



## **The Changing Financial Infrastructure in China and What it Means for Your Business**

### **Introduction**

China, in terms of financial infrastructure, is a unique country and the unprecedented growth in recent times has astounded the world. However, sustaining a stable financial infrastructure is difficult for any country, where boom and bust cycles are common and any system reforms seem to be followed by periods of crisis. Important for China, is to improve supervisory regimes without affecting the operational conditions of the financial institutions. Luckily, the Chinese people hold a different social and economic tradition that has helped to create a secure buffering environment for any financial reforms and has helped in preventing the full impact of the crisis currently being experienced overseas.

The WTO has been offering key advice to enable China to learn from international experience and prosper within a new financial infrastructure. Such initial changes within five years after accession (2001) included allowing foreign financial institutions to provide foreign currency services without restrictions and doing business in RMB with Chinese individuals, even in local areas. This has led on to China creating regulatory bodies to help define a well-balanced regulations system and they have not been afraid to recruit foreign experience to do this. The outcome has been huge investment interest across all sectors.

### **2008 was a Critical Year**

Effective as of the 1<sup>st</sup> of January 2008, China announced the successful unification of the domestic and foreign corporate income tax laws. The new Enterprise Income was brought into effect and thus ended the preferential taxation of foreign businesses in China. A unified rate of 25% has been established, although lower rates are available for high-tech and qualified small profit companies. Also, there is a new tax incentive policy based on industry type and deviating from the old geographically based policies, applicable to high-tech, environmental and energy saving companies.

Current incentives will be phased out over the next 5 years. Anti-tax avoidance rules have been enhanced, giving tax authorities a stronger hand in administration.

By the end of 2008 new rules and regulations surrounding the turnover taxes were revamped and reissued including value added tax (VAT), business tax, and consumption tax. Turnover tax is based on business revenue and in other countries is more commonly known as sales tax, VAT, or goods and services tax. Many quick fixes were implemented to test the water during 2008 and have benefited in easing the economic slowdown on companies, especially as the demand for Chinese goods overseas has waned. Certain policies have been continued into this year, such as eliminating the previous disallowance of input VAT credit on fixed assets and lowering the VAT rate for small-scale taxpayers to 3%, keeping their competitiveness high, and both have been implemented into the new regulations.

Here is a description of each tax, with the important changes noted:

#### *Value Added Tax (VAT)*

This is on the sale of tangible goods and was previously a production-based system. It has now been reformed into a consumption-based policy. The main changes were noted above and there are certain transitional arrangements in place to help companies deal with the new system. Notably the issue of splitting revenue between business tax and VAT tax has been amended, so total revenue must be split at the state and local tax bureaux.

#### *Business Tax*

This applies to service income. Previously, service tax was paid at the location the services were rendered but is now where the taxpayer is located - with the exception being the construction industry. Also, the term "provision of services" has been altered and now the service provider or the recipient in mainland China or its territories can be taxed. Which similarly entails that overseas providers, performing services for a Chinese company outside of China, are now subject to taxation under a "reverse charge" scheme, common in many other countries.

#### *Consumption Tax*

This is based on a selected list of luxury and pollution-creating products. There are no radical changes for the consumption tax but provisional regulations and implementation rules are in place. Starting in 1<sup>st</sup> January 2009 there is an increase in fuel (leaded, unleaded, diesel and aviation) and lubricant tax. However, other fees, surcharges and levies imposed by the local governments have been abolished.

### **Benefits of a System Reform**

In this time of economic struggle the benefits of revising the system can help reduce its impact on businesses and consumers. Moreover, China will be able to fit in alongside other international countries more easily, essentially bringing China to a higher level of standards. During 2009, the aptly named "second wave" of tax reforms will be underway with the turnover tax as the target. One aim is to bring together the

two current business related tax regulations, VAT and BT, into one. But, we will have to wait and see if the amalgamation is successful.

The Chinese accounting system has been well known for being inherently different to that in the Western world. However nowadays, as China becomes more international, it is increasingly easier to find foreign companies doing business here, bringing with them their own way of accounting. Thus, overall, the Chinese approach to accounting is taking a more Western path. *Eyes on China* recognizes this change and, with an international team of experts, is confident in utilizing both approaches to provide its clients with the most effective and efficient *best practices*.

### **Effects on a Foreign Company**

For the foreign company, the change in the income tax law will depend on the type of industry in which they are involved. Current companies already on tax incentives will see an increase in taxation and prospective players will need to take into account the new laws. That said, the government is actively encouraging foreign involvement in China and the announced abolition of “tax holidays” could make entering the Chinese market more appealing. The finishing adjustments to the turnover tax will take time. But, during this period of global financial difficulty, the Chinese government will continue its efforts to sustain China’s overall growth and further its development, particularly in the technological industries.

### ***Eyes on China* has the Full Scope of the new Financial Infrastructure**

*Eyes on China* has a highly experienced team, with expert knowledge of the complex tax situation and the constant changes taking place in China and how these will affect a company, regardless of size or specialized industry. *Eyes on China* has their own in-house accountant available to cover a full range of financial services plus access to internationally recognized specialist partner organizations. *Eyes on China* will, for example, perform bookkeeping, accounting and taxation services according to Chinese practices but using international accounting standards and experience. All financial statements are delivered in English and Chinese.

The comprehensive list of services includes:

- Monthly Bookkeeping
- Revenue, Expense Accruals
- Account Reconciliations
- Inventory Accounting
- Tax Accounting, Filings and Returns
- Risk Management

Despite the global economy woes, *Eyes on China* sees great opportunities for growth in China and with many years experience will always strive to provide the best-in-class service. Best practices from both the East and the West have resulted from a broad range of empowered talent and a first class team environment. The finance management advisory team delivers cost-effective solutions to the client’s tax and finance needs. Importantly, for any existing or prospective business in China, keeping up to date with the tax changes can be a difficult task. *Eyes on China* is proud of its

extensive local knowledge, built up over many years of operational experience. Commonly, there are many local differences between provinces and even cities. For example, from a taxation point of view, incorporating a business in Hong Kong is vastly different to starting up in Beijing.

*Eyes on China* offer a comprehensive auditing service including internal, concurrent, management, operations and efficiency audit services. Also, *Eyes on China* will represent the client at local tax authorities, handling any issues regarding tax audits or other business related issues that may arise during the course of operations.

Other specialist services include accounts payable and accounts receivable. All financial documents are delivered in Chinese, for the Chinese authorities and in English, in the form of reports.

Accounts Payable	Accounts Receivable
Entering bills of vendors tracking	Account for revenue and generate
Input vendor invoices to payable system	invoices
Communicate and manage payments	Input transactions into the system
Reconcile statements to ledger records	Process any changes and maintain ledger
	Prepare and deliver periodic statements

The dynamic tax environment requires a close eye, as many new rules are provisional and subject to change with little notice. Reassuringly, the new system is actually aimed at making it easier to do business in China. However, it is imperative to monitor closely all evolutionary steps over the coming years. *Eyes on China* is well equipped for this task and commits to deliver the optimum financial strategy for business operations in China.