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Foreign Invested Enterprises and management fees

State Tax Authority Notice on Tax Treatment of Services Provided by Foreign Invested Headquarters to Subsidiaries. Jing Di Shui Ying [2002] No. 590, effective from January 1, 2003.

Where foreign invested headquarters provide services to subsidiaries, the service fee should be at arms length. Otherwise, the tax authority reserves the right to make adjustment.

Foreign invested headquarters should not charge or apportion any management fee to their subsidiaries.

Tax incentives continue in the west

State Tax Authority Notice on Carrying out Tax Policies of Western Area Development. Jing Di Shui Qi [2002] No. 460, issued on and effective from October 16, 2002.

For entities established in Western Area engaged in businesses categorized as encouraged industries, if the revenue from main business account for 70% or more of their total revenue, they can apply for a preferential income tax rate at 15%.

If investment is made on transportation, electricity, water conservancy, post and broadcast infrastructure industries, foreign entities can enjoy a preferential policy of 2-year exemption and followed by a 3-year half deduction of income tax.

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Research and Development tax incentives

Beijing Municipal Notice on Encouraging Establishment of Science and Technology Research and Development Center in Beijing. Jing Guo Shui Fa [2002] No. 301. Effective from October 1, 2002.

Goods and equipment used by expatriate experts working with R&D center will be free of customs duties if within reasonable quantities.

Revenue from technology development, transfer, and relative consulting, service and training are exempted from business tax.

Income from sales of software is also free of business tax if the software is officially registered and the copyright is transferred when it is sold. Centers with net technology revenue below RMB300,000 per annum can be free of income tax.

增值税

"Zeng Zhi Shui"

(Value Added Tax)

Beijing's Anti-Trust rules may trip up multinationals

Leading multinationals may run afoul of Beijing's proposed anti-trust provisions aimed at preventing them achieving market dominance in any sector through acquisitions.

While details are being revised, a sketchy outline reported by state media on Tuesday indicated companies which were highly reliant on acquisitions for growth were likely to bear the brunt of the clauses, contained in the draft merger and acquisition measures.

Market share is a key benchmark of judging whether tighter scrutiny will be required, according to the clauses being drafted by the Ministry of Foreign Trade and Economic Co-operation. Foreign firms with more than one-quarter of domestic market share will trigger a special hearing, as part of the rules.

Market research data indicated multinationals likely to be affected by the provisions included Eastman Kodak, with a near 50 per cent market share in camera film; Nestle (China) with a 38 per cent share of the mainland's ready-to-drink coffee market; and Procter & Gamble Guangzhou with about 30 per cent of the hair-care products sector.

Hewlett Packard (China) and Epson (China) respectively have 25 per cent and 30 per cent of the high-end internet based server and computer printers markets.

In Shanghai alone, Taiwanese food giants Tingyi Group and President Group control the instant-noodle market. Their national share is unclear.

But analysts stressed it might be too early to jump to conclusions on the likely victims using industry estimates.

George Crocker, principal, head of the Beijing office of United States-based consultancy Monitor Group, said: "These rules do not appear to impact all foreign companies in China.

"The fact that some companies already have over 25 per cent market share does not mean that they cannot continue to grow organically. It only means that they cannot buy more share through acquisitions."

Companies highly reliant on acquisitions for growth would be most affected, he said, citing Nestle as an example of an acquisition-oriented growth play.

Mr Crocker said it was important the government clearly defined industry boundaries.

"For example, Wrigley has about a 45 per cent share of the gum market, but something like a 75 per cent of the sugarless gum market. On the other hand, if you look at its share of overall confectionery it would be very low, just a few per cent probably," he said.

增值税

"Ying Ye Shui"

(Business Tax)

消费税

"Xiao Fei Shui"

(Consumption Tax)

所得税

"Suo De Shui"

(Income Tax)

Mr Crocker believed the consumer goods sector was where consolidation would accelerate.

"Consolidation may happen by acquisition, which is regulated by the anti-trust laws, or it may happen by natural competitive forces, which does not appear to be regulated," he said. "This is how these laws generally happen in other countries: if you can grow to being a very strong No 1 player it's okay, but the government won't let you buy your way there beyond a certain point. Having anti trust laws is probably in some senses a signal of progress, and better than allowing unfair competition in achieving monopoly status."

Source: SCMP, October 24, 2002

Interim Regulations on Utilization of Foreign Investment to Reorganize State Owned Enterprises

Issue Date: November 8, 2002

Issuing Authority: State Economic and Trade Commission, Ministry of Finance, State Administration of Industries and Commerce and State Administration of Foreign Exchange

Effective Date: January 1, 2003

Summary: The Regulations specifies requirements and procedures to reorganize state-owned enterprises and companies with state-owned shares (jointly referred to as SOEs but excluding financial institutions and public listed companies) by utilizing foreign investment.

The Regulations list five alternative ways of using foreign capital; including SOEs selling the whole or part of the SOE to foreign investors, transferring all or part of state-owned shares to foreign investors, creditors of a SOE assigning their claims against the SOE to foreign investors, selling whole or part of the assets of the SOE to foreign investors and foreign investors subscribing to the increased shares of a SOE.

To reorganize SOEs, foreign investors shall first follow the requirements established in the Foreign Investment Industry Guide Catalogue. Foreign investors shall also fulfill asset evaluation of the SOE and make reasonable redundancy plan that may be acceptable to the employees.

The authorities now pay more attention to the effects of reorganization on market competition. The Regulations require that the reorganization of SOEs shall not lead to monopoly of the market. When applying to the competent authorities for the reorganization, the reorganized SOE shall submit information on the foreign investor including market percentage of the foreign investor in China.

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