Belt and Road - exploring a blueprint for steady growth in overseas investment

April 2018
US Tax Reform: the impact on Chinese enterprises investing into the US

2.1 Singapore
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3.1 Potential business implications of US tax reform
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3.3 Location selection for Chinese-funded enterprises with US inbound investments

Conclusion and outlook
The global economy has been picking up since 2017, with trade and investment trending positive. China’s economy has also made steady progress. In 2017, global economic growth rose by 3.6%, while China’s economy grew at 6.9%.

China is open towards its integration into the global economy. In 2017, the world saw the fastest economic growth since 2011, while China contributed as high as around one third to the global growth. Chinese companies made steady progress in overseas investment as they act as key players in the improved infrastructure and accelerated industrialization in many developing countries. They have also played a vital role in expanded operations, increased employment and funding among developed countries. In 2017, tightened capital control policy on Chinese overseas investment, the rise of international trade protectionism and the increasingly complex global investment environment resulted in a decline in Chinese overseas investment. However, the steady adjustment in outbound investment, continued optimization of industry structure and the enthusiastic advancement of Belt and Road Initiative (BRI) give us confidence in the future of China overseas investment.

“Going abroad” is the inevitable trend for Chinese investors. In 2018, companies will further deepen their “going abroad” journey in BRI. These investments help the transformation and upgrade of Chinese real economy which will continue to be supported by the Government, and thus, push the Chinese companies to accelerate the pace of the globalization.

I hope Chinese investors will find this issue of China Go Abroad insightful and inspiring, and EY professionals will always be here to assist you go with the tide and seize opportunities in overseas investment.
With 15 years of rapid development, China has seen compelling achievements in overseas investment and China’s outward direct investment flow ranked 2nd only to the United States in 2016, rising from 26th in 2002. Although the overall scale declined in 2017, investment and cooperation along the Belt and Road (B&R) keeps thriving.
Executive summary

Loletta Chow
Global China Overseas Investment Network Leader

With 15 years of rapid development, China has seen compelling achievements in overseas investment and China's outward direct investment (ODI) flow ranked 2nd only to the United States (US) in 2016, rising from 26th in 2002. Against the backdrop of tightened capital control in China and increased global investment uncertainties in 2017, China's ODI decreased by 32% on a year-on-year (YoY) basis to US$134 billion, reflecting a shift to a steady adjustment period.

In 2017, disclosed deal value of China overseas mergers and acquisitions (M&As) dropped to US$144.8 billion, down by 32% YoY. Despite a significant decline in Chinese overseas M&As, deal value in automotive and transportation, power and utilities, oil and gas and life sciences sectors posted a YoY increase, while technology, media and telecommunications (TMT) and diversified industrial products ranked the first two sectors by deal volume for two consecutive years. This shows even though the scale of China outbound investment decreased in 2017, investments in real economy still keep a steady momentum.

2017 was a fruitful year for the development of BRI. M&A deal value in the B&R countries disclosed by Chinese companies climbed to US$48.2 billion, up by 81% YoY, among which, M&As in ASEAN countries reached a new high, representing a quarter of the total deal value of Chinese overseas M&As disclosed. As a member of ASEAN and an important B&R country, Singapore attracted the most Chinese M&A capitals and replaced the US as the most popular destination for Chinese oversea M&As in 2017. Over the past few years, ASEAN's economy has seen steady progress. Benefiting from ample human resources and extensive opportunities in infrastructure and other sectors, ASEAN is drawing increasing attention from investors. Looking forward, China and ASEAN are expected to further improve their relationship and expand broader cooperation in BRI. In Section 2 of this report, we will focus on the investment environment in three member countries of ASEAN - Singapore, Malaysia and Indonesia and their growth potential under BRI.

By the end of 2017, the US President Donald Trump signed a US$1.5 trillion tax bill into the law, seen as the most drastic tax overhaul in 30 years - the bill has been passed and come into effect since January 2018. EY has identified that the new policy will improve US investment attractiveness for Chinese companies via the reduced corporate income tax rate and the simplified US tax system. However, challenges always come with opportunities. In Section 3, we will find out how the US tax reform affects Chinese enterprises' investment in the US.

In October 2017, the 19th Communist Party of China (CPC) National Congress was convened successfully. During the conference, BRI was not only established with high priority for future Chinese companies to go out, but also incorporated into the CPC Constitution, demonstrating China's determination to promote BRI to achieve regional cooperation, build a new type of international relations and seek win-win outcomes with all countries involved. We believe that China will take a firmer step towards going out, while Chinese companies are expected to raise their competitiveness and influence and will do even better in the era of globalization.

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1 Source: MOFCOM
2 Source: MOFCOM, State Administration of Foreign Exchange (SAFE), EY analysis
3 Source: Mergermarket, including data for Hong Kong, Macau and Taiwan
China outbound investment has entered into a steady adjustment period

Over the past 15 years, China has seen compelling achievements in overseas investment. Representing 13.5% of total global FDI outflows rising from 0.5% in 2002, China’s ODI has been increasing for 14 consecutive years from 2002 to 2016, which shows that Chinese companies are raising their profiles in global investment. In 2016, China’s ODI flow reached a new record high of US$196.2 billion and ranked second only to the US (US$299 billion) 4.

In the context of complex global investment environment and tightened domestic regulation on cross-border investment, China’s ODI amounted to US$134 billion, down by 32% YoY. Along with a substantial drop, China outbound investment showed three characteristics, reflecting a shift from rapid expansion to a steady adjustment period.

Firstly, industrial structure continued to optimize, with investment focused on real economy sector. Against the backdrop of a significant decline in China’s ODI last year, investment mainly went to sectors closely related to the real economy, including leasing and commercial services, wholesale and retail, manufacturing and information technology sectors 4.

Secondly, investment is being stabilized and regain growth momentum at the year end. The decline of China’s non-financial ODI in 2017 H2 was 34 percentage points less than that in 2017 H1. In November and December, China’s non-financial ODI rose by 35% and 49% respectively, contributing to the narrowed YOY decline for the whole of 20174.

Thirdly, investments to B&R countries increased despite overall drop in China outbound investment. In 2017, Chinese companies made non-financial ODI of US$14.4 billion in 59 countries along the B&R, accounting for 12% of total non-financial ODI, up 3.5 percentage points YoY, while total value of newly signed overseas contracted projects amounted to US$144.3 billion, up 15% YoY4.

Figure 1: China’s ODI flows, 2002-2017 (US$ billion)

Source: MOFCOM, National Bureau of Statistics of China, State Administration of Foreign Exchange (SAFE)
1.1 Sector analysis

Industrial structure continues to optimize

With respect to overseas M&As, total investment announced by Chinese companies fell 32% YoY to US$144.8 billion in 2017, while the number of deals declined 12% to 620. Against the backdrop of overall slowdown in outbound investment, transactions in the automotive and transportation sector thrived, making it the most popular sector among investors in 2017. By deal value, the automotive and transportation sector ranked the highest, followed by power and utilities and TMT, all of which represented more than 60% of total China overseas M&As.

On the other hand, the TMT (148) and diversified industrial products (108) sectors have led by deal volume for two consecutive years (2016 and 2017). And life sciences (78) exceeded consumer products by deal volume to rank 3rd, with an increase of 26% YoY.

Figure 2: China overseas M&As by sectors for 2016 and 2017, by value (US$ billion)

Figure 3: China overseas M&As by sectors for 2016 and 2017, by volume

Source: Mergermarket, including data for Hong Kong, Macau and Taiwan
<table>
<thead>
<tr>
<th>Investor</th>
<th>Target</th>
<th>Country</th>
<th>Sector</th>
<th>Value (US$ billion)</th>
<th>Key investment considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vanke, Hopu Investment, Hill House Capital, BOCGI, Management of Global Logistic Properties Limited</td>
<td>Global Logistic Properties Limited</td>
<td>Singapore</td>
<td>Automotive and transportation (Logistics Real Estate)</td>
<td>16.0</td>
<td>Complementing each other’s advantages; global footprint expansion in logistic properties business; exploring new business model</td>
</tr>
<tr>
<td>China Investment Corporation</td>
<td>LogiCor Europe Limited</td>
<td>United Kingdom (UK)</td>
<td>Automotive and transportation (Logistics Real Estate)</td>
<td>13.8</td>
<td>Optimistic for the outlook of e-commerce and logistics in Europe; stable and attractive investment return</td>
</tr>
<tr>
<td>CK Infrastructure Holdings, CK Property Holdings, Power Assets Holdings</td>
<td>Duet Group</td>
<td>Australia</td>
<td>Power and utilities</td>
<td>9.8</td>
<td>Resources allocation optimization; market expansion into Australian, European and American power and energy sector</td>
</tr>
<tr>
<td>CEFC China Energy Company Limited</td>
<td>Rosneft Oil Company OAO</td>
<td>Russia</td>
<td>Oil and gas</td>
<td>9.3</td>
<td>Strengthening cooperation in energy sector; deepening economic ties with Russia</td>
</tr>
<tr>
<td>CITIC Group, Charoen Pokphand Group, CHEC, China Merchants Group, TEDA, Yunnan Construction Engineering Group</td>
<td>Kyaukpyu port</td>
<td>Myanmar</td>
<td>Automotive and transportation</td>
<td>5.0</td>
<td>Establishing presence in B&amp;R countries; expanding oil and gas transmission channels</td>
</tr>
<tr>
<td>State Grid</td>
<td>CPFL Energia</td>
<td>Brazil</td>
<td>Power and utilities</td>
<td>4.0</td>
<td>Market expansion in power and energy sector in Brazil; enhancing Sino-Brazil economic ties</td>
</tr>
<tr>
<td>CK Asset Holdings</td>
<td>Reliance Home Comfort</td>
<td>Canada</td>
<td>Consumer products</td>
<td>3.6</td>
<td>Stable investment return; anti-cycle feature of the investment; market expansion in utilities sector in Canada</td>
</tr>
<tr>
<td>Zhejiang Geely Holding Group</td>
<td>AB Volvo</td>
<td>Sweden</td>
<td>Automotive and transportation</td>
<td>3.2</td>
<td>Strategic investment to expand commercial vehicle and construction equipment market</td>
</tr>
<tr>
<td>Chow Tai Fook</td>
<td>Alinta Energy</td>
<td>Australia</td>
<td>Power and utilities</td>
<td>3.1</td>
<td>Diversification strategy; cash flow optimization; optimistic about Australian power and energy sector development</td>
</tr>
<tr>
<td>AIA Group</td>
<td>Commonwealth Bank of Australia (life insurance unit)</td>
<td>Australia</td>
<td>Financial Services</td>
<td>3.0</td>
<td>Expanding market shares; consolidating the leading position in the market; enhancing distribution capability in Oceania to boost profits</td>
</tr>
</tbody>
</table>

Source: Mergermarket

Note: As liabilities to be borne by investors might be included, deal value may be different from that available to the public.
EY observes that, Chinese enterprises maintain strong appetite in investing overseas targets in automotive and transportation sector (including logistics real estate).

Future transportation features land-to-sea connectivity

The automotive and transportation sector thrived in 2017 as transactions reached peak levels in history.

In 2017, the deal value of China overseas M&As in the automotive and transportation sector swelled to US$45.1 billion, up 504% YoY. 4 out of the top 10 overseas M&As came from the automotive and transportation sector. In the context of further advancement of the BRI, Chinese logistics, warehousing and port companies invest actively in B&R countries, especially in the logistics and transportation markets in Singapore, Myanmar and Malaysia. Through active investment and M&As, Chinese companies have improved facility connectivity and trade facilitation between China and the local countries; expanded the transportation, warehousing and logistics markets; broadened profit growth sources and improved core competitiveness and capabilities to manage external risks. EY believes the development of transportation is the foundation for facility connectivity. With further development of the BRI, Chinese enterprises will continue expanding their footprint in the global automotive and transportation market (especially in Asia) as they gain more international competitiveness.

Total global goods exports will reach US$68 trillion by 2050

HSBC forecast

Asia's share of global exports is predicted to reach 46% in 2050, compared with 33% in 2015.

HSBC forecast

Asia is projected to become 64% urban by 2050.

UN forecast

In the meantime, as China has been boosting the industrial and consumption upgrade in domestic life sciences sector, China overseas investment in the sector surged due to expanded market demand. The trend is expected to continue in the upcoming years.

Innovation-driven growth leads more life sciences companies to go out

EY believes that Chinese life sciences companies are seeking growth through innovation and diversification, and they will maintain momentum to bring more life sciences technologies, brands and principles into China via cross-border M&As.

China's life sciences sector has been shifting business model to become innovation-driven in recent years. At present, more than RMB20 billion of special funds are available for technology and high-tech industrialization*. With the advancement of the China Food and Drug Administration's (CFDA) drug approval system reform, a series of policies such as quality and efficacy consistency evaluation of generic drugs, single disease payment, and two-invoice system will not only shorten the investment return cycle of innovative drugs and devices with clear clinical value, but also accelerate industry consolidation. In addition, enterprise scale expansion sets the foundation for R&D innovation and overseas M&As.

Driven by favorable policies and markets, Chinese life sciences companies achieved significant growth in 2017, with the added value of the pharmaceutical industry above designated size rising by 12.4%*, much higher than the GDP growth rate.

China overseas M&As in life sciences sector has maintained an annual growth rate of more than 40% in the last three years.

Mergermarket, 2015-2017

Source: people.cn

* Note: According to National Bureau of Statistics of China, “industrial enterprises above designated size” refers to the industrial enterprises with RMB20 million annual income or more from the core business.
Consumption upgrade and the aging problem both spur domestic demand for health-care services. In 2016, China issued the Healthy China 2030 Planning Outline which will act as the action guideline for building a healthy China in the coming 15 years. As per the Outline, China will be engaging in several major objectives including improving China's healthcare services, developing China's health industries and establishing basic medical and health care system in the upcoming years. Boosted by thriving domestic demand and national strategies, China has been very active in cross-border M&As in the life sciences sector in the last few years. Data show that China overseas M&As in the life sciences sector have enjoyed an annual growth of more than 40% for three consecutive years. In 2017, disclosed value of China overseas M&As increased 61% YOY to US$9.9 billion.

In recent years, Chinese overseas investments in life sciences sector show four characteristics. Firstly, both pharmaceutical groups and institutional investors increase investments in innovative products and technologies. In September 2017, Shangdong Weigao Group Medical Polymer acquired Arqon Medical Devices for US$850 million, whose innovative biopsy and vascular interventional products are sought after in China. In November 2017, MicroPort Medical acquired the cardiac rhythm management business of LivaNova for US$190 million, sealing its place as one of the key players in China's cardiac rhythm management industry. Driven by domestic consumers' increasing health awareness and the reformed consumption structure, M&As in the health care products market are increasingly dynamic. Chinese investors made several acquisitions of Australian healthcare companies. The latest case is the acquisition of Life-Space, an Australia-based probiotics supplier, by China's By-Health for US$550 million in January 2018. The transaction helps integrate both the product and business strengths in respective market segments and may generate new growth opportunities and realize greater value. Secondly, Chinese enterprises achieve synergy across different businesses along the industrial value chain to strengthen corporate competitiveness. In June 2017, Humanwell Healthcare and a Chinese-based consortium acquired RiteDose, a US-based market leader in blow-fill-seal (BFS) manufacturing for US$610 million. And target to introduce the BFS technology to Hubei Province in the future. Thirdly, Chinese enterprises realize their international strategies through overseas M&As. In September 2017, Fosun Pharma acquired a 74% stake in India-based Gland Pharma for US$1.1 billion. The deal greatly increased Fosun's global presence, as India is one of the key pharmaceutical markets. At last, transactions are in line with national strategies and corporate demands, while the BRI drives regional investments. On one hand, Chinese companies are doing more M&As in the B&R countries with leading positions in the life sciences sector such as Singapore and Israel. Blue Sail Medical acquired Biosensors International Group, a medical equipment company in Singapore, for nearly US$1.2 billion at the end of 2017, which was the largest single deal in medical equipment industry in B&R countries. On the other hand, Chinese companies start to seek more investment opportunities in the B&R countries which have huge populations but undeveloped health infrastructures, such as India, Vietnam and Thailand.

EY predicts that Chinese overseas investment in life sciences sector is expected to continue achieving rapid growth, while innovative technologies and products and life sciences companies along the B&R will keep being targets of Chinese enterprises.

Figure 5: Major China overseas M&As in life sciences sector since 2017

<table>
<thead>
<tr>
<th>Investor</th>
<th>Target</th>
<th>Sector</th>
<th>Value (US$100 m)</th>
<th>Key investment considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creat Group</td>
<td>Biotest</td>
<td>Pharmacy</td>
<td>16</td>
<td>Product line expansion</td>
</tr>
<tr>
<td>Bluesail Medical</td>
<td>Biosensors International</td>
<td>Medical equipment</td>
<td>12</td>
<td>Product line expansion</td>
</tr>
<tr>
<td>Fosun Pharma</td>
<td>Gland Pharma</td>
<td>Pharmacy</td>
<td>11</td>
<td>Product line synergy and global market expansion</td>
</tr>
<tr>
<td>Shangdong Weigao</td>
<td>Arqon</td>
<td>Medical equipment</td>
<td>8.5</td>
<td>Product line and global market expansion</td>
</tr>
<tr>
<td>Sanpower Group</td>
<td>Dendreon</td>
<td>Pharmacy</td>
<td>8.2</td>
<td>Product line expansion</td>
</tr>
<tr>
<td>Humanwell Healthcare</td>
<td>RiteDose</td>
<td>Pharmacy</td>
<td>6.1</td>
<td>Advanced production technologies introduction</td>
</tr>
<tr>
<td>Consortium led by GL Capital</td>
<td>SciClone Pharmaceuticals</td>
<td>Pharmacy</td>
<td>6.0</td>
<td>Financial investment</td>
</tr>
<tr>
<td>Shanghai Pharma</td>
<td>Cardinal Health</td>
<td>Medicine circulation</td>
<td>5.6</td>
<td>Industrial consolidation</td>
</tr>
<tr>
<td>By-Health</td>
<td>Life-Space</td>
<td>Health care products</td>
<td>5.5</td>
<td>Product line expansion</td>
</tr>
<tr>
<td>Jiangsu Yuyue Medical Equipment &amp; Supply</td>
<td>Esaote</td>
<td>Medical equipment</td>
<td>3.1</td>
<td>Product line and global market expansion</td>
</tr>
</tbody>
</table>

Source: Capital IQ, public information
1.2 Regional analysis

BRI creates strong momentum while ASEAN leads the growth

In 2017, China saw a decline in M&As in Europe and the Americas but a significant increase in M&As in Asia (especially ASEAN) and Oceania.

Figure 6: Regional analysis of China overseas M&As over the last five years, by value (US$ billion)

Source: Mergermarket, including data for Hong Kong, Macau and Taiwan

China overseas M&As in Europe fell by 50%, while the automotive and transportation sector was the most popular among investors. In 2017, Chinese companies posted a decline by 51% YoY to US$47.6 billion in M&As in Europe, outperformed other continents and remained the most attractive destination for Chinese investors. By deal value, the automotive and transportation, oil and gas, and industrial products sectors ranked top three in China overseas M&As in Europe in 2017. By country, the UK ranked the first in Europe, the third globally as the most popular investment destination, which saw 68% increase in M&As made by Chinese investors in 2017, mainly targeting the automotive and transportation and TMT sectors. China Investment Corporation acquired Logicor, a leading logistics company based in London for US$13.8 billion, making it one of the largest M&As in the automotive and transportation sector in Europe in 2017.

China overseas M&As in Asia hit a new record high while ASEAN showed great potential. In 2017, the deal value of China overseas M&As in Asia hit a new record high to US$44.5 billion, ranking second of the 6 continents. As the BRI develops, investment cooperation among China and other Asian countries was further strengthened. In 2017, the deal value of Chinese M&As in ASEAN surged to US$34.1 billion, rising by 268% and representing 77% of the total value of Chinese M&As in Asia. As the largest China overseas M&A in 2017, a Chinese consortium acquired Singaporean logistics real estate giant Global Logistic Properties (GLP) for US$15.9 billion. EY believes ASEAN is becoming a key investment destination in Asia for Chinese companies with its geographic advantage as a trade hub under BRI, along with the investment opportunities in the infrastructure, technology, energy and mining sectors, ample human resources and vast market potential.

China overseas M&As in North America dropped by more than 60%, and Chinese investors tend to be more prudent. In 2017, the deal value of Chinese M&As in North America decreased by 68%, and fell sharply by 78% to US$13.8 billion in the US, dropping out of the top three destinations of Chinese overseas M&As. The decline could be a combined outcome of China’s stricter rule on overseas investment and the scrutiny imposed on foreign investment by the US. However, in 2017, Chinese enterprises totally made 144 M&As in the US, showing it’s still Chinese investors’ favorite investment destination by volume. We estimate sectors such as TMT, life sciences and diversified industrial products will attract more attention.

China overseas M&As in Oceania grew by more than 4 times, focusing on utilities and financial services. In 2017, Australia became the second largest destination for China overseas M&As, and the transactions were mainly in the power and utilities and financial services sectors, driving total deal value increased by 413% to US$19.5 billion in Oceania. Major deals included CK Infrastructure’s acquisition of Australian utility operator Duet Group (US$9.8 billion), Chow Tai Fook’s acquisition of Australian energy company Alinta Energy (US$3.1 billion) and AIA’s purchase of the life insurance business of Commonwealth Bank of Australia (US$3 billion).

Source: Mergermarket, data show that top 5 destinations for Chinese overseas M&A in 2017 were Singapore, Australia, UK, United States and Russia, however, the United States was the largest destination for Chinese overseas M&A in 2013-2016.
1.3 19th CPC National Congress formulates a new “going global” blueprint

In recent years, China has been playing an increasingly significant role as the world's economic growth engine. With steady growth on its own, China also speeds up the efforts to promote BRI so as to enhance regional connectivity and pursue the new order for international cooperation by establishing the Asian Infrastructure Investment Bank (AIIB) and the Silk Road Fund and other activities. The 19th CPC National Congress stated that the BRI should be taken as a priority to make new ground in pursuing China to open up on all fronts, and as such, the initiative was enshrined in the party constitution to step up such effort and internationalization. We predict 5 trends of China "going global" after the 19th CPC National Congress as follow:

1. **Promoting the real economy becomes a major consideration for overseas investment**

The real economy is the foundation of economic strength that makes China prosper. The Party's Report to the 19th CPC National Congress (the Report) states: “we must focus on the real economy”. Therefore, China had launched the revitalization plan for 10 key industries since the global financial crisis and issued *Made in China 2025* in 2015. Through these national policies, the country has been keeping a firm grip on the real economy as a base to stabilize its domestic economic development. EY believes that as the real economy is gaining traction, facilitating the development of China's real economy will become a key consideration for overseas investment which will focus on industries such as advanced manufacturing, high-end consumer goods, high technology, environmental protection, pharmaceuticals and education.

2. **Going global strategy is deeply incorporated with BRI - infrastructure construction, trade and green field investment are the major cooperation models**

The Report stresses that “we should pursue the BRI as a priority, give equal emphasis to ‘bringing in’ and ‘going global’” and proposes to “build a community with a shared future for mankind”. Since the BRI was proposed five years ago, China has been pursuing unimpeded trade, facilities connectivity and financial integration with related countries, providing new impetus to the economic recovery and sustainable development of the countries along and beyond. Infrastructure construction, trade and green field investment have then become the major cooperation models. Outbound investment is an important way to promote the initiative as well as allowing Chinese enterprises to deeply participate in the international division of labor and optimize their resources allocation. The resources and the markets of the B&R countries can complement the industrial and technological advantages of Chinese enterprises in railway transportation, power, telecommunications and infrastructure sectors. Despite the ever changing international environment, Chinese companies still have many opportunities. In the future, Chinese investment into the B&R regions is likely to keep rising.

3. **Chinese enterprises will further enhance globalization: international financing and supply chain will be the trend**

As the Report notes, “we will turn Chinese companies into world-class, globally competitive enterprises”. As China speeds up its participation in the race of globalization, international operation has great significance for the country in transforming its economic development mode and economic structure. The international supply chain requires enterprises to have a global mindset when they expand supply chain systems globally and when they carry out related planning, coordination, operation, control and optimization. On the other hand, international financing is also critical for enterprises to go global because it can help ease the funding shortage as they accelerate internationalization. This is reflected by the development of the BRI as related bonds have been issued at home and abroad by several banks.

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10 Source: Xinhua news agency
11 Source: National Development and Reform Commission
Moreover, the BRI drives the RMB internationalization which can in turn facilitate China's foreign trade and investment. In January 2018, Pakistan agreed to use the RMB for bilateral trade with China12 and the RMB is also likely to be used in the projects under the China-Pakistan Economic Corridor. The Russian Direct Investment Fund (RDIF) also signed an agreement with China Development Bank in July 2017 for the proposed establishment of the China-Russia RMB Investment Cooperation Fund of RMB 68 billion to invest in bilateral projects under the BRI and the Eurasian Economic Union proposed by Russia13. This cooperation allows Chinese investors to make investments in RMB and has the potential to shore up cross-border direct investment and joint projects between these two countries.

4 The explosive growth in demand for international talents will determine the increment of overseas investment

The report states that “talent is a strategic resource for China as it endeavors to achieve national rejuvenation and stay ahead in international competition”. The further global development of Chinese enterprises steps up the demand for international talents who are able to communicate in foreign languages, understand common international rules, command rich professional knowledge and innovation capabilities as well as intercultural competence. For instance, there are more than 50 official languages in the countries and regions along the B&R but only 20 out of those are covered as major foreign language courses in colleges. So far, BRI faces a shortage of foreign language talents (such as Arabic and Hindi). One EY survey in 2017 shows that local talents recruitment and retention is one of the biggest challenges encountered by Chinese enterprises in managing their overseas business. EY predicts that the explosive growth in demand for international talents will determine the increment of overseas investment. Enterprises may implement due diligence on human resources before M&A and align the talents strategy with M&A goals to maximize the benefits from human resources.

5 Policies will be become more stable and predictable, promoting healthy and rapid growth of overseas investment

Since 2013, Chinese authorities have made great efforts to push forward the reform to “streamline administration, delegate power, strengthen regulation and improve service”, making substantive progress for the facilitation of China overseas investment. As the Report noted, “we will develop new ways to improve macro-regulation, give full play to the strategic guidance of national development plans”. Under this guideline, review process on overseas investment has now generally shifted from an “approval” to a “record-filing system” to greatly facilitate investment. The National Development and Reform Commission (NDRC) issued new Administrative Measures for Outbound Investment by Enterprises in December 2017. It streamlines administrative procedures and delegates power, while strengthening regulation over outbound investment to increase investment quality. We foresee the new measures, as the foundation for China's overseas investment management, will play a significant role in normalizing and guiding Chinese enterprises in foreign investment, optimizing related comprehensive services, improving regulation throughout overseas investment and promoting its healthy development.

Figure 7: Overview of Administrative Measures for Outbound Investment by Enterprises

<table>
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<th>Key Implication</th>
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<td>Issued with the purpose of simplifying approval procedures and strengthening regulation over outbound investment by domestic firms to facilitate enterprises going global</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eased procedures before investment</td>
</tr>
<tr>
<td>Strengthened comprehensive supervision</td>
</tr>
</tbody>
</table>

- Removal of “confirmation letter” (Road-pass). Chinese companies that acquire or bid for overseas projects worth over $300 million are no longer required to report project information beforehand and obtain confirmation.
- Relax requirements on the deadlines for companies to obtain approvals or file records. Chinese investors shall obtain the verification and approval document or the record-filing notice prior to the implementation of the project (actual payment of funds).
- Waived first round review of local NDRC's counterpart and handover procedures. Allow direct online applications for projects under NDRC's jurisdiction.
- Reduced process assessment time. Time limit is reduced to 30 days or less (except for extraordinary circumstances).
- Redefined outbound investment activities, broadened the range of investors and scope of outbound investments by financial institutions under supervision.
- End to end regulation through the investment process to strengthen disciplinary actions.

Source: NDRC, compiled by EY

12 Source: Yicai
13 Source: website of China Development Bank Capital
The BRI is leading the way in pursuing opening up on all fronts

The B&R connectivity updates

Policy coordination:
- 86 countries, regions and international organizations have signed 100 cooperation agreements with China on jointly building the B&R.
- By October 2017, China has signed bilateral tax treaties, agreements and arrangements with 106 countries and regions, within which 54 countries are along the B&R.

Facilities connectivity:
- During 2017, 3,600 China-Europe freight trains offered their services, surpassing the total number of combined runs from the previous 6 years.
- In 2017, China has signed contracted projects worth of US$144.3 billion with 61 countries along the B&R, accounting for 54% of total value and increased by 15% YoY.

Unimpeded trade:
- In 2017, China’s imports and exports with B&R countries recorded a total value of RMB7.37 trillion, up 17.8% YoY.
- China is developing 75 overseas economic and trade cooperation zones along the B&R. Accumulative investment has exceeded US$27 billion, attracting nearly 3,500 companies to move in. This also has contributed US$2.2 billion taxes to the local countries and has created nearly 210,000 jobs.

Financial integration:
- Chinese enterprises invested US$14.4 billion into 59 countries along the route in 2017, accounting for 12% of the total, up 3.5 percentage points YoY.
- AIIB has approved 24 projects and issued nearly US$4.2 billion of loans since its opening in 2016.

People-to-people bond:
- China reached agreement with 24 B&R countries on mutual academic degree recognition.
- The “Silk Road Scholarship” from the Chinese Government offers no less than 3,000 new scholarships each year for students from B&R countries.

14 Source: Belt and Road Portal
15 Source: General Administration of Customs, EY Analysis
16 Source: Ministry of Education
Key area along the B&R - ASEAN

As the regional hub of BRI, ASEAN is critical for the connectivity between China and other countries along the route. Besides its critical geographical position, ASEAN is attracting more attention from investors with its young population, large labor force, abundant natural resources and huge opportunities to invest in its infrastructure sector.

ASEAN has attributed steady growth in recent years and seen broader prospects for cooperation with China. The two parties have agreed to improve their connectivity through integrating “Master Plan on ASEAN Connectivity 2025” and the BRI. 2017 marks the 50th anniversary of ASEAN and by 2018, it is 15 years since China established a strategic partnership with it. Building on this occasion, the two parties should deepen trade and investment cooperation to create greater growth opportunities. By 2020, the trade volume between China and ASEAN and new two-way investment may reach US$1 trillion and US$150 billion, respectively10.

The 15th China-ASEAN Expo in March this year set a clear direction on future collaboration between China and ASEAN countries. They will continue to promote infrastructure cooperation, deepen international production capacity cooperation, build demonstrative economic and trade industrial parks, as well as cross-border industrial chains. In addition, a China-Asean projects database is planned to improve information connectivity.
2.1 Singapore

As an important member of ASEAN, Singapore serves as the regional hub of finance, trade, services and shipping. It assumes a critical role for the BRI. As it is developing the connectivity and bilateral relations with China, Singapore is also the launch pad for Chinese enterprise to expand in the Southeast Asian market.

2.1.1 An overview of Singapore’s economy and investment environment

Top 3 industries by GDP:
manufacturing, wholesale and retail, and business services
Singapore Department of Statistics

2018 projected GDP growth 2.6%
IMF

Rank 2nd on the Ease of Doing Business
World Bank 2017

World’s 3rd largest center for foreign exchange trading and offshore RMB settlements
China’s Ministry of Commerce

The 3rd most innovative country
Bloomberg Innovation Index 2018

Located in the core area of ASEAN and adjacent to Indonesia and Malaysia, Singapore enjoys an extraordinary geographical advantage in connecting with ASEAN countries and maintaining close commercial relationship with major Asian and western countries, including China, Japan, South Korea and the US, making it a business hub that can link the whole Southeast Asia and even the Asia-Pacific market[17]. Moreover, Singapore has high ranks on an array of core indicators related to making investment and doing business, such as the Ease of Doing Business ranking, Index of Economic Freedom and national innovation capability, given Singapore’s improved infrastructure, developed economy, stabilized society as well as advanced business network, sound judicial system, and an incorrupt and efficient government.

However, due to limited land and natural resources, Singapore is a typical export-oriented economy that is highly dependent on global markets[4]. As the BRI gains momentum in recent years, Chinese enterprises are putting more investments and broadening their portfolio in Singapore. Currently, Singapore’s economy mainly depends on professional services, such as finance and shipping, and the manufacturing industry like electronics, petroleum and petrochemical. In the coming years, the Singaporean Government plans to fully explore the digital industry and other innovative fields, and take the advantage to assist Chinese enterprises expand the technological innovation market in Southeast Asia, becoming the technological innovation pilot zone along the B&R.

Figure 9: Singapore’s major economic zones

Source: EY Report, Rediscover ASEAN - A growth story of 10 countries

[17] Source: International Enterprise Singapore
Singapore's incentives

The Singapore Government offers a wide range of tax incentives to attract foreign investments. Tax incentives are targeted at getting companies to anchor substantive high value-added activities and strengthen capabilities, such as innovation and know-how in Singapore. Complementing Singapore's attractive overall business environment, tax incentives have been an effective fiscal policy tool in strengthening Singapore's value proposition as a compelling global hub for business and investments.

Global Trader Programme (GTP)

**Purpose:** To promote international trading activities

**Tax benefits:** GTP provides a concessional corporate tax rate of 5% or 10% (the standard corporate income tax rate is 17%) on qualifying trading income, for companies managing global trading activities with Singapore as their base.

Regional Headquarters (RHQ)/International Headquarters (IHQ) incentive

**Purpose:** To attract companies to establish their regional or international headquarters in Singapore

**Tax benefits:** Companies awarded with RHQ status enjoy a 15% concessory tax rate on incremental qualifying income. For IHQ award, the concessory tax rate ranges from 5% to 10%.

Research and Development (R&D) tax benefits

**Purpose:** To promote innovation and encourage companies to build up R&D capabilities in Singapore

**Tax benefits:** Businesses can enjoy a base tax deduction of 100% and enhanced tax deduction of 50%* on qualifying expenditure incurred on qualifying R&D activities in Singapore up to year of assessment 2025.

*To be increased to 150% proposed under the Singapore Budget 2018

Finance and Treasury Center incentive

**Purpose:** To encourage companies to grow their treasury management activities in Singapore and conduct such activities for the region

**Tax benefits:** An approved Finance and Treasury Center (FTC) company is eligible for a reduced corporate tax rate of 8% on income derived from qualifying FTC services and activities.

Regional Headquarters (RHQ)/International Headquarters (IHQ) incentive

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2.1.2 Singapore's role and outlook under the BRI

China and Singapore are important trade partners, whose bilateral economic and trade cooperation develops rapidly, heading broader and deeper in recent years. Chinese investors have long considered Singapore as one of the most significant foreign investment destinations, and Singapore has become China's biggest M&A destination in 2017 as M&A activities by Chinese enterprises surged, mainly in the transportation, technology, telecommunications and life sciences sectors.

As a critical country along the "Maritime Silk Road", Singapore serves as a strategic point for the BRI. Singapore and Chinese enterprises are now working together to develop more projects and investment opportunities in various sectors along the B&R including energy, infrastructure, shipping, logistics, finance, property development and new media.

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Source: EY summary
Disclaimer: Information is subjected to change and readers are advised to visit relevant sources to find out the latest information.
Promising industry for investment #1: Financial services

To further attract investment and develop Singapore into a global financial hub, the Monetary Authority of Singapore eased regulation on domestic banking and insurance in 2017 for the first time, allowing the acquisition of Singapore's non-bank financial enterprises by foreign capital. It has also shifted from a regulation to a risk control-oriented approach and lifted restrictions on the management of domestic funds by funds management companies, in order to develop the debt market and improve corporate governance.

The Belt and Road Insurance Consortium of Singapore was formed by the end of 2017 to support BRI development, with China Reinsurance Group Singapore as the administrator. Singapore's insurance, reinsurance and insurance brokerage companies came together to focus on providing engineering, cargo and liability insurance services. The consortium envisages to provide one-stop solutions including high-quality underwriting, professional insurance cover and risk management services for B&R projects.

Promising industry for investment #2: Emerging technology industries

Singapore is one of the most innovative economies in Southeast Asia and even Asia Pacific, as a top 10 global innovative country. It achieves rapid growth in emerging technologies such as e-commerce and Fintech and thus attracts a large amount of foreign investment. The Government of Singapore not only provides tax incentives for enterprises to intensify R&D and optimize their innovative capabilities, but also launches Productivity and Innovation Credit (PIC) to support the development of the local emerging technology industry.

EY believes the development of emerging technologies requires robust systems, open markets and creativity. Equipped with great opportunity, low risk, openness and creativity, Singapore has the potential to serve as the pilot zone for emerging technology industries along the B&R. For instance, the Chinese e-commerce giant Alibaba invested in Singaporean counterpart Lazada and built a logistic park in Kuala Lumpur, 350km away from Singapore, in recent years. Through this, Alibaba was practicing its “new retail” business philosophy that has integrated online, offline and the logistics in Singapore and its surrounding areas.

EY Observation:

As the coordinator of China-ASEAN Relations and holding the ASEAN rotating presidency in 2018, Singapore is committed to promoting the development of the China-ASEAN cooperation relationship. EY believes Singapore will play an important role in BRI development, especially in the implementation of the BRI in ASEAN countries.

Regional financing hub: China is deepening cooperation with the Singaporean Government in recent years to promote RMB internationalization. To facilitate B&R financial integration, Singapore is not only one of the initial 21 founding members of the AIIB, but also has committed about SGD90 billion worth of financing services for B&R projects across the region. Furthermore, Singapore is actively developing its bond market and has issued several USD, SGD and RMB-dominated B&R bonds in the local capital market, which will be used in the B&R infrastructure projects. In addition, the recently established Asia Pacific Exchange (APEX) in Singapore is the first Chinese-backed derivatives exchange in overseas markets. APEX will issue RMB-denominated commodity futures and options, and RMB-USD financial futures, so as to widen the RMB's portfolio in commodity pricing, financial transactions, global trade, liquidations and settlements.

Regional logistics and infrastructure construction hub: Singapore has formed a complete industry chain of infrastructure construction such as ports, airports, power stations, water treatment plants and industrial parks, covering major production process from project planning, design and technical patents to equipment, procurement, construction and operation. Taking advantage of this industry chain and its innovative engineering technology solutions, Singapore can play its full role in developing the infrastructure market of ASEAN countries.

RHQ and IHQ location of enterprises: Based on Singapore's favorable economic and business environment for corporate development, it has always been the preferred location for Japanese and western multinational enterprises (MNEs) to set up regional headquarters. In recent years, many Asia enterprises are choosing Singapore as the hub to explore global business. To attract more MNEs, Singapore is providing lower corporate income tax rates and other concessions for enterprises settling up their RHQ and IHQ. At present, around 4,200 MNEs have set up their RHQ in Singapore.

High-level talent pool: Given Singapore’s talent advantage, Chinese enterprises take it as a gateway to invest in Southeast Asian markets. In addition to high education level, nearly 60% of the workforce in Singapore has a good command of Chinese and over 40% is bilingual with knowledge of Chinese. The Singaporean Government is also committed to fostering young talents to understand China and Asia well, through multiple training programs and incentives with different parties.

Lee Hsien Loong
Prime Minister of Singapore

18 Source: Xinhuanet
19 Source: China Re Group
20 Note: Singapore is the only Asian economy that ranks in the Top 10 lists of Bloomberg’s 2017 the World’s Most Innovative Economies and the 2017 Global Innovation Index, published by Cornell University, INSEAD and the World Intellectual Property Organization
21 Source: Lianhe Zaobao
22 Source: Caixin website
23 Source: Singapore Department of Statistics (DOS)
2.2 Malaysia

Malaysia is a strategic partner of China, especially in the field of infrastructure. The two countries have broad prospects for cooperation through the BRI and international production capacity cooperation.

2.2.1 An overview of Malaysia’s economy and investment environment

Malaysia, located in a strategic and central location along the East-West trading route, gives easy access to ASEAN, China, India, Australia, New Zealand and other markets. In addition, Malaysia has a world class halal certification system, the most convenient way for Chinese enterprises to enter Muslim markets and penetrate the international halal market. In recent years, the macro-economy of Malaysia has maintained growth momentum, averaging 4.9% GDP growth in the last three years. The Government of Malaysia has also introduced a number of “Economic Transformation Programs”, aimed at promoting sustainable economic development, focusing on improving productivity and innovative capability, as well as developing the targeted growth industries, to enhance its global competitiveness.

- **Top 3 industries contributing the most GDP:** services, manufacturing, construction
  - Department of Statistics Malaysia

- **2018 projected GDP growth:** 4.8%
  - IMF

- **Ranked 2nd in 2017 within ASEAN in terms of doing business**
  - WB

- **Ranked 2nd in 2017 within ASEAN in terms of the level of Human resource development**
  - World Economic Forum

- **Ranked 5th in 2016 globally in terms of infrastructure investment destinations**
  - Arcadis

- **Economic Transformation Program:** introduced 12 key economic areas, focusing on developing the pillar industries, to enhance Malaysia's competitiveness.

- **Transformasi Nasional 2050:** the objectives include to build Malaysia into a developed country in 30 years, and enter the top 20 countries in terms of economic development, social progress and innovation.

Source: National Economic Advisory Council (NEAC), Prime Minister’s Office of Malaysia, official website of TN50, Ministry of Commerce of People’s Republic of China
Malaysia’s incentives

To push forward the continuous and sustained growth of the national economy, the Government of Malaysia introduced Principle Hub tax incentives in early 201524, to make it a more popular investment destination in a highly competitive global environment. The Government of Malaysia continues to introduce new tax incentives including expanding current preferential tax policies to invite investments in specific sectors in Malaysia.

**Principle Hub tax incentives**

**Objectives:** Encourage multinational corporations to use Malaysia as a base to conduct their regional and global businesses and key management operations.

**Preferential Tax:** Under different conditions, qualifying corporations (specific requirements include paid-up capital, minimum annual revenue and applicable industry) can enjoy a three-tiered corporate preferential tax rate of 0%, 5% and 10%. Currently, the corporate income tax rate in Malaysia is 24%.

**R&D incentives**

**Objectives:** Encourage enterprises to conduct R&D activities, and improve Malaysia’s abilities to apply and develop technology through R&D and innovative activities, maintaining global competitiveness.

**Preferential tax:** Double Deduction for Research and Development:
- A company can enjoy a double deduction on its revenue (non-capital) expenditure for research that is directly undertaken and approved by the Minister of Finance.
- Double deduction can also be claimed for cash contributions or donations to approved research institutes, and payments for the use of the services of approved research institutes, approved research companies, R&D companies or contract R&D companies.
- Approved R&D expenditure incurred during the tax relief period for companies granted Pioneer Status can be accumulated and deducted after the tax relief period.
- Expenditure on R&D activities undertaken overseas, including the training of Malaysian staff, will be considered for double deduction on a case-by-case basis.
- Subsidies for eligible Research and Development activities.

**Manufacturing incentives**

**Objectives:** Encourage enterprises to invest in products and businesses that are promoted by the government in manufacturing industry, including health care devices, electronic products and components, and halal food.

**Preferential tax:**
- **Pioneer status and Investment Tax Allowance (ITA):** Corporations enjoying the above-mentioned preferences must meet a few preferential conditions, such as higher value-added product, advanced technology and related industry.
- **Pioneer status:** A company approved with a “Pioneer Status” certificate can enjoy income tax exemption between 70-100% of statutory income for 5-10 years.
- **Halal food processing and certification:** 100% income tax exemption on capital expenditure for a period of 10 years.

**Service industry incentives**

**MSC Malaysia Status**

**Objectives:** Develop the Information Communication Technology (ICT) industry in Malaysia, attract investors that are interested in innovating, distributing and applying multimedia products and services to set up businesses in MSC Malaysia.

**Preferential tax:** Enterprises operating in the ICT center of MSC Malaysia with MSC Malaysia status are eligible for the following incentives:
- **Pioneer status:** 100% income tax exemption of statutory income for 10 years; or enjoy 100% investment tax allowance regarding the qualifying capital incurred within a period of 5 years, which can be used for 100% statutory income tax deduction for each tax assessment year.
- **Eligible for R&D subsidies** (Only applies to enterprises with MSC Malaysia status that have Malaysians as majority shareholders).


Disclaimer: Information is subjected to change and readers are advised to visit relevant sources to find the latest information.

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### 2.2.2 Malaysia’s role and prospects under the BRI

Driven by the BRI and international production capacity cooperation, China and Malaysia have been pushing ahead practical cooperation in politics, economy, humanity and security. Currently, Chinese enterprise investments in Malaysia are not only co-development projects on local properties and infrastructure, such as Malaysia’s East Coast Rail Link, Melaka Gateway, but also in various manufacturing and service industries including telecommunications, automobile and other advanced technology. During the 10 years between 2008 and 2017, around 50 M&A transactions in Malaysia which worth about US$10 billion had Chinese investor footprints, most of which occurred in the financial services, power and utilities and consumer products sectors6.

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24 Definition of Principal Hub: A locally incorporated company that uses Malaysia as a base for conducting its regional and global businesses and operations to manage, control, and support its key functions including management of risks, decision making, strategic business activities, trading, finance, management and human resource.
As Malaysia focuses more on the Asia-Pacific market and capitalizes on its strategic position at the crossroad of east-west trade routes, we expect more Chinese investors will look to Malaysia in the future. Among them, the "six economic corridors" planned by Malaysia provides a wide range of investment opportunities in areas such as agriculture, education, logistics, manufacturing, oil and gas, and professional services.

Figure 10: Malaysia's Six Economic Corridors

Promising industry for investment: infrastructure

The Government of Malaysia always values the investment in and construction of the infrastructure of highways, ports, airports and power. In the 11th Malaysia Plan 2016-2020, many key projects of infrastructure are underway. The Government expects to reinforce the connectivity between different transportation and regions through a series of plans, and to improve the safety and services in transportation, resulting in socio-economic transformation and increased standard of living. Meanwhile, the proposed infrastructure construction plans attract foreign investments including construction projects.

In terms of infrastructure cooperation, many Chinese enterprises have been active in infrastructure projects in Malaysia, and have been highly acclaimed by local governments and enterprises due to the advanced technology, efficient performance and good after-sales services. In addition, Chinese enterprises have participated in a number of greenfield infrastructure projects in Malaysia. China Railway Group spent US$2 billion setting up regional headquarters in Malaysia in order to promote its infrastructure development throughout Southeast Asia. Huawei has also set up regional headquarters in Malaysia in 2016, with a US$3.6 million investment to set up South Pacific Customer Solution Innovation and Integration Experience Center (CSIC) in Kuala Lumpur, and plans to set up cloud storage, Internet of Things and big data laboratories locally. In addition, China will collaborate with Malaysia to carry out the "one city center" project; both will invest 150 billion ringgit in Central Kuala Lumpur to build a transport hub and regional economic center for high standard smart city construction.

EY commentary on investment approach

EY believes, with advantages such as quality business infrastructure, access to regional and global markets, rich natural rainforest resources, and a local multi-linguistic talent pool, Malaysia is fast transforming to be another global investment destination. To explore investment opportunities in Malaysia, investors may consider five action points:

1. Establish dialogue with local professional services firms and relevant business partners
2. Research Malaysia’s corporate laws, taxes and practices of doing business in the target sector
3. Develop long-term strategies and action plans on regional market access to Malaysia
4. Collaborate with the right local partner with synergy
5. Perform market assessment and develop a detailed business plan

The BRI can help Malaysia venture into new markets, expand the distribution channels for local products and services, as well as attracting foreign investments, and improve logistics services, increase funding efficiency, create a significant number of jobs in multiple industries and boost cultural exchange, all of which help integrate economic resources and coordinate economic policies, thereby promoting mutual development.

Najib Razak

Source: Embassy of the People's Republic of China in Malaysia

Source: Malaysian Investment Development Authority, compiled by EY
2.3 Indonesia

The Government of Indonesia seeks to increase foreign investments in order to boost the country’s economic growth. As the BRI advances further, China investment in Indonesia is expected to scale up, and it will play an important role among foreign investors.

2.3.1 An overview of Indonesia economy and investment environment

Top 3 industries contributing the most GDP: manufacturing; agriculture, forestry, fishery and husbandry; construction

Ministry of Commerce of People’s Republic of China

2018 projected GDP growth 5.3%

IMF

Ranks 1st among the ASEAN based on economic aggregate, population size and national territorial area

World Bank

In recent years, Indonesia’s political and social environment has stabilized while the local economy has been on the rise since 2016. Oil and gas, manufacturing and agriculture are the major industries in Indonesia. In addition, due to the abundant natural resources in Indonesia and the relatively large reserves of coal, tin, nickel, bauxite and copper, the mining industry is also an important source of local foreign exchange earnings and revenue. The unique natural and cultural landscape of tropical islands gives Indonesia rich tourism resources, making tourism one of the top five pillar industries that the Indonesian Government has prioritized to develop. It is also an important country where China carries out overseas investment activities along the B&R.

Figure 11: Indonesia’s Six Economic Corridors

Source: EY report Rediscover ASEAN - A growth story of 10 countries, Ministry of Commerce of People’s Republic of China
Indonesia's incentives

In 2017, the investment environment in Indonesia improved further, and the ranking increased by 19 in 2016 in terms of the local business environment's convenience. To attract foreign investment, the Indonesian Government implements a “negative list” system on foreign investment. In 2016, through the 10th Economic Package, the Indonesian government updated its list of negative investments and opened foreign ventures such as crumb rubber, cold storage, raw materials for pharmacy, e-Commerce in partnership with SMEs, marketplace (100% for investment above IDR 100bn, and 49% for investment under IDR 100bn), film industry, toll road operation, tourism such as sports centers, restaurants, bars, and cafés.

Due to the limited supply of locally produced products which are also below specific standards, the two-year import tariffs can be reduced or exempted for certain industries and a maximum of four years import tariffs can be exempted for enterprises producing products using more than 30% of local equipment and raw materials. These specific industries include the tourism and cultural industries, public transport, public health services, mining, construction, communications and ports.

Certain tax payers that are categorized into “Pioneer industries” are eligible for relevant policies regarding tax holidays. During the tax holiday, a corporate income tax reduction or exemption (could range from 10% to 100% of income) is provided on the income derived from qualifying business activities for a period of 5 to 15 years, and the possibility of a further 5 years extension (total of up to 20 years) in special cases is subject to the Minister of Finance’s discretion. Indonesia’s Ministry of Finance will likely to grant this extra tax holiday of up to 20 years to ensure the competitiveness of national enterprises and the strategic value of certain industries.

<table>
<thead>
<tr>
<th>Applicable industries</th>
<th>Conditions for qualifying tax payer</th>
</tr>
</thead>
<tbody>
<tr>
<td>The following industries are qualified as Pioneer industries: Oil refineries</td>
<td>Must be a new tax payer</td>
</tr>
<tr>
<td>Manufacturing based on agriculture, forestry and fisheries</td>
<td>Has investment plans approved by relevant government authorities, with the total investment amount amounting to at least IDR1 trillion (about US$ 75 million)</td>
</tr>
<tr>
<td>Telecommunications, information and communication</td>
<td>Must meet the thin capitalization ratio requirements made by the Ministry of Finance</td>
</tr>
<tr>
<td>Marine transportation</td>
<td>Must submit a statement confirming that 10% of the total investment will be deposited into the Indonesian banking system and not withdrawn until the investment is realized</td>
</tr>
<tr>
<td>Manufacturing as part of the main industry in Special Economic Zones</td>
<td>Must invest in the form of a legal entity in Indonesia, and the Indonesian legal entity must be established after 15 August 2011</td>
</tr>
<tr>
<td>Economic infrastructure outside of a government and business entity scheme</td>
<td></td>
</tr>
</tbody>
</table>

Source: EY Tax Guide for Investment along the Belt and Road (2017/2018), Investment Coordinating Board of the Republic of Indonesia (BKPM)

Disclaimer: Information is subjected to change and readers are advised to visit relevant sources to find out the latest information
2.3.2 Indonesia’s role and prospects under the BRI

In 2017, China became the 2nd largest foreign investment source country of Indonesia. Chinese M&A value in Indonesia increased by 4 times YoY.

In October 2013, during a state visit to Indonesia, Chinese President Xi Jinping proposed the initiative of building the “21st Century Maritime Silk Road” for the first time, highlighting the importance of Indonesia in the “Road”. Indonesia, as the country with the largest economy in the ASEAN region, has great potential for future cooperation with China.

At present, Indonesia is committed to building itself into a “Global Maritime Axis” and embarking on the “Maritime highway program” - including the construction of 2,000-kilometers of highway, 10 new airports, 10 new seaports and 10 industrial parks in the future so as to improve the domestic connectivity of sea, land and air, and to promote the infrastructure projects such as energy, communications and electricity, all of which are highly compatible with the BRI. In the future, both sides can focus on the hotspot areas such as infrastructure construction, to connect the BRI and the “Maritime highway program” to deepen the level of connectivity between the two countries.

Source: Xinhua Daily
Source: Ministry of Foreign Affairs of the People’s Republic of China
Investment trend along the B&R

The potential of infrastructure investment remains huge

In view of the lagging infrastructure conditions in Indonesia, the Indonesian Government has put infrastructure construction as the first priority in national development. From 2011 to 2025, 367 infrastructure projects will start, valuing US$440 billion in total. The Indonesian Government has said that about 40% - 50% of the funds need to be obtained by attracting private investments29. In order to promote the BRI, in 2015, the Chinese Government promised to invest US$50 billion in Indonesia’s infrastructure construction, covering railways, power plants and toll highways30. The potential for investment in local infrastructure is still huge.

At present, Indonesia and China have been relatively comprehensive in their cooperation in economic and trade cooperation zones and infrastructural projects. In 2017, the Jakarta-Bandung high-speed rail project (Jakarta-Bandung high-speed railway) in Indonesia was officially launched. As the first order of going global for China’s entire high-speed railway industrial chain, the Jakarta-Bandung high-speed railway is of great significance to realize the connectivity goals, including financial integration in transportation infrastructure, between China and the B&R countries. Indonesia has said that the final decision to build China's Jakarta-Bandung high-speed railway project, was based on the superior financing scheme China provided: China does not require the Indonesian Government to guarantee funding, nor to spend Indonesian Government funds; in May 2017, China Development Bank signed a loan agreement of US$4.5 billion with Indonesia for the Jakarta-Bandung high-speed railway31 to facilitate the financial integration. In addition, along with the B&R construction, China has set up a number of economic and trade cooperation zones in Indonesia to provide pilot infrastructure parks with robust infrastructure, stronger industrial chains and higher radiation capabilities, therefore, allowing enterprises to invest in Indonesia efficiently. At present, industrial zones such as the China-Indonesia JuLong Agricultural Industry Cooperation Zone are developing well in Indonesia, becoming a model industrial zone under the BRI.

Indonesia has a huge potential for marine economic development. The demand for infrastructures such as expressways, ports, airports and electric power, and for industrial parks is booming and Indonesia hopes to strengthen cooperation with China. The Indonesian Government welcomes the Chinese enterprises to invest in Indonesia and will provide them with a good investment environment.

Joko Widodo
President of Indonesia

The potential of the consumer electronics industry is unleashing

Indonesia is currently the fourth largest country in the world in terms of population. At the same time, Indonesia has a large base of young working people which is expected to grow twice by 2030, doubling the middle-class and affluent population by 202032. However, the per capita share of consumer electronics in Indonesia is relatively low. In order to stimulate domestic consumption, the Indonesian Government has gradually reduced or eliminated the consumption tax on luxury goods for certain low-priced electronic products and household appliances. Therefore, in the future, Indonesia has the potential to become a consumer electronics market with great investment potential in Southeast Asia.

Since 2017, the investments in Indonesia by Chinese enterprises have started to shift from traditional industries such as power, mining and metals to emerging industries, mainly in the technology industry. Among them are investors led by Tencent’s acquisition of Go-Jek Indonesia, an Indonesian travel platform, for US$1.2 billion, and Alibaba’s US$1.1 billion takeover of Indonesia’s e-commerce platform PT.Tokopedia33. Both whopping deals indicate Chinese investors are getting optimistic about Indonesia’s future demographic dividend and are accelerating investment in the industries benefiting from Indonesia’s demographic advantage.

EY commentary on investment risks

Under the BRI development, Indonesia has great investment potential, however, its investment risk remains.

1. Indonesia, as a presidential country, where its current president and vice president run until 2019, possess high political risk
2. Due to Indonesia’s poor infrastructure and its high cost, as a multi-island country, power supply and supply chain disruption may continue to blight foreign-funded enterprises
3. Indonesian rupiah’s continuous depreciation and the Bank of Indonesia’s ban of domestic US dollar trading pose a greater risk of exchange rate fluctuations
4. The autonomy of local governments is large. Local and central laws conflict with each other. Indonesian judicial system needs to be improved
5. The Indonesian Government’s restrictions on foreign investment and trade barriers may increase the operational risk of foreign-funded enterprises

29 Source: Indonesian Government
30 Source: Global Indonesian Voices
31 Source: MOFCOM, Xinhua news agency
32 Source: MOFCOM, BMI database
33 Source: gov.cn
On 22 Dec 2017, the US President Donald Trump signed a US$ 1.5 trillion tax bill into law in the US, seen as the most drastic tax code overhaul in 30 years. The bill came into effect since January 2018. One of the primary goals of the US Tax Cuts and Jobs Act (TCJA) is to encourage US companies to repatriate their retained profits from overseas back to the US through providing them a competitive tax regime, a move to create more jobs in the States. The following aims to analyze the specific implications of the TCJA on Chinese-funded enterprises who have US Inbound Investments. In general, as an overseas investment destination of Chinese-funded enterprises, the US will be more attractive due to the significant reduction in US federal corporate income tax rate and the simplifications of part of the tax regimes.

3.1 Potential business implications of US tax reform

Growth and strategy
Leverage tax reform to identify ways to grow your business and bring new products to market:
- Expected economic growth impact on firm’s strategy and investment decisions
- New M&A and product opportunities
- Impact on IPO market

Operating model
Companies should reassess their current business model and transaction flows:
- Location, legal entity and operations footprint
- Location of intellectual property, trading activities and offshore service centers
- Impact of new provisions on flow of products

Financials
Companies will need to understand the immediate and long-term impact of legislation on financial statements and reporting:
- Potential recapitalization due to lower tax rate driving reduction in deferred tax assets
- Additional audit procedures
- Impact to capital and effective tax rate
- P&L impact of transition tax
- Timing of reporting disclosure of the impact of enacted bill
- Increased complexity of M&A reporting

Capital
Capital investment and cash management strategies to be re-evaluated:
- Utilization of foreign cash, repatriation
- Impact of changes associated with anti-base erosion measures (BEAT) on capital and balance sheet risk management
- Possible impact of unfavorable changes to the carryback of NOL on hypothetical loss scenarios

Technology
Wide-ranging technology impacts could be felt:
- Potential impacts to strategic sourcing and procurement
- Location of IT investments, staff and data centers
- Financial reporting, forecasting and modeling
- Master data (product, customer master, etc.)
- Decisions on transformative IT investments

Liquidity and investment
Various provisions may drive company’s liquidity and investment decisions:
- Optimal location of third-party borrowing
- Capital deployment with respect to domestic and offshore businesses will impact global interest deductibility
- Tax efficiency of movement of cash within current corporate structures

People
Tax reform legislation alters the landscape of executive compensation and employer-provided benefits:
- Design of benefits programs
- Workforce strategy, sourcing, retention and location
- Immigration risk and compliance

An enterprise-wide strategic change office is needed to manage the comprehensive nature of immediate and long-term potential changes required of your business.
3.2 Key tax reform measures and impacts

• Driven and stimulated by relevant tax reform policies, Chinese-funded enterprises that have planned or made investments in the US will have motivations to increase the proportion of local capital expenditures, in order to be eligible for the tax benefits under the expensing of capital expenditures.

• Under the influence of Base Erosion and Anti-abuse Tax (BEAT) - the US giant companies invested by Chinese-funded enterprises will be subject to limitations on US federal tax deductions in terms of payments of interest, rentals, royalties and service fees between related parties. However, considering the limited number of giant companies, such measures will show limited impact on Chinese-funded enterprises.

• The tax policies of foreign derived intangible income (FDII) and global intangible low-taxed income (GILTI) under the new tax code aim to impact the global intangible property (“IP”) arrangement of the US-based multinational corporations (especially large tech companies), and encourage them move the IP ownership back to the States. If Chinese-funded enterprises consider IP restructuring due to the above tax policies, they should conduct prudent assessment on the comprehensive US and non-US tax implications together with business considerations on implementation of contemplating IP structuring.

I. Lower corporate income tax rate applied

Chinese-funded enterprises investing in the US are subject to the federal corporate income tax at a lower rate of 21%, with effect from 1 January 2018. US is a high-tax country with a far higher comprehensive tax rate than the 25% PRC statutory corporate income tax rate in China. The income tax paid by Chinese-funded enterprises investing in the US includes US federal, state and local income taxes and the withholding tax on dividends. Apart from the reduction of the corporate income tax, the alternative minimum tax (AMT) will be abolished, which will result in increasing return on investments (ROI) and reduce tax burdens and uncertainties. This may up the US profile as an attractive overseas investment destination by Chinese-funded enterprises.

II. Impacts of capital expenditure expensing

The TCJA provision allows write-off of qualified property placed in use after 27 September 2017 and before 1 January 2027. However, the ratio of expensing will decrease 20% per annum from 1 January 2023 to 0% by 1 January 2027.

The expensing of capital investment will encourage the Chinese-funded enterprises, who have been purchasing and upgrading equipment inside the US, to increase initial capital investment in order to reduce costs on US corporation tax.

Before the tax reform, a Chinese enterprise who engaged in contracted construction projects in the US, for instance, was contemplating to purchase machinery and equipment for engineering construction from China and then export them to US subsidiaries. In that case, most trade profits from equipment procurement would be recognized by the subsidiaries in China who were responsible for centralized procurement of machinery and equipment within China. However, after the US tax reform, considering numerous implications such as transportation costs for the equipment from China, US import duties and the provisioned 100% capital expensing for US subsidiaries, it may be more cost effective for US subsidiaries to purchase the construction equipment within the US than to import them from China.

Chinese-funded enterprises who perform production and operation activities in the US need to reconsider the optimal supply chain arrangements under the new tax framework.

III. Base Erosion and Anti-abuse Tax (BEAT)

The TCJA has introduced a new base erosion and anti-abuse tax, which is calculated based on the total deductible expenses of the current tax year (including interests, rentals, royalties and service fees) to overseas related parties, which are paid by enterprises with turnover of over US$500 million. The BEAT rate is 5% in 2018, 10% from 2019 until 2025, and 12.5% from 2026. Qualified US companies must pay the higher of its regular US federal corporate income tax liability or the new BEAT.
In theory, BEAT will exert some impacts on the Chinese-funded enterprises’ tax planning of eroding their US subsidiaries’ tax bases by limiting the deductibility of payment to overseas related parties from their US subsidiaries. In practice, however, due to the high thresholds (to be specific, US corporations should have the average annual turnover of at least US$500 million for three-year period ending with the preceding taxable year), not many Chinese-funded enterprises will be materially affected by the BEAT provisions.

**IV. Impacts of foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI) measures**

In accordance with the TCJA, overseas sourced profits derived from intangibles held by domestic US companies are subject to US corporate income tax at a lower effective rate of 13.125%, which will be increased to 16.406% after 2025. The tax benefits on FDII aim to encourage US enterprises to retain their intangibles within the US while their overseas companies will use such intangibles via licensing or authorization.

The term global intangible low-taxed income (GILTI) refers to the excess if any of a US shareholder’s net controlled foreign corporations (CFC) tested income over its net deemed tangible income return (usually set at 10%). As required by the TCJA, whether the profits will be repatriated to US parent companies or not, multinationals should include the GILTI into the US federal tax bases and be entitled to an 80% foreign tax credits. From 2018 to 2025, the tax rate is 10.5% and will rise to 13.125% from 2026. The measures aim to offset the tax efficiencies achieved by US multinationals whose patents, copyrights, trademarks and other intangibles are transferred overseas with different jurisdiction, especially to the low-tax jurisdictions in Europe, so as to eliminate the tax motivations of such US multinationals to transfer their intangibles out of the US.

By implementing FDII and GILTI in parallel, the TCJA encourages multinationals to hold intangibles within the US (via FDII), and concurrently discourage multinationals to transfer the intangibles out of the US (via GILTI).

If Chinese-funded enterprises hold intangibles in the US (subsidiaries) through cross-border M&As, they will benefit from preferential tax treatments regarding FDII under the TCJA. However, if Chinese-funded enterprises hold acquired intangibles through US overseas subsidiaries in the cross-border M&As, they may be required to include the GILTI into the US federal tax bases, that would be the adverse effect of GILTI. In both cases, Chinese-funded enterprises who are buyers of cross-border M&As, should conduct prudent assessment on the impacts of the TCJA provisions on their intangible structuring.

**V. Other major tax reform measures**

In addition, other major tax policies under the TCJA, such as participation exemption for non-US source dividends, changing US from the worldwide tax system to the territorial tax system, and the one-off transition tax on US offshore profits, will primarily affect multinationals headquartered in the US but have less impacts on Chinese-funded enterprises who do not hold assets and equities outside the US via US subsidiaries.

### 3.3 Location selection for Chinese-funded enterprises with US inbound investments

For US investment purpose, Chinese-funded enterprises should take the diverse commercial and tax environments of different states in the US into account, and assess the preferential policies the state and local governments have introduced toward attracting new investments and creating jobs, and various operation costs incurred in respective States. For location selection purpose, Chinese-funded enterprises should consider aligning their business strategies with the federal, state and local economic development and employment strategies to maximum extent.

US corporations are governed by many different state and local tax systems with respect to tax jurisdictions and tax bases. The taxation is carried out by each jurisdiction, including but not limited to: states, municipalities, counties and townships. The tax items include but are not limited to: sales and use tax, property tax, individual income tax, income or franchise tax and public utility tax. EY Location Investment Service Team understands the key differences among tax jurisdictions clearly in respect of these factors by building tax models.

Furthermore, EY can provide a holistic approach to client’s US inbound location investment decisions by integrating various resources from different service lines. For any service demands in this regard, please contact our professional service teams.

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* The Washington Council Ernst & Young practice of Ernst & Young LLP (WCEY) is an advisory services group that helps clients manage opportunities and risks associated with the legislative and regulatory process.
In 2018, with the steady recovery of the world economy, marked increase in international trade and steady growth in China’s economy, the demand environment and development conditions for overseas investment generally favor Chinese enterprises. However, there are still many risks and uncertainties across the globe. China’s overseas investment still faces many difficulties and challenges.

Under the complicated international situation, the BRI has a long-term perspective and endeavors to promote the building of a new type of globalization characterized by "openness, tolerance, inclusiveness and sharing" and to inject new impetus and new ideas into economic globalization. The resolution of the 19th NPC clearly proposed that the building of the BRI should be written into the Party Constitution, fully demonstrating China’s determination and confidence in bolstering international cooperation in the B&R.

ASEAN countries are the priority and important partners for China in developing the BRI. At present, the ASEAN-initiated Regional Comprehensive Economic Partnership (RCEP), in which China is invited, is steadily advancing. In the future, it is expected to enhance the level of regional cooperation and to build up connectivity among B&R countries.

EY believes that in the future, Southeast Asia will form a closer economic partnership as the BRI strengthens. China and ASEAN countries will continue to bolster strategic mutual trust, strengthen good neighborliness and friendship, build an upgraded version of the China-ASEAN Free Trade Area, and increase the global competitiveness of industries in both ASEAN and China. Driven by the BRI, ASEAN will concurrently draw increasing attention from investors.

On the other hand, although the US has always been one of the most important destinations for China overseas investment, with the recent implementation of Trump’s tax reform, Chinese enterprises will have new opportunities and challenges when investing in the US. Therefore, they should get a comprehensive knowledge of the details of the tax reform to effectively manage potential risks and seize underlying investment opportunities.

With roadblocks ahead, Chinese overseas investment has to keep breaking barriers while EY’s professional services continue to be at the service of Chinese enterprises.

Conclusion and Outlook

The BRI has a long-term perspective and endeavors to promote the building of a new type of globalization characterized by "openness, tolerance, inclusiveness and sharing" and to inject new impetus and new ideas into economic globalization.
China Overseas Investment Network helps Chinese businesses navigate through global markets

The current wave of globalization continues to transform the business landscape and impact companies around the world. With the B&R initiative, China will undoubtedly play an increasingly mature and globalized role in the global economy. The global economic situation is still uncertain and challenges may arise due to cultural differences, language barriers, financing difficulties and regulatory issues. Chinese companies need to respond in a timely manner to these challenges while navigating a complex and dynamic outbound transaction environment.

The China Overseas Investment Network (COIN) links EY professionals around the globe, facilitates collaboration, and provides consistent and coordinated services to our Chinese clients making outbound investments. Building on the existing China Business Group in the Americas, EMEIA, Asia-Pacific and Japan areas, COIN has expanded our network into over 70 countries and territories around the world.
Our global COIN network

Our global COIN network
For more information on our China Overseas Investment Network, please visit our website at www.ey.com/cn/coin or contact:

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