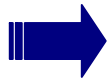




Welcome to the April 2009 edition of Pragma's China Newsletter, prepared by Jesa



## News from Jesa

Economy restoring in China is expected to start in the second half of 2009. Sounds too good to be true?

This is what "*the Economist Intelligence Unit*", linked to the British journal "*The Economist*" is forecasting in an analysis done under the leadership of Mr Stephen Joske, previous member of Beijing Treasury.

One of the biggest effects of the financial crisis is the changes in the growth rates of Chinese Provinces, which is shifting the focus of attention out of the well know "Chinese developed areas". The internal western provinces are growing faster than the other cost side areas, that were considered the "world's factory".

The East Cost Provinces cover a small percentage of the total Chinese Mainland territory and the inhabitants represent only the 20% of Chinese Billionaire Population. Despite this the contribution to the total GDP has always been around 80%.

What this financial crisis is highlighting sharply is that area such as Guangdong, Beijing and Shanghai are deeply affected. Moreover the evidence is that different areas have been hit in very different ways.

The most affected is the South of China. GDP in Guangdong Province, heart of the Economic Miracle of Deng Xiaoping, in 2009 is expecting to growth only at 5.1%.

Due to the geographical position, the companies in this area have always been export-oriented. The export drop has inevitably caused disasters there: many companies shut down and many workers became unemployed, increasing the risks of delinquency and social distress. The luckiest ones are moving to other areas, mainly internal, and accepting lower salaries.

The "Shanghai Area" (Shanghai, Zhejiang, Jiangsu, Shandong), has always been characterized by high private initiative and a more balanced mix among export-oriented production and domestic market. This situation is helping several companies not to be kicked out of the business but they can rely only in minimum part on the government rescue plans.

Regarding the Northern territory, on one side there in Beijing that is facing with the financial crisis but its GDP is suffering less than other Chinese areas thanks to the focus on services and to the vicinity with areas such as Tianjing (usually consider as Beijing's main maritime post). In this area the government is investing a lot to attract foreign investors.

Foreign investors have always preferred costal area because of the infrastructures and development. Government is currently shifting the focus of investment from these areas to the internal provinces where it is still possible to find lower salaries and local incentives. The investment are aimed in improving the infrastructure, communication and skilled labour education to create a suitable environment for foreign investment. The Chinese "race to West" is already started and represents the future of the country. It an important opportunity both for the Government, that will encourage an equal development of the provinces, and the investors that can find new area of investment at lower costs with big space of development in the future.



by Saro Capozzoli  
Founder and GM of  
Jesa Investment &  
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## What is Jesa?



Pragma's and  
Jesa's logos in  
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Jesa is a service company headquartered in Shanghai specialising 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 technicians following "in loco" projects. Commercial relationships are exclusive and strictly confidential, ensuring the highest expertise on every 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 and time.

Jesa is currently expanding its services providing support to those companies seeking to develop distribution network and retail system in China as well as in Mongolia.

We also perform HR audit and investment analysis (trouble-shooting analysis) to verify performances in support to companies already established in China, and we provide tax and accounting consultancy.

## China says No to protectionism clause

US has approved the 900-billion stimulus package on February 13<sup>th</sup> and President Obama in his Saturday address, celebrated the passage of the American Recovery and Reinvestment Act as a "major milestone" on the road to recovery US economy. But the stimulus bill contains some protectionist clauses that makes US trade partners worry. The so-called "Buy American" provision bars the use of foreign steel, iron and manufactured goods for infrastructure projects funded by the massive economic package. Moreover the package restricts banks and other financial institutions that get taxpayers' money as bailout funds from hiring high skilled immigrants on temporary work basis.

Even if US ensured that the provision will not affect existing trade treaty obligations, grave concerns and reactions come from all over the world (Europe, Canada, Japan and China).

Chinese Government announced in a note on February 10<sup>th</sup> by Vice-Commerce Minister that China will not adopt "Buy Chinese" clauses in its stimulus package mirroring the "Buy American" one. Domestic and Chinese goods will be treated as equal as long as there is demands.

Trade protectionism seems to protect domestic industries and jobs, but actually hurts the interest of every country. Zhang Xiaoji, researcher at Development research Centre of State council, a think tank under the Cabinet, defined the protectionism as a double-edge sword. Not only exporters will suffer from the restrictions, but also consumers will be forced to buy more expensive domestically made products.

Moreover, such measures could prolong the economic woes as the history experienced during Great Depression.

What, according to Vice-Commerce Minister, every country should do is to try their best to best meet consumers' demand through international trade and he stressed the quality and prices of its products make an economy competitive.

On the same focus are all Chinese official announcements made in these days.

Vice Premier Zhang Dejiang, during his visits to steel, textile, high-tech and pharmaceutical companies in Hebei province, has urged Chinese companies to shift from quantity to quality.

Government will encourage and support companies that will invest in research and development and boost their growth through technological progress.

Chinese Premier Wen Jiabao announced in February that the government will send a purchasing group to Europe aimed to keep contact and import advanced equipment and technology. This announcement has been confirmed by the spokesman of Ministry of Commerce. A delegation of businesses and industrial association will leave for a four European Countries trip (Spain, Germany, Britain and Switzerland) to buy products ranging from equipment to technology.

During Premier's trip to Europe he called on nations to guard against the protectionism and send a clear signal of China opposed position, calling for other countries to joint the battle.

## New Transfer Pricing Regulation

On January 9<sup>th</sup> 2009, the State Administrative of Taxation (SAT), China's highest tax authority, released "Implementation Measures for Special Tax Adjustments", under which the transfer pricing regulations have been issued.

"Special tax adjustment" refers to "tax avoidance" associated with the use of tax havens via controlled foreign corporations, sham arrangement for the purpose of tax evasion and promulgates the transfer pricing measures together with a set of nine forms that taxpayer will be required to fulfill as part of the annual income tax return filing requirement for FIEs. The document has been issued as implementation rule of Special Taxation adjustment to the Corporate Income Tax (CIT) Law and these provisions take effect retroactively from January 1<sup>st</sup>, 2008.

The document is divided into 13 chapters and the measures are intended to ensure high standard and consistency throughout the different tax bureaus in China, making the transfer pricing discipline uniform in the Country.

Deadline for preparing transfer pricing documentation is May 31<sup>st</sup> and the regulation explains that profits that fall below the median of the inter-quartile range as established by comparable transaction or companies, are supposed to be adjusted to the median.

Two types of related party transaction will be required: the annual reporting and the contemporaneous documentation.

The annual reporting consists of nine forms that include:

- related party relationship;
- summary of related party transaction;
- purchases and sales;
- labour services;
- intangible assets;
- fixed assets;
- financing;
- foreign investment status;
- Foreign payments.

Contemporaneous documentation must be submitted within 15 days in case the tax office will require it and it is more detailed than the annual reporting.

It covers 5 categories that totally include 28 sub categories of information required. Certain enterprises could be exempted from the contemporaneous documentation preparation if:

1. Annual transfer pricing transaction amount is below 200 million RMB in related-party sales and purchases or below 40 million RMB in other-related party transactions;
2. Advance Pricing Arrangement is still effective.
3. They only have related party transaction within China.

A grace period has been given for the preparation of 2008 contemporaneous documentation and the due date has been extended to the end of the year (December 31<sup>st</sup> 2009). The 2008 annual reporting must be fulfilled within May 31<sup>st</sup>. Both documentation for 2009 and onwards must be compelled and submitted within five months from the end of the financial year (May 31<sup>st</sup>).

Since the time for the preparation of the documentation is limited, and only fifteen working days are given to provide the local authorities with entire documentation once they require, enterprises will have few time to collect all documents. Moreover this documentation requires more detailed data than in past years that could not be easy to extrapolate from accounting books and reporting system.

## How to deal with HR in economic downturn

If some companies are facing in this period serious economic problem here in China, probably Mother Companies are trying to answer to hot questions such as: How to deal with workers and employees in economic downturn?

The purpose of the following article is giving a brief overview of the implications of the new labour law and its implementation rules on companies' decision to cut jobs or salaries.

The new Labour contract law, its implementation rules and linked regulations give the complete framework of provisions companies should follow in case of downsizing, stand down of production and salary reduction to handle the HR situation during downturn.

Company can undertake the way of *staff reduction* in case of bankrupt, relevant changes in the business status or production direction or big changes caused by economic situation that make the current labour contract lose the bases on which it has been signed. When company cut at once more than 20 people or 10% of the total workforce it is considered staff reduction and it is regulated by the law.

Some categories of employees such as who has long term labour contract, open ended contract terms, whose family has no other income source, should be kept at work. Moreover in case the company will hire personnel within 6 months, fired employees has the priority. The law also identifies employees that can not be fired by the company, such as who is affected by occupation disease and subjected to medical treatments, female in pregnancy and others.

Economic compensation to the dismissed employees must be paid by the employer on the bases of the years employee has been working in the company (one month salary for each full year of contract). The linked regulation put limits on the monthly salary that can be paid compared to the average salary of the municipality where the company is located. Company that want to *stop the production* in the plant should reach an agreement with the staff and ensure salary and allowance till the dismissal is completed.

In serious operation crisis, Company can also proceed with a *salary reduction* of part of or whole staff. Government welcomes salary reduction if company can avoid labour contracts termination. Company can decrease the work hours (salary cannot be less than local minimum salary), change position or just cut the salary (monthly salary can not be less than 80% or original one neither less than local minimum level).

The mentioned procedures, however, are not just a matter of agreement between the company and the employees and an amendment to the labour contract. Companies are invited to “consider the opinion” of labour union and relevant labour administration bureau. A report outlining the economic situation and contingency plan should be prepared and agreed by both parties. The approval of Labour Union and local labour authorities will allow amendments to the labour contract.

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