

China Focus. With our latest issue, we share with you insights on the latest China regulatory updates, trends, and other news. Each month, we bring this e-newsletter to you as part of JLJ's value-added service.

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Market Insights

Opportunities & Challenges in China's Pharmaceutical Industry



In 2009, China's central government launched a Healthcare Reform Plan, investing RMB 850 billion to build up a comprehensive national healthcare system to provide basic medical insurance to 90% of the population. As a result, demand for pharmaceuticals have been increasing by about 20% annually with a total output value exceeding RMB 1.2 trillion in 2010, ~5% of China's GDP; China is expected to be the world's 2nd largest pharmaceutical market by 2015.

For foreign players considering entry into China's pharmaceutical market, there are several considerations:

- **Regulatory Environment** - new drug approval from the State Food and Drug Administration (SFDA) can be time consuming and complicated, e.g. officially the approval can take 2-3 months, but in practice can exceed 9 months; additionally, some drugs are subjected to price controls and other regulatory restrictions
- **Fierce Competition** - Over 1,000 foreign and over 5,000 domestic players are currently competing in the market; understanding how the sales and distribution channels work is crucial for success
- **12th Five-Year Plan** - Although the 2009 healthcare reforms are still the most significant, China's 12th Five-Year Plan also encourages the development of new drugs, Traditional Chinese Medicine (TCM), medical devices, and biomedicines, demonstrating that the industry is still receiving attention from the central government.
- **Increasing health consciousness and growing demand** - Chinese people have become more health conscious and are demanding better healthcare services as their incomes continue to increase, which will drive demand for the pharmaceuticals industry well into the near future.

Opportunities may exist in China's pharmaceutical sector; however the challenges of the market can be significant. Above highlights a few considerations for foreign players in regards to potential entry or expansion plans for China's pharmaceutical sector. It is therefore recommended that companies conduct proper market research and fully understand the opportunities and risks of the China market.

For inquiries about this article, or other work of consulting division, please email Mark Ray at mark.ray@ijigroup.com.

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Tax Updates

Clarifications on VAT Reform Pilot in Shanghai

On January 1st 2012, a pilot tax reform was launched in Shanghai designed to resolve issues with double taxation and expand the development of the value-added tax (VAT) system with VAT gradually replacing the function of Business Tax in certain business types within transportation, leasing, and other service industries. The initial project was outlined by Circular 110 and more specifics provided in circular 111. But these initial circulars failed to go into details on some important particulars, such as VAT treatment for export of services. On December 29 2011 the Ministry of Finance (MOF) released Circular 131 to clarify this issue.



Circular 131 describes the exported services scope covered by the pilot and how they will be treated for taxation. The three main service areas which can benefit include:

- **International transportation services** - inbound, outbound and offshore passengers and freight.
- **R&D services** to foreign entities by pilot enterprises and individuals.
- **Design services** to foreign entities by pilot enterprises and individuals - excluding design for real properties located in China.

Only enterprises or individuals who acquired the appropriate qualifications and licenses will be eligible to receive preferential tax treatment offered by the pilot program. Providers of export services who hold general tax payer status will be able to receive zero-rated tax treatment. Those who have small-scale tax payer status will not qualify for zero-rated treatment but will be instead exempt from VAT for providing such services. Both general and small scale payers will be required to report on a monthly basis.

To learn more about the VAT Reform Pilot in Shanghai, contact georgia.zhu@ijigroup.com.

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Human Resources

Tips on Tax for Year End Annual Bonus

It is common practice in China to pay employees their annual bonus right before or right after the Chinese Spring Festival holiday. Since the holiday has just finished and bonus payments are being made, the issue of individual income tax on these bonuses comes up. One issue in particular is the so called "blind spots" in the current tax rate table, where an employee's bonus can be larger than another's, but they end up getting less in the end.

For example, if an employee has a bonus of 18,000 RMB, their net bonus income after tax is 17,460, but if their bonus is 18,001 RMB, their net bonus after tax is just 16,305; over 1,000 RMB more in tax for just 1 RMB more in bonus (assuming taxable salary greater than 3,500 RMB for Chinese, 4,800 RMB for foreigner).

Such blind spots are due to a quirk in the current individual income tax system and occur in the following 6 ranges:



Annual Bonus IIT Blind Spots Range (RMB)

18,000 to 19,283.33
54,000 to 60,187.50
108,000 to 114,600
420,000 to 447,500
660,000 to 706,538.46
960,000 to 1,120,000

*If the annual bonus amount falls between the bottom and top of the ranges, the employee will end getting less net bonus; at the top of the range the net bonus is equal to the bottom.

Although these blind spots are not exactly fair to employees, there are a couple ways to lessen their impact on the net bonus amount:

1. **Split up the bonus:** Coordinate with the HR and finance department to pay the amount of bonus which exceeds the arrest point as part of the following month's salary. The special IIT calculation for annual bonus can only be used once a year, therefore the split portion of the bonus will be taxed as normal salary income.
2. **Make a charitable donation:** According to current policies, an individual donation to designated charities can be deducted from taxable income when calculating individual income tax, including for bonuses.

If an employee donates the portion of their annual bonus, which falls in the "blind spot", this portion would not be taxed. This allows the employee to lower their taxable annual bonus amount and gain the advantage of having it at the bottom of the blind spot range. For this solution an official receipt for the donation is required as proof to make the deduction.

For more information on the annual bonus IIT calculation or other China HR matters, please contact Elaine Yu at Elaine.yu@HROneOnline.com.

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China FDI

Foreign Investment into China's Mining Industry

China will make efforts to improve the mainland's resources utilization efficiency in order to support the 5-years-plan's (5YP) aim to sustain and stabilize social and economic development, said the Land and Resources Minister, Xu Shaoshi. As part of this objective, China is keen to further promote Foreign Direct Investment (FDI) into the mining sector.

The recently held 13th China Mining Congress and Expo in Tianjin featured improved international cooperation and accelerated geological studies. The event attracted over 4,800 government officials and senior representatives in mining and financing industries from all over the globe.



Amid the 5YP's increasing resources demand, China's mining industry is facing development opportunities and challenges, said Xu. There is an effort to modernize China's mines and introduce updated technologies into the mining industry. At the same time, the country will implement a resource and energy-saving strategy to guarantee sustainable growth of the mining sector. Foreign companies are welcome to invest in the Chinese mining market and local companies are encouraged to cooperate with global parties who can not only provide capital but also technology, expertise, and sustainable mining practices.

Currently, the majority of China's mining FDI is in gold, as well as coal, silver and phosphate; however the country is gradually opening the doors to other resource types as well. In Aug. 2011 FDI in the mining industry was valued at over USD 170 billion and was sourced from more than 60 companies, 70% of which was invested by Canadian firms. Experts believe that China inbound FDI will grow further in the mining sector as the market develops.

For more information about FDI into China's Mining Industry, contact Tim Lamb tim.lamb@ijigroup.com.

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The JLJ Group

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China Offices

Shanghai
Suite 603-605
Oriental Center
699 Nanjing West Rd., / Wujiang Rd, 200041
T: +86 21 5211 0068 | F: +86 21 5211 0069

Beijing
Suite 2002, Building 1
Blue Castle International Centre
3 Xi Dawang Rd., Chaoyang District 100026
T: +86 10 6582 0268 | F: +86 10 6582 0251

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