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CMS Bureau Francis Lefebvre

Letter from China

The President of the People's Republic of China, Hu Jintao, and Nicolas Sarkozy at the last G20 summit.

Event

From G20 to G2?

The G20 summit in London was an opportunity, in these times of economic and financial crisis, to deal out a few of the cards of globalisation.

For some analysts, China was enthroned as the pre-eminent partner of the Americans and the era of the United States-China duumvirate has begun, to be followed, perhaps, by an era of Chinese dominance. The same analysts were quick to re-christen the G20, G2. Others, however, estimate that although China has climbed up the ranks, it is still far from being the anticipated superpower, since its international influence is still limited and, more importantly, its interior situation carries risks of instability, particularly on the social front. Furthermore, China's theories, whilst widely discussed during the G20, have not been taken up by the wealthiest countries. It is true nonetheless that emerging countries are rallying to them practically unconditionally. There is no planned change in the reserve currency, from dollars to an international currency, nor any strong measures in the fight against protectionism or regulation of the financial markets. One fact remains: China will most likely grow by at least 7% this year, which should account for half of all global growth. It is about to become the second largest economy in the world, ahead of Japan. Its market is considerable and its exchange reserves allow it to quietly pursue a strategy of major domestic revival. This strength was acknowledged by the G20. This was crucial for China, proud of its 5000 years of history and aware that time is on its side. ■

7 %

All the international organisations predict that Chinese growth will exceed this figure in but stay below the 8 % predicted by the Chinese government

3 of the 5 largest market capitalisations in the world are now Chinese companies: PetroChina (energy), ICBC (banking) and China Mobile (telecommunications).

Summary

Editorial

The rise to power of the Yuan

Criticisms of the undervaluation of the Yuan, a recurring theme of the United States for several years, have now softened. On 15 April Washington stated that China is not manipulating its currency, whereas a few days before, the IMF had stated the contrary. In any case, there is no doubt that the Yuan is destined to become a truly international currency in the medium term, as the American dollar loses its supremacy. For this there will need to be complete convertibility of the Yuan, which is not planned for at least ten years.

The convertibility of the Yuan, desired by Beijing since 1993, will in fact happen little by little: China has moved from non-convertibility to partial convertibility, available in particular for capital operations, but subject to rigorous controls. Furthermore, in recent months, currency agreements have been struck by China with six other countries (South Korea, Malaysia, Byelorussia, Hong Kong, Indonesia and Argentina) for a sum total of 650 billion Yuan. Companies from these countries can now carry out operations directly in Yuan without having to go through the dollar and suffer its fluctuations.

元

"Yuan"

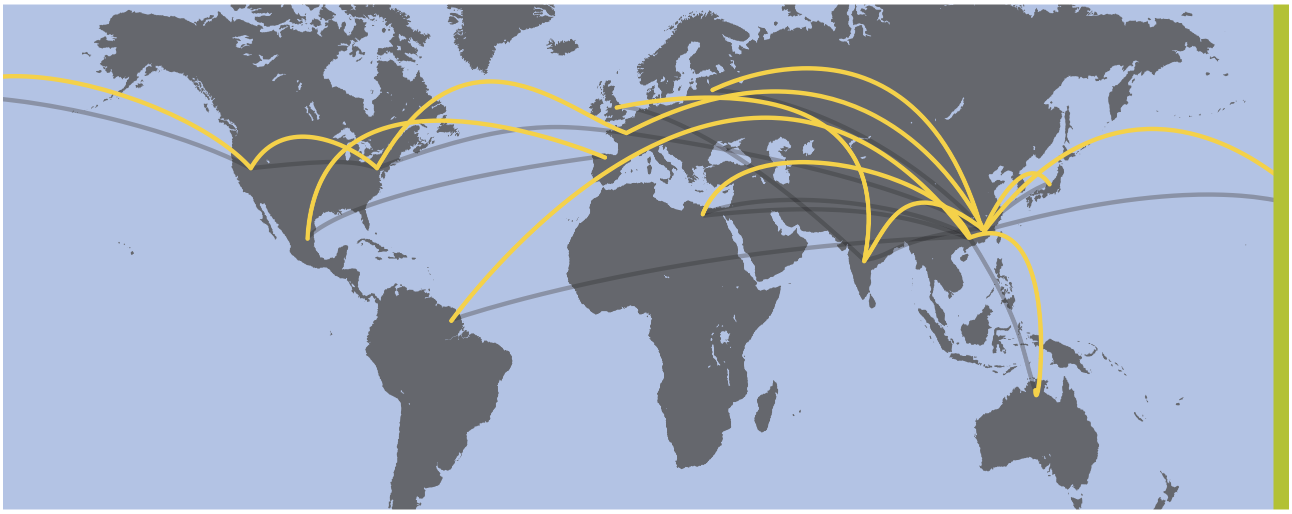
The Yuan, followed by "renminbi" (the people's currency), is the official Chinese currency. This is the modern transcription of an ancient character meaning "round object", symbolising ancient coins.

News

Investments

Paying the right price between subsidiaries

New Chinese regulations regarding tax on income, which came into force on 1 January 2008, aim to be stricter on transfer pricing. Let us explain.



When a French company buys from its subsidiary or group company in China, the price paid by the French parent or group company indirectly determines how much profit is declared by the Chinese subsidiary or group company. This in turn determines the amount of tax to be paid. The State in fact requires that transactions be aligned with **market prices**, to avoid artificial localisation of profits in a subsidiary of a group. China is looking more and more vigilant in this respect. The new law on income tax, which came into force on 1 January 2008, aims to combat anomalous transfer pricing. With this in view, all businesses reaching a threshold fixed by law must now provide detailed documentation on their transactions, including a description of the structure of group companies, of the transactions and of the transfer pricing methods used. They may also have to provide supplementary documentation if they have made or adhered to a cost division agreement.

Adjustments

The tax authorities have extensive **discretionary powers** in terms of fiscal control. In this context, the authorities carry out **a detailed investigation** into the business's transfer pricing, and may request any accounting documents, including ones originating from target businesses and group companies, or even third parties. The authorities then monitor the company for a **surveillance period** of five years (up from three previously). Two methods are habitually used to re-adjust the price, the **"comparable price"** and **"cost plus"** methods. Note that price adjustments can be applied retrospectively over a maximum period of **ten years**.

Pricing security

In order to avoid adjustments, a business with transactions above **40 million RMB** can enter into an advance pricing agreement (APA) which is valid for three to five years (previously two to four years). Another solu¬tion is an agreement to divide costs including a calculation of expected profits and determination of cost division. On termination of the agreement, the profits must be shared among the parties in a reasonable manner. Development, sales of intangible assets and sharing of profits from services set out in a cost division agreement are **tax deductible from the profits of the companies who are party to this agreement**, on condition that the agreement is registered with the tax authorities within 30 days of its conclusion.

No penalty or administrative sanction

Under Chinese law, the anomalous transfer of profits does not constitute tax evasion. There is no **administrative sanction** set out, beyond the adjustment and possible late payment interest. However a refusal to apply an adjustment decision can result in fines ranging from 50 to 500% of the amount.

Financial advice

Serficom wants to take care of the fortunes of the wealthiest Chinese

A subsidiary of the Swiss private bank Pasche, itself an asset of the French Group CIC-CM, the financial advice firm Serficom Family Office has just this year opened its first offices in Asia, in Shanghai, under the direction of Patrick Nouvel. This venture was made possible with the help of CMS.

Letter from China: why go into China?

Patrick Nouvel: The development strategy of Pasche Bank recently has been to open subsidiaries in all major emerging markets. Serficom Family Office's Shanghai opening took place at the beginning of 2009, subsequent to the opening of our office in Dubai in October 2008. Other offices will be opened throughout 2009.
We have chosen to open our first Asia office in Shanghai because we want to get into this market immediately, knowing that in the near future it will become the most important market in the region.

Why do it now?
The large international banks are pulling back from wealth management advice activities across the world, and in particular in the emerging markets, due to their financial issues. Also, there is currently no activity in China comparable to our business of advisory services for the investment and management of wealth for private individuals.

What is the business of your Chinese office?
It is twofold. First, we supply wealthy Chinese individuals with advisory services relating to select onshore investment products. Then we offer an intermediary service to European SMEs who want to invest in China as well as Chinese SMEs who want to invest abroad and are opening up to the offshore business world of acquisitions and direct investments. We are ready to meet their needs.

What is your aim?
These are wealthy Chinese individuals who are looking to pass on their family assets or whom we can help structure their professional investments across the world, via our intermediaries. Each month there are around 10 more Chinese dollar billionaires. There are currently 415,000 families with over one million dollars of cash available to invest. That is more than there are in France!

Why only asset advisory activity?
Opening an investment consultancy office allows us to enter the Chinese market quickly. If we had been launching a banking operation, the conditions would have been stricter and the approval procedure longer. And we were able to open our office in only six months, thanks to partnerships with firms like CMS.

What are your strengths in this market?
Our group is 100% owned by a large European bank, which is now classed by the Fitch ratings agency among the fifty leading establishments worldwide, in terms of its financial management. Furthermore, we offer the personalised services of a bank on a human scale, with 125 years of experience in this business in Switzerland. ■

Economy

Chinese restructuring: what are the business opportunities?

Chinese restructuring is resolutely focussed on infrastructure, of which the country is in dire need. This situation presents many opportunities, even though the authorities seek to favour national industry.

4000 billion Yuan (over 450 billion Euros), representing 7% of GDP over two years. The Chinese restructuring plan is a real New Deal on the scale of the country and the challenges faced by its economy as a result of the crisis. It is a plan which, as in France, is very focussed on infrastructure: motorway construction, railways, undergrounds, airports etc. More than a quarter of the whole plan budget (1,180 billion Yuan) will be invested directly by the central government, the rest coming from regional investments (2,280 billion Yuan). Few details are available, although the Chinese government has just announced that 1,500 billion Yuan will go into infrastructure projects and 1,000 billion into the reconstruction of regions hit by the Sichuan earthquake in May 2008.

Acceleration of the five-year plan

All these funds will speed up the realisation of the 11th five year plan, which ends next year: 400,000 km of road, 15,000 km of railway, 1,300 km of underground lines and 40 airports are underway. China also wants to increase its port capacity by 80% by 2010. To do this, the five-year plan targets the creation or development of five port hubs. All these projects offer opportunities for foreign investors, even though, to promote local industry, Beijing wants to reserve around 70% of the market for Chinese businesses. The economic crisis is likely to reinforce this tendency. Regarding the road network, however, the financing needs are such that the economic mission in Beijing anticipates that the relevant authorities may "soften the legislation to attract foreign investors". ■

IN BRIEF

China brings in a law on food safety

In the pipeline for several months, the Chinese law on food safety has just been adopted. Widely anticipated following numerous scandals, including the melamine-contaminated milk scandal, the law aims to speed up the building of systems of agricultural sample control, whilst reinforcing quality standards and penalties. It remains now to apply the new rules at the regional level.

Chinese trade balance en route to stabilisation

In 2008, China had a budget surplus of 290 billion dollars. But this new record masks a trend which began in November 2008, with a gradual decrease in Chinese exports. As a consequence of the slowdown in demand, exports fell 25.7% in February 2009. The result is that the February trade balance remains positive, at 4.84 billion dollars, but this is a long way from the figures recorded up to then.

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