mechanism between investment and loan. For market entities with equity investment of fiscal funds, encourage banks in Weifang to actively dock and propose investment and loan linkage schemes. Effectively play the role of financial tools. Actively recommend market entities with fiscal equity investment to the municipal guiding fund and its participating funds, emergency transfer loan funds, policy guarantee institutions and market-oriented investment institutions, etc., to amplify the investment effect. Actively strive for the support of superior equity investment. Fiscal departments and business competent departments shall strengthen the docking with superior counterparts and actively recommend and declare projects that meet the conditions for equity investment of superior fiscal funds and have been invested by the municipality.

In terms of improving the incentive and restraint mechanism of equity investment, optimize the exit mechanism of equity investment. The equity formed by the equity investment of fiscal funds can be exited through listing, transfer, shareholder repurchase, etc. If the repurchase is in advance, a certain investment income can be conceded. Improve the income management mechanism of equity investment. [3] According to the scale and effectiveness of the funds managed by the entrusted management institution, a certain proportion of disposable investment income can be arranged to reward the entrusted management institution. Strengthen the work of fault tolerance. In the process of management and operation of fiscal fund equity investment, for investments that have been decided through fulfilling the regulations, if the investment losses are caused by objective factors such as force majeure or unpredictable market fluctuations and meet the toleranting fault circumstances, the relevant units and individuals shall be exempted from being held accountable. Strengthen the performance evaluation of equity investment. The equity investment of fiscal funds shall be incorporated into the whole process management of budget performance, and the relevant performance evaluation results shall be used as an important basis for the budget arrangement of special funds in the next year.

2.2 National Regulations

The Ministry of Finance issued an announcement on the individual income tax policy related to the equity incentive of listed companies. For the stock options, restricted stocks and equity incentives granted by domestic listed companies to individuals, after filing with the competent tax authorities, individuals can pay personal income tax within a period of not more than 36 months from the date of exercising the stock options, lifting the restrictions on the restricted stocks or obtaining the equity incentives.[4] If the taxpayer resigns during this period, he shall pay off all taxes before resigning. The domestic listed companies mentioned in this announcement refer to joint stock limited companies whose stocks are listed and traded on the Shanghai Stock Exchange, the Shenzhen Stock Exchange and the Beijing Stock Exchange. This announcement shall be implemented from January 1, 2024 to December 31, 2027. Taxpayers who exercise their rights during this period may implement it in accordance with the provisions of this announcement. Taxpayers who exercise their rights after January 1, 2023 and have not paid all taxes may implement it in accordance with the provisions of this announcement, and the period of installment payment of taxes shall be calculated from the date of exercise. The securities regulatory department and the tax department shall establish an information sharing mechanism, and the finance, tax and securities regulatory departments shall jointly do a good job in the implementation of the policy. At the same time, some relevant documents or clauses are abolished.

2.3 Trial Implementation of Local Regulations

Fengxian District formulated the implementation measures for the equity investment of fiscal funds (for trial implementation). According to the authorization of the district State Institutions, the equity investment of fiscal funds shall be in charge of by the District Finance Bureau and the entrusted management institution in accordance with the division of responsibilities. The District Finance Bureau specifically performs the duties of the State Institutions investor, is responsible for the budget review and approval, expenditure policy review of the equity investment funds, and jointly with the entrusted management institution, does a good job in budget performance management and conducts performance evaluation on the entrusted management institution. The entrusted management institution holds the equity on behalf of the finance department, is responsible for the budget preparation and specific implementation of the equity investment, proposes the equity investment plan, conducts project declaration, review and acceptance, etc., and supervises and manages the implementation of the project. The investment scope focuses on the key industrial planning of the district Party committee and the district State Institutions, mainly invests in scientific and technological enterprises with independent legal person status that are located in Fengxian District and conform to the industrial development direction of Fengxian District.

Weihai City issued the implementation measures for the pilot reform of the equity investment of municipal fiscal funds (temporary). According to the authorization of the municipal State Institutions, the equity investment of fiscal funds shall be jointly in charge of by the Municipal Finance Bureau, the municipal business competent departments (units) and the entrusted management institution in accordance with the division of responsibilities.[5] The Municipal Finance Bureau specifically performs the duties of the State Institutions investor, is responsible for the budget preparation, expenditure and budget performance management of the equity investment, takes the lead in formulating the comprehensive management system of equity investment, manages the entrusted institutions, and conducts performance evaluation on the investment projects and the entrusted management institutions. The municipal business competent departments (units) are responsible for the budget preparation and specific implementation of the equity investment of their own departments, conduct project selection, review and acceptance, etc., propose the list of equity investment projects and the equity investment plan, assist the entrusted institutions in their work, and participate in the performance evaluation of the investment projects and the entrusted management institutions. The entrusted management institution holds the equity entrusted by the Municipal Finance Bureau, establishes a project supervision and management and risk prevention and control mechanism in accordance with the entrusted management agreement, may send directors and supervisors to the invested enterprises according to the management needs, participates in the decision-making management according to the articles of association of the invested enterprises, actively helps the invested enterprises solve production and operation difficulties, and promotes the projects to become bigger and stronger.

3. Legal Provisions of Equity Finance

3.1 Legal Provisions on the Equity Management of the Capital Increase and Share Expansion of State-owned Financial Enterprises

On November 25, 2019, the Ministry of Finance issued the "Notice on Further Clarifying the Relevant Issues Concerning the Equity Management of the Capital Increase and Share Expansion of State-owned Financial Enterprises" (Cai Jin [2019] No. 130). The notice makes it clear that state-owned financial enterprises refer to financial enterprises that can be actually controlled by the state, including various financial enterprises that are legally established and have obtained financial business licenses.[6] The capital increase and share expansion of state-owned financial enterprises need to follow strict management regulations. The central and local finance departments shall, in accordance with the principle of unified Regulations and hierarchical management, supervise and manage the capital increase behavior of state-owned financial enterprises according to their responsibilities.

For example, if the proportion of state-owned equity of a state-owned financial enterprise at its own level changes due to capital increase, it must report to the finance department at the same level in accordance with the law to perform the relevant procedures; if the state no longer has the controlling right of the funded financial enterprise due to capital increase, the finance department must report to the people's State Institutions at the same level for approval. If a state-owned financial enterprise has completed the corporate system reform and has a sound corporate governance structure, the capital increase behavior of its subsidiaries shall, in principle, be independently decided by the group (holding) company in accordance with the corporate governance procedures. However, if the actual control right of a key subsidiary is transferred due to the capital increase behavior, it must report to the finance department to perform the relevant procedures. At the same time, the enterprise to be increased in capital shall conduct qualification review on the intended investors. The capital increase funds shall be the true and legal self-owned funds, and shall not use entrusted (managed) funds, debt funds and other non-self-owned funds to participate in the capital increase.[7] If the contribution is made in non-monetary property, the asset evaluation shall be carried out in accordance with the law. In principle, the capital increase of state-owned financial enterprises shall disclose information publicly in the qualified provincial (including) or above property rights trading institutions, solicit intended investors, and the public solicitation time shall not be less than 40 working days.

3.2 Legal Provisions in the Implementation Measures for the Equity Investment of Fiscal Funds in Fengxian District

The implementation measures for the equity investment of fiscal funds in Fengxian District (for trial implementation) clearly and specifically stipulate the legal provisions of the equity investment of fiscal funds

First, define the definition of fiscal funds and the responsibilities of the entrusted management institution. The fiscal funds mentioned in the measures refer to the funds at the district level that can be used for equity investment in supporting high-quality economic development, industrial transformation and upgrading, etc. The entrusted management institution is the operation subject of the fiscal equity investment funds.[8] Based on its professional advantages and investment experience, it shall implement the equity investment behavior by means of direct investment or cooperation with market-oriented management institutions.

Secondly, in terms of the division of responsibilities and the implementation scope, according to the authorization of the district State Institutions, the equity investment of fiscal funds shall be in charge of by the District Finance Bureau and the entrusted management institution in accordance with the division of responsibilities. The District Finance Bureau specifically performs the duties of the State Institutions investor, and the entrusted management institution holds the equity on behalf of the finance department and is responsible for the specific implementation work. The investment scope focuses on the key industrial planning of the district Party committee and the district State Institutions, mainly invests in scientific and technological enterprises with independent legal person status that are located in Fengxian District and conform to the industrial development direction of Fengxian District.

Furthermore, in terms of the management of the entrusted management institution, the entrusted management institution shall issue specific provisions on the management of fiscal equity investment, including project screening, project review, investment decision-making, etc., and submit them to the District Finance Bureau for the record. At the same time, the entrusted management institution shall establish a project plan list of investment projects and report the basic situation of the operation of the entrusted management funds to the District Finance Bureau every six months.[9]

In terms of equity management, the District Finance Bureau and the entrusted management institution shall establish a registration and management system for the equity of fiscal funds, conduct timely registration and management, and dynamically, comprehensively and accurately reflect the equity status. At the same time, a tripartite regular verification mechanism for equity investment information shall be established.

In terms of equity exit and income collection, the equity investment of fiscal funds shall realize the equity exit through equity transfer, shareholder (enterprise) repurchase, liquidation and dissolution, etc. in accordance with the agreement of the equity investment agreement. The obtained income can be recycled for investment. For the overdue unrecovered investment funds or income and the bankrupt liquidation of the invested enterprise with no distributable property, after being reviewed and approved by the District Finance Bureau, the asset loss of the equity investment project can be recognized and the relevant accounting treatment can be carried out.

In summary, from the equity management of the capital increase and share expansion of state-owned financial enterprises to the implementation measures for the equity investment of local fiscal funds, the process and responsibilities of equity management are clearly defined, providing legal protection for the standardized development of equity finance.

4. Current Situation and Challenges of Equity Finance

4.1 Hot Discussion and Benefits

In 2023, equity finance was widely discussed, which has profound reasons. From the perspective of local finance, equity finance indeed shows many benefits. First, it can reduce the dependence of local State Institutions on land finance. In the current situation of the reduction of land finance, for those places with a high degree of dependence on land finance, the pressure brought by land finance prompts local finance to actively explore new paths. By introducing various social capitals, private capitals and industrial capitals, continuously expanding and strengthening state-owned assets and improving the return on investment of high-quality state-owned assets, a virtuous cycle is formed, providing new support for local finance.

Secondly, equity finance can alleviate the revenue and expenditure contradiction caused by the mismatch between the financial power and the administrative power of local State Institutions. Under the tax-sharing system, the shared income of value-added tax and enterprise income tax is an important pillar of local fiscal revenue. However, in recent years, the growth of private enterprises has encountered difficulties, and the land revenue has declined systematically, while the expenditure responsibilities of local finance have continued to increase, resulting in the continuous expansion of the fiscal gap. The emergence of equity finance provides a new source of revenue for local State Institutions and helps to alleviate this revenue and expenditure contradiction.

Finally, equity finance can help to resolve the debt risk of local State Institutions. In the context of the high debt levels of various localities, the pressure on local State Institutions to repay principal and interest is relatively large. As a new source of revenue, equity finance can make up for the gap of land finance, increase State Institutions revenue by improving the return rate of state-owned assets, and thus provide support for resolving the debt risk of local State Institutions.

4.2 Reasons Why It Cannot Be Replaced Temporarily

From the perspective of the definition of finance, finance and equity are two relatively independent concepts. Finance implements the management system of separating revenue and expenditure, and fiscal revenue cannot be distributed according to equity, which is the basic principle of fiscal revenue and expenditure management. Therefore, it fundamentally determines that equity finance cannot simply replace the traditional fiscal model.

In terms of revenue volume, in 2022, the national land use right transfer revenue was as high as 6,685.4 billion yuan, while the state-owned capital operating budget revenue was only 568.9 billion yuan, with a huge gap. The proportion of land transfer fees in fiscal revenue at present determines that equity finance is far from being able to replace land finance in the short term.

From the perspective of the operation of state-owned assets, China is still in the primary stage of development, and the grass-roots State Institutions in various counties and districts generally face the situation of no income or even negative income in the operation of state-owned capital. At the same time, there is a lack of professional market talents, and it is impossible to find a profitable model. In the process of investment and operation, huge implicit debts are easily generated. In contrast, the successful precedents of equity investment models at home and abroad are more suitable for promotion and reference at the provincial and municipal State Institutions levels with more advantageous resources.

In terms of stimulating the economy, the pulling effect of land finance on various industries in economic and social development is unmatched by equity finance. Land finance is accompanied by the real estate industry. As an important pillar of the national economy, the added value of the real estate industry in 2022 was close to 7.4 trillion yuan, accounting for 6.1% of GDP, and it also indirectly drove the manufacturing industries such as building materials and furniture, as well as the tertiary industries such as finance and business services. Equity finance is more of a financial means, and its pulling effect on the economy is relatively limited.

4.3 Current Situation of Regulations and Laws

At present, equity finance is emerging in Regulations and laws. For example, the Temasek model has been emulated by some local state-owned assets supervision and administration commissions. Some local state-owned assets supervision and administration commissions have increased investment in emerging industries, integrated industrial chains, frequently made moves in the capital market, expanded the scale of assets, and successfully adjusted the fiscal revenue structure [10]. The Hefei State-owned Assets Supervision and Administration Commission has cultivated three national strategic emerging industry clusters with a series of miraculous operations. In the past decade, it has cumulatively invested more than 140 billion yuan in capital, driving the total investment of projects to exceed 430 billion yuan and the upstream and downstream industrial chains to reach 500 billion yuan.

5. Challenges and Future Prospects of the Regulations and Laws Related to Equity Finance

Amidst the macroeconomic backdrop of decelerating urbanization and declining land finance revenues, equity finance, as an innovative fiscal strategy, is increasingly demonstrating its importance and growth potential within the fiscal system. Research indicates that equity finance can effectively reduce local State Institutions' dependence on land finance, alleviate fiscal imbalances caused by the mismatch between fiscal authority and expenditure responsibilities, and play a positive role in mitigating local State Institutions debt risks. Nonetheless, equity finance still faces numerous challenges in practice, including the limited profitability of state-owned capital operations, a shortage of market professionals, and, compared to land finance, its relatively limited economic stimulus effect.

Looking ahead, the development potential of equity finance is particularly significant against the backdrop of rapid development in scientific innovation and emerging industries. To promote the robust development of equity finance, the policy and legal frameworks need further refinement to expand the scope of fiscal equity investment, clarify the industrial support areas and investment criteria, and enhance the efficiency of fiscal fund utilization. In addition, it is crucial to construct and strengthen risk prevention and control mechanisms, including establishing a comprehensive risk assessment system for in-depth risk assessment and monitoring of investment projects. Improving the investment exit mechanism to ensure the timely withdrawal of fiscal funds and the realization of returns is also vital for the sustainability of equity finance. Overall, equity finance plays an important role in promoting economic structural transformation, alleviating local fiscal pressures, and driving the preservation and appreciation of state-owned assets, and its future development is highly anticipated.

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