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"Peeling the Onion Part 4" - Corporate Valuations in China

Revised Bankruptcy Law still a long way off

Preferential tax treatment for Foreign Invested Enterprises

Foreign investment in China's Aviation Industry - Regulations

New Regulations Governing Foreign Exchange Convertibility for FIE's

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## "Peeling the Onion Part 4 - Corporate Valuations in China"

In the latest edition of "Peeling the Onion" released last week we examine the difficulties of conducting corporate valuations in the rapidly developing and dynamic market place that is China. Here is a snippet of what the article is about:

*With China one of the only growing economies in the world, coupled with the array of corporate meltdown's currently taking place in the United States, many companies are looking to China to diversify revenue flows, expand market share and, most importantly, drive future sales growth. Whether it be Japanese manufacturers such as Seiko looking to cut labour costs or American I.T companies such as Oracle or Agilent looking to jump on board the China juggernaut, multinationals from all nations are re-thinking their global strategy and China has surfaced as the last frontier.*

*Conveniently, at present there is also a glut of factories and operations for sale in the market, as the Chinese government continues to sell off State Owned Enterprises (SOE) and many multinationals rationalize their non-core and non-profitable investments in the mainland. However, with all this market movement and Foreign Direct Investment flowing in and out of the country, multinationals need to even more carefully evaluate their investment options and analyse opportunities.*

*In the 1990's many multinationals threw endless dollars into the 'China pit' with the idea that China was, without a doubt, the great big market of the future. Whilst many would argue that this claim certainly still rings true, CFO's no longer have endless budgets to blow on over-priced Chinese investments, and CEO's realize that their heads are on the chopping boards if investments prove not to be in the best interest of shareholders. On the flip-side, as multinationals begin to re-structure their existing operations within China itself, including divesting assets and re-negotiating joint venture terms, shareholders are demanding greater financial scrutiny and market understanding.*

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Business Management

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We hope you find the article useful and informative. Please let us know what other topics you are interested in by contacting us at [newsletter@lehmanbrown.com](mailto:newsletter@lehmanbrown.com).

### Revised Bankruptcy Law still a long way off

Recent rulings regarding China's bankruptcy legislation are due to come into effect on September 1 this year. The Supreme Court has issued its second judicial interpretation of the controversial 1986 Bankruptcy Law, to curb growing instances of illegal behaviour by many local governments and private enterprises. The ruling comes at a time when China is under pressure to halt the growing instances of firms reneging on their debts simply by declaring bankruptcy and to minimise sometimes illegal interference of local governments in liquidation procedures and court procedures.

The ruling is seen by many as a large step towards making China's bankruptcy procedures more transparent and uniform. Previously, local governments were using the law to declare firms bankrupt and thereby effectively ruling out any chance for creditors to claim the large sums of money owed to them. Once declared bankrupt many officials and factory managers would then purchase the factories very cheaply and were able to write off the debt. The law governing such issues was very scattered and not consistent across China.

The new nation-wide interpretations are aimed at standardising bankruptcy rules and regulations between the different judicial jurisdictions in China and ensuring that the procedures are clear and transparent. It also hopes to ensure that all creditors enjoy access to remedies and equal status in front of the law.

With bankruptcy cases growing exponentially each year, especially in light of the recent economic downturn and the collapse of State Owned Enterprises (SOE), many people hoped that the government would revise the bankruptcy law either before or just after the National People's Congress to be held later this year.

However, with the government and many analysts concerned about the impact of the drafted new law on the SOE's and the social ramifications, the main consensus now is that the bill will not be approved in the foreseeable future. This is a major blow for the country's financial and banking sector which is reeling from the billions of dollars of bad loans that will seemingly never be collected.

### Preferential tax treatment for Foreign Invested Enterprises

The Ministry of Finance and the State Administration of Taxation (SAT) have passed a retrospective Notice on the *Eligibility of Follow-Up Foreign-Invested Enterprise Investment for Preferential Enterprise Income Tax Policies*. The ruling, issued on June 1, 2002 will come into effect as of January 1, 2002.

The Notice is in response to recent policy statements in which the government has made clear its commitments to standardising the treatment of foreign invested enterprises (FIE) and local companies for taxation purposes. Such legislation is expected to come into effect in the coming years, effectively limiting the preferential tax treatment that was afforded to many FIE's in encouraged industries and geographical areas. These commitments are in line with WTO requirements.

This recent Notice is applicable to investors who are not covered by original contracts, but are wishing to invest in follow-up projects. The ruling provides that income obtained through such follow-up investment projects (of an FIE investor) will be eligible for independent fixed-period tax exemptions and reductions (typically the 2-year exemption and 3-year 50% reduction) if the foreign-invested enterprise is engaged in an Encouraged Category project and one of the following conditions is met:

- the additional registered capital formed by the follow-up investment reaches, or exceeds, US\$ 60 million;
- or the additional registered capital formed by the follow-up investment reaches or exceeds, US\$ 15 million and it reaches, or exceeds, 50% of the enterprise's original registered capital.

The Notice provides further details on qualifying for the independent exemptions and reductions, accounting requirements and transitional measures.

## 增值税

"Zeng Zhi Shui"

(Value Added Tax)

## 增值税

"Ying Ye Shui"

(Business Tax)

## 消费税

"Xiao Fei Shui"

(Consumption Tax)

## 所得税

"Suo De Shui"

## **Foreign Investment in China's Aviation Industry - Regulations**

**The Regulations on Foreign Investment in Civil Aviation** were issued by the Civil Aviation Administration of China, the Ministry of Foreign Trade and Economic Cooperation and the State Development Planning Commission, after approval from the State Council, on June 21, 2002. They will come into force on August 1, 2002.

The Regulations state that the scope of foreign investment in civil aviation covers civil airports, public air transport enterprises, general-purpose aviation enterprises and projects related to air transport. It is prohibited for foreign investors to invest in, and manage, air traffic control systems.

When foreign investors invest in civil airports, the relative controlling interest must be held by the Chinese party.

When foreign investors invest in public air transport enterprises, the Chinese party must hold the controlling interest. The proportion of investment held by any one foreign investor (including its affiliates) may not exceed 25%.

When a foreign investor invests in aircraft maintenance (with the obligation to undertake business in the international maintenance market) or aviation oil projects, the Chinese party shall hold the controlling interest.

The Regulations explain who the relevant approval authorities will be in different situations and set forth the approval process.

*China Legal Change - July 19, 2002*

## **New Regulations Governing Foreign Exchange Convertibility for FIE's**

The Notice of the State Administration of Foreign Exchange on Reforming the Method of Administration for Foreign Exchange Settlement for Foreign Investment Capital Funds was issued on June 17, 2002 and came into force on July 1, 2002.

The Notice implements on a nationwide basis trial reforms that were introduced in selected areas beginning last August.

The reforms permit foreign-invested enterprises to convert foreign currency funds in their "foreign exchange capital accounts" into Renminbi without obtaining approval from the foreign exchange authorities. Renminbi obtained in this way must be used for normal production and operation expenditures of investment projects.

The Notice provides details on how the reforms will work, on the authorization of banks to handle this type of foreign exchange settlement and on specific steps to be taken to implement the reforms. An annex to the Notice sets forth the procedures that authorized banks must follow when approving this type of foreign exchange settlement.

*China Legal Change - July 29, 2002*

**Keep an eye out for LehmanBrown's analysis of what is shaping China's Foreign Exchange regulations in the up-coming special edition of "insights@lehmanbrown"!**

## *"Providing an alternative in China"*

[insights@lehmanbrown](mailto:insights@lehmanbrown) provides updates of the latest taxation and accounting regulations in the People's Republic of China. It is designed to provide you with interesting and informative information to assist in your dealings with China or any China-related issues that you may encounter.

If you do not wish to receive this newsletter, we have provided an unsubscribe facility below.

LehmanBrown also provides a monthly newsletter *Peeling the Onion* which investigates certain topical issues affecting businesses in China, particularly for those companies and individuals with operations in the PRC, or looking to establish a presence in-country.



### **Recent editions include:**

- ▶ Due Diligence in China
- ▶ Transfer Pricing Strategies in China
- ▶ Business Fraud in China
- ▶ Corporate Valuations in China
- ▶ Crisis Management in China
- ▶ China's Changing Tax Environment
  - ▶ Internal Controls in China
  - ▶ Establishing an SME in China
- ▶ Managing Your China Business Under SARS
  - ▶ Treasury Management in China
  - ▶ Banking in China
- ▶ Mergers and Acquisitions in China
- ▶ Bridging the Accounting Standards Gap in China
- ▶ The Changing Role of CFOs and Accountants in China
  - ▶ Transfer Pricing Investigations...When not if!

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