



Jesa Consulting Ltd.

NEWSLETTER

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What is Jesa?

Jesa is a service company headquartered in Shanghai specializing in facilitating start-up of new industrial productions while providing reliable management and control solutions. We operate 4 main branches in China and a foreign office in Ulaan Baatar (Mongolia). Since 1998, Jesa has built a team of 70 specialized employees in addition to 25 engineers following "in loco" projects. Commercial relationships are exclusive and strictly confidential, ensuring the highest expertise on each single commercial and technical issue. Jesa is a leader in managing manufacturing processes and eliminating any industrial and regulatory problems while helping our clients save financial resources. Jesa is currently expanding its services to provide support to those companies seeking to develop environmental projects in china, such as alternative energies and environmental management.

Unified Corporate Income

Tax Law

The advent of the new unified corporate tax law in is seen as a natural progression of development towards a modern China. The law is set to consolidate two separate enterprise income tax regimes (for domestic and foreign enterprises) into a single regime. This long-awaited tax reform comes as no surprise; yet even now the information that has been supplied is merely a framework of general tax provisions and does not contain any specific information on the various regulations. It is common practice for any major tax reform to be handled in such a way that supplemental tax circulars are introduced over time to facilitate its application. Once the new tax regulations come into effect there is an expected reduction of income tax

revenue collection of up to 93 billion RMB; with collection from domestic enterprises reducing 134 billion RMB and collection from foreign enterprises increasing 41 billion RMB.

The new corporate tax regulation rate is set at 25% but there are still companies that will enjoy a lower tax rate, such as thin-profit enterprises (20%) and high-technological enterprises (15%), *regardless* of their geographic location. For foreign enterprises which are currently facing a 33% tax rate, the benefits of the tax will be immediately seen. To avoid that some foreign companies experience a drastic 15%-point increase in the tax rate (e.g. a company currently enjoying a 10% rate), the government will introduce regulations to gradually phase in the tax over five years.

In addition to this, enterprises which would be negatively affected by the new law and which qualify for (or are currently enjoying) a tax holiday, will be able to maintain their holiday until it expires.

For those companies which have not yet started their tax holidays, they will be forced to commence it as soon as the new law is effective in January. This is done in order to shorten the transition period and to avoid that foreign companies postpone their profit making year in order to leave the lower 'holiday' tax rate for the future.

For companies that have registered after April 1st, 2007, there will no longer be any tax holiday advantages.

The tax law is structured to be industry-based, rather than geographically-based, in order to draw investments into specific sectors which the government considers important.

There will be tax advantages and some preferential treatment applied to manufacturing enterprises, double intensive enterprises, technologically advanced enterprises, service

oriented enterprises in Special Economic Zones (SEZ), and high-new-technology enterprises in hi-tech zones.

It is clear that the PRC is encouraging future overall investment in technological development, environmental protection, energy conservation, production safety, venture capital, projects located in autonomous regions and in the western part of the country, and continuing investment in agriculture, forestry, animal husbandry, fisheries, and infrastructure development. Investment incentives for these areas will come in the form of a combination of tax holidays, lower rates, super deductions, investment tax credits, accelerated deductions/depreciation, etc.

Upon analysis of the different industries in China, it is clear that some will have an overall benefit from the new tax while others will not. The sectors of banking, beverages, communication, coal, steel & iron, petro-chemical, commercial, and real-estate will benefit overall while industries such as electricity, metallurgy, transportation, medical biology, textile & apparel, automotive, home appliances, machinery, and electronic parts will suffer overall. Specifically looking at the impacts to foreign investors within some these industries, varied effects can be seen:

Commercial Retailing

This industry does not belong to either high-tech industries or any other type of encouraged industry. It will therefore be affected in the short-term due to the removal of some of the preferential policies but will recover in the long-term thanks to the massive growth China is experiencing in the consumer market. The relative labour costs, constantly improving commercial legislations, and overall high quality all still remain important factors for foreign investment.

Real-estate

In terms of real-estate, all domestic companies will be benefiting from the reduced

tax level except for those located in Shenzhen, which enjoyed a 15% tax rate previously and will have it raised. For foreign investors, the preferential policies were on the verge of ending in the near future in either case; they will thus be eagerly waiting to hear about the detailed regulations which will be coming out.

Electricity

Since there are few foreign investors operating in this sector, the new law will have little impact. The profits for the industry grew greatly in 2006 (without price rising) and the actual portfolio ratio of many state-owned plants were lower than the loans ratio.

Coal-related Industries

Recently, many foreign investors have put their eyes on coal-related industries despite certain government restrictions in this area. Investment in new-types of coal-chemical development is especially encouraged for foreign investors. Therefore, enterprises involved in this sector will be negatively affected by the new tax and will be experiencing even greater losses if the oil prices decrease, which would magnify the impact of the tax.

As foreign enterprises are gearing up for the new Unified Tax Law, all eyes rest on the government to submit the first supplementary regulations which will clear many doubts still troubling foreign enterprises in China.

Whether or not the law will have a strong impact on your company directly, it will make a large difference in terms of China's progressive development. We should see such reforms as the modernization of a government structure which for many outsiders is still largely unfamiliar.

Sustainable Design in China: opportunities for foreign companies?

By Alessandro Bisagni

Air pollution indexes soar and the world watches. Tense and concerned like schoolchildren facing their first real exam, "developed countries" around the world eagerly monitor and prepare for what could come. China is their focus; the sleeping dragon that has already begun to rise. The latest developments from Beijing tell us that the air was considered "un-breathable" for 24 days of the year in 2006 (double the previous year) and during this time, all denizens had been urged to stay indoors. Perhaps reminiscent of an industrial-age London, this situation is nothing new for our society; however this time it's different. With global warming on the rise and warnings heralded across the globe about the impacts of rising emissions, it seems that we are all now in this together. Thus we remain helpless on the sidelines, watching and waiting to see how China will be able to sustain its unprecedented development while keeping pollution at bay.

However, the idea that foreign countries are helpless is in fact far from the truth. A new market is being created in China - the environmental market. Foreign enterprises are pouncing on opportunities that have been created thanks to the PRC's new environmental agenda. The government's goals are serious and their desire to change, even more so. Overseas companies are realizing that their know-how in this sector offers them a distinct competitive advantage, which the Chinese are willing to invest largely in. Aldo Leopold might turnover in his grave if he ever realized the commercialization of the environment that has occurred; yet this is none-the-less the reality we face and may be the only real chance we have at stopping pollution before it spirals out of control. Foreign companies are bringing innovative ideas to the table on how to tackle environmental hurdles in a profitable way, even though certain

concepts have still to enter into the consciousness of the Chinese businessman. One such progressive concept that is taking place throughout China is the method of sustainable design and construction.

By definition, green construction practices do not just significantly reduce or eliminate the negative impact of buildings on the environment and its occupants but also present a design that is intent on balancing environmental responsiveness, resource efficiency, and cultural and community sensitivity. Taking into consideration that people spend 75 - 90 percent of their lives indoors, it is important to ensure building ergonomics are optimal for its occupants' well-being.

The single largest factor impacting the natural world in China is the built environment. China is spending US\$ 375 billion each year on construction and is, in the process, using 54.7% of the world's production of concrete, 36.1% of the world's steel, and 30.4% of the world's coal. In Shanghai alone there are 400 commercial high-rise buildings constructed each year and a total area of 80,000,000 m² has been used to build new residential areas only in the past five years. Being the world's largest construction market (adding 2 billion square meters of floor space annually), China spends up to 45 percent of its total energy for construction purposes. It is clear that if this rate of construction continues, China will not be able to provide a sufficient amount of energy for all of its structures.

To combat future energy shortages, the government is looking towards energy-efficient buildings and construction practices that will slow down rising energy consumption. The PRC drafted in its current five-year plan, an energy saving objective of 50 percent for new buildings nationwide and up to 65 percent for buildings in the four large municipalities of Beijing, Shanghai, Tianjin, and Chongqing. As a supplement to this, the government supplied a design standard requiring construction contractors to use energy

efficient building materials and adopt energy saving technology in heating, air conditioning, ventilation, and lighting systems in civil buildings.

The largest hurdle that green buildings are facing in China is the opposition from those who feel that construction costs are too high. On average, green buildings cost from 100 RMB to 150 RMB (US\$ 13 -19) *more* per square meter than a typical building. Furthermore, in terms of purchasing behavior, most people are interested in location, design, or neighborhood rather than environmental factors. These misconceptions are slowly changing as numerous studies conducted on energy-efficient buildings are coming out, which prove that while the buildings cost are an extra 2-5 percent in the short-run, the benefits over 20 years can be more than 10 times the original investment (and this is not including qualitative benefits such as occupant well-being which are not factored into the equation).

Investigations have shown that buildings in Shanghai are three times *less* energy-efficient than their counterparts in more developed countries. This is due to a myriad of factors that are all related to poor planning and/or attempts to save short-run construction costs. Yet energy loss can be drastically reduced with the implementation of green construction practices which focus on the general well-being of all building occupants. One of the most important things that can improve overall efficiency is the building envelope. Since the work entails merely improving insulation and implementing more effective windows and doors, the whole process is very cost efficient. The results of this can be seen with regards to improved air quality and a more naturally stable indoor temperature year round. These improvements can be supplemented with the insertion of efficient building technologies that can improve climatic conditions and/or save energy. On more advanced projects, renewable energy sources can be incorporated within the planning of a building, significantly reducing the energy expenditure to the point where it might be entirely self-sustainable. Such technologies

include biogas and water management, solar energy, wind energy, and geothermal energy.

The opportunities to operate in this market are quite high for foreign enterprises and many have decided to take advantage of this opportunity by setting up offices in China. Some companies are providing their services independently to Chinese customers while others have been cooperating directly with Chinese partners for their mutual benefit. There are quite a few examples of large companies working in sustainable design in China. For example; SOM, a U.S.-based company has worked on projects such as the Jim Mao Tower in Shanghai, and ARUP, an English-based company working on the master-planning of eco-cities in China (one located on the island of Chongming near Shanghai). There are also examples of many small-medium enterprises entering the market. Ecobuild is a Sino-German cooperation program that promotes green design in Shanghai and is working to plan eight energy efficient construction projects. The program has also been working to introduce German companies in this market specialized in planning, architecture and engineering, building envelope construction/repair, building technologies, interior decoration, and energy saving and environmental improvement services. This sector is open for entry to virtually any company operating in areas of construction, building technologies, and planning, among others.

The construction sector will remain attractive for enterprises as long as China's expansion continues. The push towards sustainable design is an indication that we are experiencing a paradigm shift in the manner in which our built environment is envisioned. Planners are adding non-traditional energy-saving approaches to their designs and construction companies are altering their techniques to produce efficient buildings. Smaller companies are also benefiting from the sheer demand of technologies and the need of specific know-how on green construction practices. As

China moves into a new stage of development it brings with her ideas and opportunities which are geared towards improving the urban environment and in turn the country's overall ecological and social well-being. It thus looks favourably toward foreign enterprises seeking to enter this market and improve new-China as it grows.

Highlights from Around China

- State breaks own monopoly in oil trade
China has issued new guidelines regarding private company entrance into the crude and processed oil wholesale business, thus further breaking the monopoly the State holds on the market. The guidelines, in the form of two documents released by the Ministry of Commerce (MOC), lay out the details of how domestic and overseas companies can apply to enter the crude and processed oil market.
- Four Foreign Invested Banks Approved to Open Businesses
Four overseas banks have received formal approval for their Shanghai branches to prepare to offer RMB business to Chinese enterprises. This is considered a significant breakthrough in the liberalization of China's banking market. The banks: Citibank, Hong Kong and Shanghai Banking Corp (HSBC), Hong Kong-based Bank of East Asia, and Japan's Mizuho Corporate Bank, were among the first five groups to apply to conduct RMB business with Chinese enterprises. For now HSBC will be able to conduct RMB services with Chinese enterprises only its Shanghai branch but can actually provide its services in all 13 Chinese cities that are open to foreign banks, as well as Jiangsu and Zhejiang provinces. According to the CBRC's (China Banking Regulatory Commission) provision, all of the successful international banks should be prepared for inspection in four months. After this, they will receive the final licence to serve their Chinese clients.

- Tax unification won't upset foreign investment

The Minister of Commerce has publicly declared that the tax unification will not upset foreign investment. The past preferential rate for foreign-invested companies was logical since it helped funnel overseas investment to fuel the nation's economic growth. This unification will now bring the foreign capital utilization to a higher stage. According to the Minister, income tax is but an aspect for investors, who will also take into account other factors, such as infrastructure, science capacity, support services, and investment environment before deciding to enter the mainland market.

- Fuel Oil Tax In Sight

Officials have announced that a new oil tax will be imposed in the near future and the country is thus waiting for the right time to adjust its refined oil pricing mechanism. Reform of the mechanism is closely tied to international oil price fluctuations but the government has to consider the people's capacity to adapt to the changes. The purpose is to link the prices of refined oil products on the domestic market more closely to international levels.

- China issues new regulations on futures trading

The State Council published the country's new regulations on futures trading. They extend its coverage from commodities futures trading to financial futures and option contracts trading. The new regulations, which will come into effect on April 15 of this year, no longer prohibit financial institutions from doing futures trading or raising funds and offering securities for futures trading. The Chinese futures market is required to improve its risk control system by setting up a guarantee fund and an interest compensation mechanism for futures investors, according to the regulations. Currently, investors can only profit when the stock index goes up. With the introduction of index futures, investors will be able to make money when the index falls.



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