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Unified tax laws may cause a hike in FIE tax rates

Fund Management market set to open to foreign firms

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Unified tax laws may cause a hike in FIE tax rates

As you may be aware, as part of China's commitments to the WTO and to "even the playing field" for domestic and Foreign Invested Enterprises (FIEs), there is a requirement to harmonise the tax treatment of local and foreign enterprises. Whilst this is a long-term commitment, there has so-far been no agreed time-frame or agenda for its implementation.

However, just the other week the PRC Minister of Finance Xiang Hui Cheng came out and officially announced that the government planned to amalgamate the two sets of existing tax regulations for domestic enterprises and FIE's by next year. Although this would involve enacting the legislation through the National People's Congress sometime over the coming year (most likely in March 2003), it is believed that the new rules would come into force as of January 1, 2004.

What does this mean for FIEs in china, or companies looking at entering the China market?

For those companies **looking to establish operations** in the PRC, there is obviously a distinct benefit of setting-up an FIE within China before the changes come into effect. In this way the company could possibly secure the existing tax benefits available to the industry, within the coastal cities or bonded areas. This, for example, could include 5 years tax holidays for some manufacturing and high-tech enterprises, preferential tax treatment in "Free Trade Zones" or even lower corporate income tax rates for entities established in designated districts or zones.

For those companies with **existing operations in the PRC**, the new regulations may mean that the company should change their legal or operating structure to take advantages of the existing regulations. For example, entities operating simply as processing arrangements for their companies offshore may consider actually establishing a presence in China. This may take the form of a Joint Venture or a Wholly Foreign Owned Enterprise. In this way, the company may be able to lock-in current tax

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advantages.

In any case, companies looking to invest in China, or with existing operations in-country need to understand how the planned tax changes will effect their investment. The tax changes are very significant for FIEs and, depending on which way the government goes, could result in a significant rise in tax rates for FIEs and/or dissolution of many of the tax benefits that are currently offered. Whilst these scenarios will not be confirmed until the regulations are tabled, the Minister has certainly alluded to hikes in rates and also possible transition periods for FIEs to transfer to the new system.

Regardless of the outcome, companies need to assess the impact and investigate possible tax structures to ensure their investments remain tax efficient given the possible new regulations.

Fund Management market set to open to foreign firms

The *Rules for the Establishment of Fund Management Companies with Foreign Equity Participation* were issued by the China Securities Regulatory Commission on June 1, 2002. They will come into force on July 1, 2002.

These regulations essentially allow foreign investors to own stakes of up to a third in domestic securities firms and fund management companies (including both direct holdings and indirect holdings). This cap will be raised following China's entry into the WTO to 49% in the coming years.

However, a foreign shareholder of a fund management company with foreign equity participation must meet the following conditions:

1. It must be a financial institution that is established in accordance with the laws of the country where it is located and whose existence is lawfully continuing. It must not have been subject to major penalties from the securities regulatory authorities or the judicial authorities in the preceding three years.
2. The country where it is located must have sound securities laws and regulatory systems. The country's securities regulatory authorities and the CSRC must have concluded a memorandum of understanding on securities regulatory cooperation and maintain an effective relationship of regulatory cooperation.
3. The actual paid-in capital must not be less than the equivalent of RMB 300 million in a freely convertible currency.
4. It must meet other prudential requirements stipulated by the CSRC.

With regards to brokerage firms, the new regulations did not provide for foreigners to own larger stakes in domestic companies.

Under the new rules, however, securities firms with foreign shareholders will be allowed to underwrite bond and stock issues, carry out restricted trading of bonds and also provide brokerage services in foreign-currency denominated stocks and bonds.

With these changes in mind, the regulations states that at least one domestic shareholder must own more than one-third stake in a brokerage to ensure Chinese investors remain in control of the operation.

Conditions for establishing a foreign bank branch in the PRC

With foreign banks now increasing their presence in the China market, especially in line with relaxing of restrictions to offering foreign currency services in mainland branches, we thought that it might be interesting to review the conditions foreign banks must meet before they are able to open branches in the mainland.

Under article 7 of the *Regulation Governing Foreign-funded Financial Institutions of the People's Republic of China* effective as of February 1, 2002, applicants wishing to establish a foreign bank branch in the PRC must:

Business Management

Taxation Terms

增值税

"Zeng Zhi Shui"

(Value Added Tax)

营业税

"Ying Ye Shui"

(Business Tax)

消费税

"Xiao Fei Shui"

(Consumption Tax)

1. Have had a representative office in the territory of China in more than two years;
2. Have total assets of not less than US \$ 20 billion at the end of the year prior to the application and the capital sufficiency rate may not be less than 8%;
3. Have a sound system for financial supervision and administration in the country or region to which it belongs, and being effectively controlled by the competent authorities of that country or region;
4. Have acquired the consent from the competent authority of the country or region to which it belongs for its application; and
5. Satisfy other prudential conditions specified by the People's Bank of China.

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"Suo De Shui"

(Income Tax)

"Providing an alternative in China"

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.

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.



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- ▶ Transfer Pricing Strategies in China
- ▶ Business Fraud in China

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