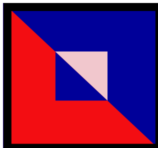

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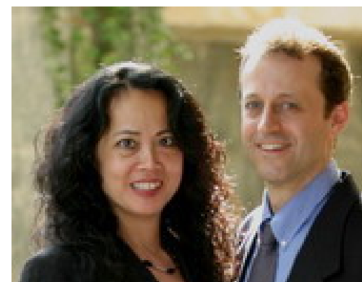
S+C NEWSLETTER Volume 1, Issue 10, May 2, 2007

GREETINGS…

Greetings to our friends, contacts, clients, and associates in the U.S. and China. Frances and I are looking forward to our upcoming visit to Shanghai, Suzhou and Beijing in mid-May. As always, past editions of our newsletter can be found at www.splusc.com/newsletter.htm.

Sincerely,
Aaron Schechter and Frances Chou

HOT TOPICS…



New Real Property Laws in China…

In March, the National's People's Congress passed China's first law codifying the protection of private property. Analysts said that the legislation, theoretically, puts both state and private ownership in China on equal footing. The law had been expected to pass the legislature earlier in 2006, but there was some contentious debate that lengthened the process. Many see the law as a positive step in China's 25 year phase of growing their market economy.

What the law does do is to give some clarity and transparency to the property law situation in China. In China, the state owns all the land, and homeowners and business owners are only able to lease it for 70 years or less. Lease holding is common in countries like the United Kingdom, where there is a clear legal precedent for how to renew. But China's laws had left unanswered what the future could bring. One thing the law does is to automatically extend the right to use. Previously, the right to use for residential property was 70 years. The new law appears to allow leases on land to be extended forever. This gives the rising middle class of homeowners some peace of mind that they can pass on their properties to the next generation and to have an economic incentive to make longer-term improvements. Also, the rights of the homeowner associations have been increased, giving homeowners groups the right to organize so homeowners are not taken advantage of by poor performing property management groups or developers who keep the rights to the common areas of properties. The passage of the new legislation demonstrates the growing power and influence of the growing middle class in China.

Home ownership is high in China, where in the cities homeownership rates can be as high as 80%, compared to 69% in the U.S. While there are speculators, and local regulations to curb them, around 80% of purchasers are buying for their own use. There has been plenty of investment in commercial real estate as well, including foreign investment banks like Morgan Stanley and Goldman Sachs. In 2005, overseas institutions purchased property worth 3.4 billion U.S. dollars in China. In the first quarter of 2006, foreign investors purchased 4.5 billion USD worth of property in China, an increase of 32% over the entire amount for year 2005. Over 90% of foreign investment in China's property market took place in Beijing and Shanghai, and most of that investment came from the U.S., Singapore and Australia. Approximately 88% of the foreign investment was in office and retail properties. Also in 2005, foreign investors invested 5.4 billion USD in the property development sector in China. While experts see the law as a positive breakthrough, there still remains a legal system that needs to be reformed and a relatively open media that have yet to be developed to support the individual rights to the extent that exists in other countries like the U.S. Additionally, the new law does not address protections for poorly educated and weakly organized rural farmers whom corrupt officials are forcing off rural land in growing numbers.

Intel Announces Plans to Build a Chip Fabrication Plant in Dalian...

Intel Corp. announced plans to build a $2.5 billion chip-fabrication plant in Dalian, China, and to begin production in 2010. Intel would be the first semi-conductor company of anywhere near Intel's size and technological strength to build a chip-making factory in China. The plant will build accessory products called chip sets, which do not require cutting-edge production technology that U.S. authorities would not likely approve for export to China. Intel's plant will allow it to be closer to the rest of the computer supply chain and give Intel a larger profile in China, the fastest growing major market in the world.

Following the Carlyle-Xugong Story...

Carlyle Group's is still awaiting approval to buy a revised 45% stake in Xugong Group Construction Machinery for approximately $233 million, reducing it's previously proposed plan for a controlling stake in the company. For more details on this ongoing saga, please see the November 2005, and May and December 2006 Schechter + Chou newsletters at http://www.splusc.com/newsletter.htm. In general, the big buyout firm like Carlyle are scaling back their ambitious plans in China and focusing on minority stakes in Chinese companies, often for less than $100 million.

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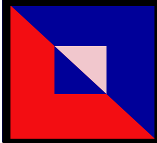

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LEARN THE ROPES…

On March 23 and April 18 and 19, 2007, Frances Chou was the lecturer on Legal Do's and Don'ts for Center for International Trade Development in Riverside, Sacramento and Long Beach..

RECENT DEVELOPMENTS…

Catch the China Wave 2007

On February 22nd, Aaron Schechter was the event leader/organizer and served as the panel moderator for the "Catch the China Wave 2007-Get the Inside Story on Doing Business with China" event at the Jonathan Club in downtown Los Angeles. Over 200 business leaders attended the event, which was co-hosted by the UC Berkeley-Haas Alumni Network-Los Angeles Chapter and the USC Marshall School of Business Alumni Association – Los Angeles Chapter. The panelists included Anne-Marie Boysen, VP of International, Lionsgate; Dr. Yongheng Deng, USC Marshall School of Business; Joy Kovaleski, Founder of Fun Zone, Inc. Jack Shang, CEO, Eforcity, Corp. James Hsu, Partner, Sonnenschein, Nath & Rosenthal. The panelists shared their experiences as well as the opportunities and challenges in doing business with China. Industries included film/entertainment, real estate, sourcing, product development, e-commerce and legal issues.

LEGALLY SPEAKING…

The following is provided by Y.F. Chou, Prof. Corp. For questions, please contact info@yfchou.com.

China Reduces Tax Incentives for Foreign Invested Enterprises

We all knew that this was coming.

China has been providing various tax incentives to foreign invested enterprises ("FIEs") since the early 1990's. However, with China's accession to the WTO in 2001, China is bound to reduce the disparate treatment between FIE's and dometic-funded enterprises ("DEs"). On March 16, 2007, China adopted the new Enterprise Income Tax Law, which will take effect on January 1, 2008, (the "New EIT Law"), abolishing various tax incentives China has been offering FIE's for years. State Council will issue more detailed implementation regulations to take effect together with the New EIT Law.

The most important change involves the reduction of various tax incentives for FIEs. Except in certain specified industries and situations, the low threshold tax incentives available before have been eliminated, such as the 2+3 tax holiday for production-oriented FIEs and the reduced 10% EIT rate for export-oriented FIEs. Also, there is no more tax refund to foreign investors for the purpose of reinvestment in China. However, the New EIT Law does provide provisions concerning grandfathering tax incentives to existing FIEs with specific rules on transition treatment. The effective cutoff date to qualify for grandfathering is March 16, 2007, with exceptions for certain high-tech enterprises established in specific zones and certain investments made in the Western region of China.

Also, the New EIT Law introduces the concept of tax resident status. An enterprise will be considered resident for tax purpose if it is incorporated in China or if it is incorporated outside China but with its actual management office in China. In doing so, those so-called "round-trip investment" enterprises, i.e., those companies owned by offshore holding companies set up by Chinese individuals or companies, will now be taxed as DEs, not FIEs, and will be taxed on their worldwide income. It also adopts a deemed profit distribution clause, which states that if an offshore company established with a round-trip investment structure has retained its profits or reduced its distribution of profits without a reasonable business need, then the shareholder of the Chinese subsidiary will be deemed to have received a distribution and will be taxed accordingly. .

The New EIT Law also includes other provisions affecting FIEs, such as the reduced standard tax rate, the heightened anti-tax avoidance rules, the consolidated tax filings and the indirect foreign tax credit.

Therefore, for those foreign investors, who are interested in taking part of China's dramatic growth, they should really take a good look at the New EIT Law in order to figure out what the actually returns of their investment might be.

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