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Building a better working world

China Tax & Investment News

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Enhance the future - China introduces more steps to retain and attract FDI

In response to the global turbulence caused by COVID-19, the Chinese government has made its best endeavor to control the domestic epidemic, proactively share its medical experience and work together with other countries to overcome the global crisis. In order to restore market confidence and recover the economy, China's central and local governments published bold measures last week.

This issue of China Tax and Investment News will introduce the details of some key supporting measures and our observations.

In response to the global turbulence caused by COVID-19, the Chinese government has made its best endeavor to control the domestic epidemic, proactively share its medical experience and work together with other countries to overcome the global crisis. To restore market confidence and recover the economy, China's central and local governments published bold measures last week releasing key messages. Primarily, China continues to open up for foreign investment, support cross-border trade and contribute its best efforts to enhance resilience of the economy.

Along the successful trajectory of its 40 years of reform, China's economic development has greatly benefited from Foreign Direct Investment (FDI). Foreign investments have not only brought over global capital, but have also expanded the market of local products to a global buyership, provided huge domestic employment and advanced management experiences from multinational companies (MNCs) having boosted long-term growth and having built foundations for innovation, therefore playing a crucial role in lifting people's general livelihood.

Diagram 1. China's FDI net inflows and GDP (1979-2018)

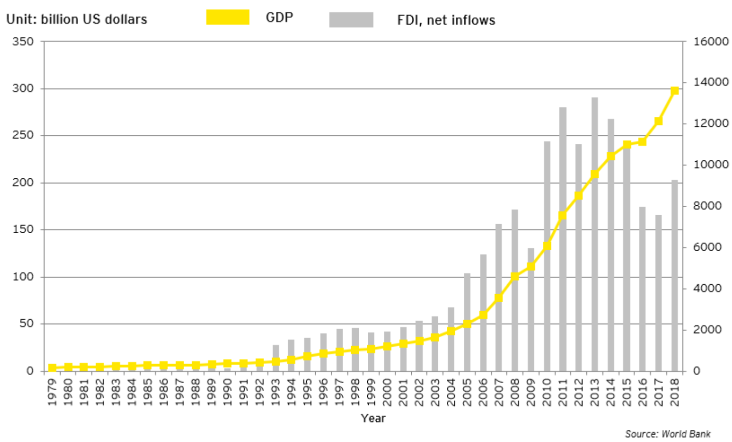
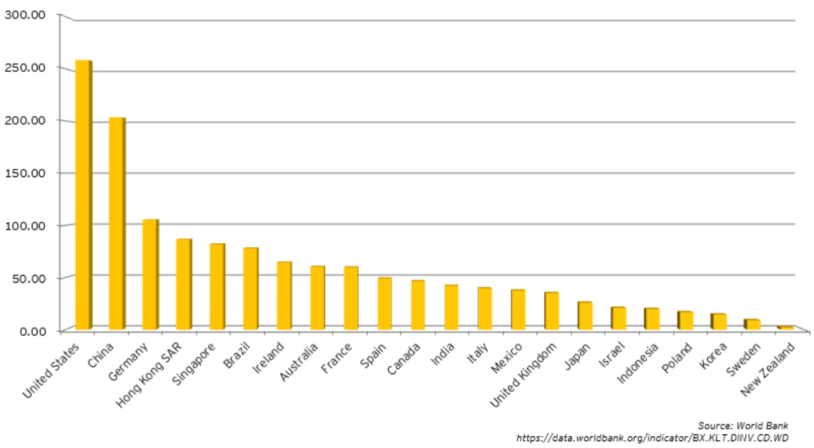
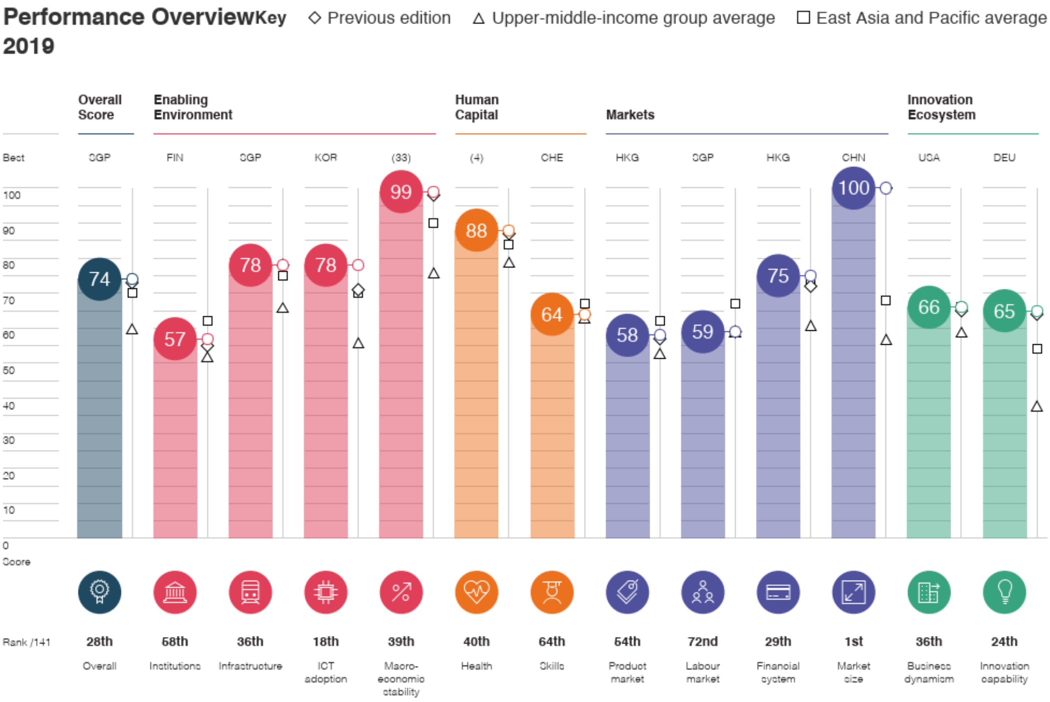


Diagram 2. 2018 FDI net inflows of major economies



As the world's second-largest country of FDI net inflows, China has never slowed its steps in terms of opening up and optimizing the business environment. According to the data published by United Nations Conference on Trade and Development (UNCTAD), global FDI has declined over four consecutive years; nevertheless, FDI into China has actually been increasing during this period. The capitals have chosen China for its unique comprehensive advantages[1] like stable political environment, huge materials supplies and consumer market, abundant skillful workforce, well-developed infrastructure with continual improvement, efficient and mature industrial chains, increasing innovation and business environment rankings, as well as some notably competitive cost advantage.

Diagram 3. 2019 Global Competitiveness Index – China



Source: The Global Competitiveness Report 2019

Note:
1. http://www.gov.cn/xinwen/gwylflkjz56/wzslqt.htm

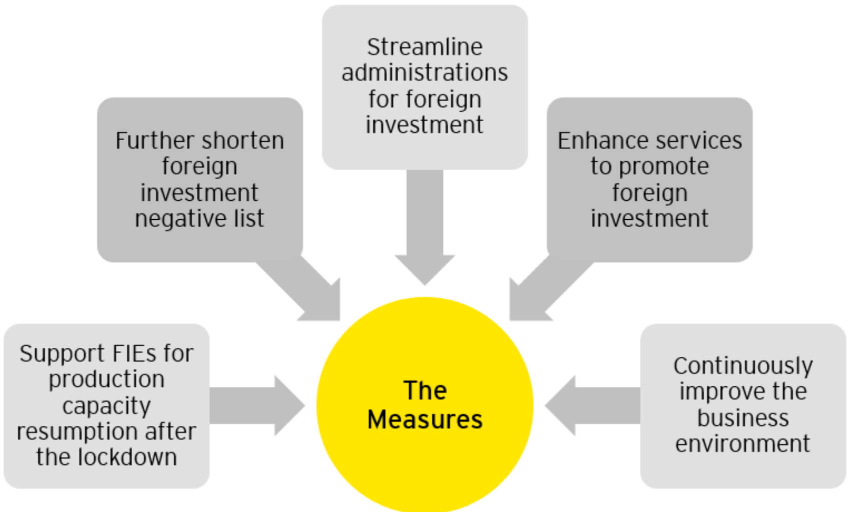
Diagram 4. Global competitiveness index 2019 rankings of major economies

Economies	Overall rank	Pillar 1: institutions	Pillar 2: Infrastructure	Pillar 3: ICT adoption	Pillar 4: Macro-economic stability	Pillar 5: Health	Pillar 6: Skills	Pillar 7: Product market	Pillar 8: Labour market	Pillar 9: Financial system	Pillar 10: Market size	Pillar 11: Business dynamism	Pillar 12: Innovation capability
Singapore	1	2	1	5	38	1	19	2	1	2	27	14	13
United States	2	20	13	27	37	55	9	8	4	3	2	1	2
Hong Kong	3	5	3	3	1	1	20	1	7	1	28	15	26
Netherlands	4	4	2	24	1	21	4	7	11	17	20	2	10
Switzerland	5	6	4	17	1	5	1	25	2	4	39	22	3
Japan	6	19	5	6	42	1	28	6	16	12	4	17	7
Germany	7	18	8	36	1	31	5	9	14	25	5	5	1
Sweden	8	10	19	4	1	11	7	16	22	8	40	6	5
United Kingdom	9	11	11	31	1	33	11	21	9	7	8	9	8
Denmark	10	7	15	9	1	29	3	12	3	11	55	3	11
Finland	11	1	22	13	1	27	2	15	17	5	60	7	12
Taiwan	12	24	16	11	1	24	23	14	15	6	19	20	4
Korea, Rep.	13	26	6	1	1	8	27	59	51	18	14	25	6
Canada	14	13	26	35	1	14	12	24	8	9	16	12	16
France	15	22	9	28	36	7	35	28	50	14	9	24	9
China Mainland	28	58	36	18	39	40	64	54	72	29	1	36	24

Source: the world economic forum

Central government — attracting FDI, striving to open for foreign capital

With the global FDI growth slowing down, competition among governments to attract foreign investment have become even more intense[2]. The increasing pressure on global economic downturns, plus the unplanned negative impact brought about by the epidemic, caused China's FDI to tumble in the first quarter of 2020. In order to enhance the attractiveness of the China market, the PRC Ministry of Commerce (MOFCOM) released 24 measures in five aspects ("24 Measures") to further promote the opening-up, stabilize the cross-border trade and endeavor to achieve the comprehensive growth goal.



Note:
2. http://news.cctv.com/2020/04/17/ARTI1OprPipQhbhPI0LjmCsY200417.shtml

Alongside the measures for supporting work and production resumption after the COVID-19 lockdown, key points of the 24 Measures also include:

- **Market access**

  China will further promote the opening-up process by aiming to:

  - ✓ Shorten further the Foreign Investment Negative List

    China has, across the nation, widely adopted the Foreign Investment Negative List as an administrative mechanism for its market entry, since its first successful trial in 2013 in the Shanghai Pilot Free Trade Zone ("FTZ"). All foreign investments, (except those mentioned in the "negative list"), would be automatically granted permission to conduct business in China's market without the need to go through the previous complicated pre-approval procedures. The prevailing Negative List was published in June 2019. Compared with the 2018 version, items in the 2019 version have already been reduced from 48 to 40. The remaining 40 items in the list fall into 13 industries, e.g., finance, agriculture, mining, information transmission, software and information technology services. Although the details of the new list have not been stipulated as yet, the latest announcement mentioned that the newly shortened list may echo China's central government's promise of further opening-up financial sector among the relaxation of restrictions on other industries.

  - ✓ Expand the scope of encouraged industries for foreign investment

    Beside the Negative List for foreign investment, China also has a catalog for selected industries which may be eligible to enjoy respective tax and other incentives. The Catalog has been periodically reviewed and revised to align with the State's macroeconomic strategies. The current applicable Catalog of Encouraged Industries for Foreign Investment was released in 2019 ("2019 Catalog"). The government announced that it will further expand the scope of encouraged industries, aiming to guide foreign capitals to invest more in advanced manufacturing, emerging industries, high-tech, energy conservation and environmental protection, etc. In addition, the announcement mentioned that the foreign investments are encouraged to be established in those less-developed areas in China, like the Central and Western Regions and the Northeast Regions.

    According to the prevailing regulations, foreign-invested enterprises (FIEs) engaging in encouraged industries are entitled to a series of incentives including preferential import-level tax policies[3], priorities in land supply[4], etc.

- **Simplify administration and optimize business environment for foreign investments**

  The 24 Measures emphasize optimization of the foreign investment environment and echo the newly effective Foreign Investment Law (FI Law) and call for full implementation of the simplified administrations enacted in the Law, i.e., cancellation of pre-approval and record filing for the establishment and alteration of FIEs. The PRC FI Law took effect on 1 January 2020 to supersede the three old laws that govern three respective types of FIEs[5]. The simplified administration will certainly enhance the effective establishment of foreign investments.

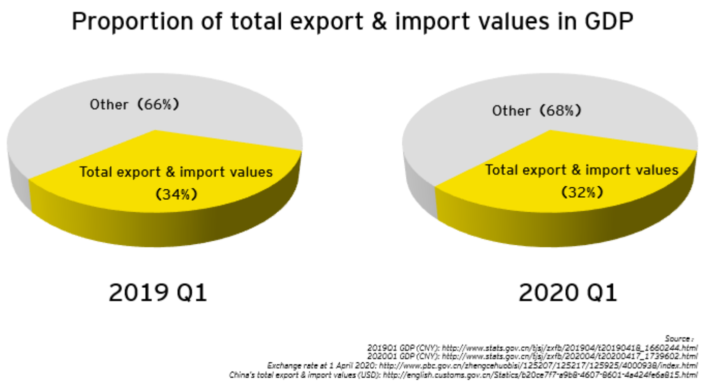
  According to the guidelines of the document entitled, "Doing Business 2020," (published by the World Bank), the business environment ranking of China has been stepping up for consecutive years, which reflects continuous efforts from China's government on optimizing the business environment. "China will never close its door, which will only open even wider," as stated by China's President Xi, identifying the State's long-term policy of aiming to establish a more business-friendly market, so, we have confidence that China's economy will become even more resilient while facing any changes.

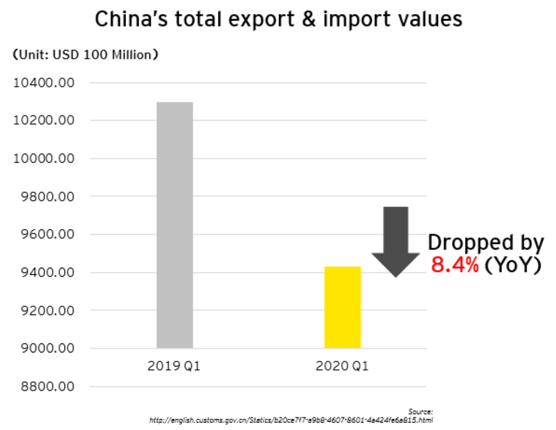
Note:
3. The importation of self-used equipment for the prescribed encouraged projects within the total investment quota would be exempt from Customs Duty
4. Price of land usage right may be discounted as low as 70% of the lowest price for the same grade industrial lands sold nationwide
5. Three types of FIEs shall refer to Equity Joint Ventures (EJVs), Wholly Foreign Owned Enterprises (WFOEs) and Contractual Joint Ventures (CJVs)

Central government — supporting cross border trade

While the epidemic affects general business operations heavily, it disrupts supply chains and in turn seriously hurts China's cross-border trade businesses.

Diagram 5. Proportion of total export & import values in GDP, China's total export & import values in Quarters 1 of 2019 and 2020

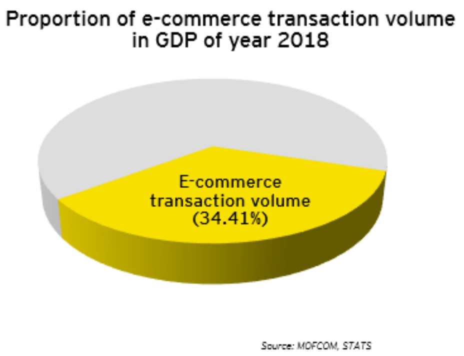


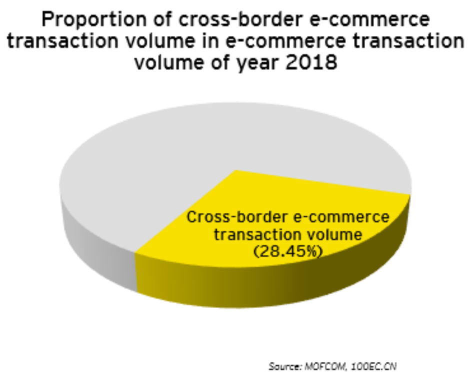


To help cross-border businesses to recover from this ongoing, unprecedented crisis, the China State Council announced several special measures:

- **Establishing 46 new cross-border e-commerce pilot zones**

Diagram 6. Proportion of e-commerce transaction volume in GDP of year 2018 and Proportion of cross-border e-commerce transaction volume in e-commerce transaction volume of year 2018





China plans to establish 46 new comprehensive cross-border e-commerce pilot zones ("ECPZs") in addition to the 59 existing zones according to a State Council executive meeting on 7 April 2020. Exported goods in all 105 pilot zones for retail may be exempt from Value-added Tax (VAT) and Consumption Tax; Corporate Income Tax (CIT) for enterprises in the zones will be levied on a deemed basis (and taxable income maybe determined at 4% of total revenue)[6].

According to this announcement, due to COVID-19, the central government realized that the traditional business models are facing challenges and may have to be "transformed" faster by using a digitalized platform and this seems to be the major driver for setting up these new 46 zones.

China's efforts in promoting cross-border e-commerce may ease the pressure of traditional cross border trade in the short term. In the long term, it may result in greater demand and market space to help optimize the adjustment of the overall economic structure.

Note:
6. http://www.chinatax.gov.cn/n810341/n810755/c3766983/content.html
http://www.chinatax.gov.cn/chinatax/n810341/n810755/c5139578/content.html

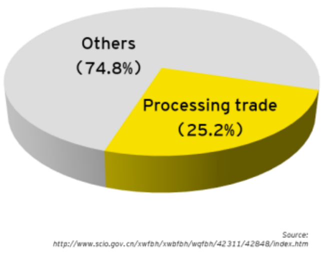
The detailed locations of 46 new Zones have not been announced. Depending on the evolution of the macro economy, the economic effect of these zones and the impact of COVID-19, it's not unreasonable to anticipate more new zones might be established in the future.

Diagram 7. Locations of the existing 59 ECPZs

	Locations of the existing 59 ECPZs
	Beijing, Chongqing, Shanghai, Tianjin
Anhui	Hefei, Wuhu
Fujian	Xiamen, Fuzhou, Quanzhou
Gansu	Lanzhou
Guangdong	Guangzhou, Shenzhen, Zhuhai, Dongguan, Shantou, Foshan
Guangxi	Nanning
Guizhou	Guiyang
Hainan	Haikou
Heilongjiang	Harbin, Suifenhe
Hebei	Tangshan, Shijiazhuang
Henan	Zhengzhou, Luoyang
Hubei	Wuhan, Huangshi
Hunan	Changsha, Yueyang
Inner Mongolia	Hohhot, Chifeng
Jiangsu	Suzhou, Nanjing, Wuxi, Xuzhou, Nantong
Jiangxi	Nanchang, Ganzhou
Jilin	Changchun, Hunchun
Liaoning	Dalian, Shenyang, Fushun
Ningxia	Yinchuan
Qinghai	Haidong
Shaanxi	Xi'an
Shanxi	Taiyuan
Sichuan	Chengdu, Luzhou
Shandong	Qingdao, Weihai, Jinan, Yantai
Yunnan	Kunming
Zhejiang	Hangzhou, Ningbo, Yiwu, Wenzhou, Shaoxing

Support processing trade

Diagram 8. Proportion of processing trade in foreign trade of Year 2019



Processing trade accounts for 1/4 of China's foreign trade[7]. The businesses are normally either toll manufacturing or contract manufacturing for the export market, i.e., they operate under bonded arrangements for raw materials imported from overseas and sell back to the overseas market after the production process. Similar to FDI, there is a list of "prohibited commodities" which are restricted from such bonded arrangements. As part of COVID-19 remedy measures, the central government decided to shorten the list. It is not clear whether it is just a temporary measure. Other supporting measures include:

- ✓ for domestic sales of bonded materials or finished products of processing trade, the interest on deferred tax payments will be temporarily waived until the end of 2020;
- ✓ rolling over the pilot program that allows processing trade businesses to choose paying tariffs either on imported materials or finished products for all domestic sales to all free trade zones.

Note:
7. http://www.scio.gov.cn/xwfbh/xwbfbh/wqfbh/42311/42848/index.htm

Echoes from local governments — Shanghai and others

To echo the central government's message, many local governments have released corresponding policies to attract capital and optimize the business environment. *Regulations on Optimizing the Business Environment in Beijing*[8] will take effect on 28 April 2020, which emphasize the collaboration with Tianjin and Hebei, aiming to adopt unified administration standards for the region and mutual recognition of qualifications. These will serve, alongside other measures, to establish a more business-friendly environment, enhance government services and promote rule of law, etc. In addition to Beijing, Henan and Shanxi have also introduced their similar local polices. We believe that more and more local governments will join in the effort to publish their respective local measures based on their respective development needs and to improve the overall investment and business environment.

As an important gateway of China and as its leading financial center, Shanghai always strives to attract foreign capital. Currently, nearly 60,000 FIEs in Shanghai have contributed more than 1/4 of local GDP, more than 1/3 of tax revenues, around 2/3 of imports/exports and gross industrial output value (of enterprises above certain scales)[9], and 1/5 of employment.

Diagram 9. Contributions of FIEs to Shanghai's economy

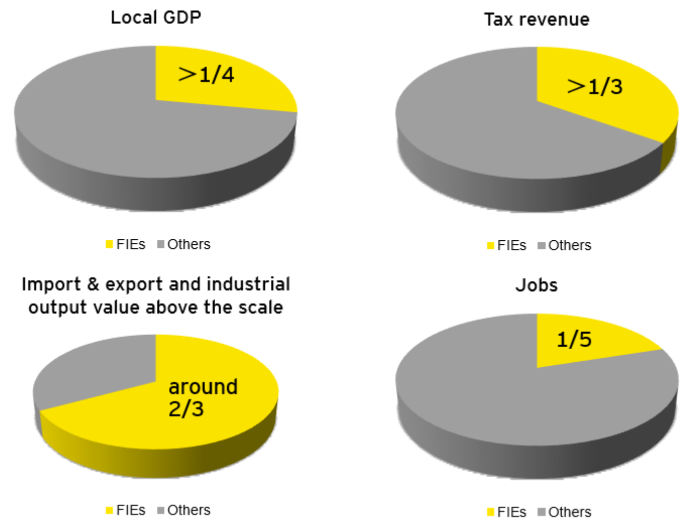
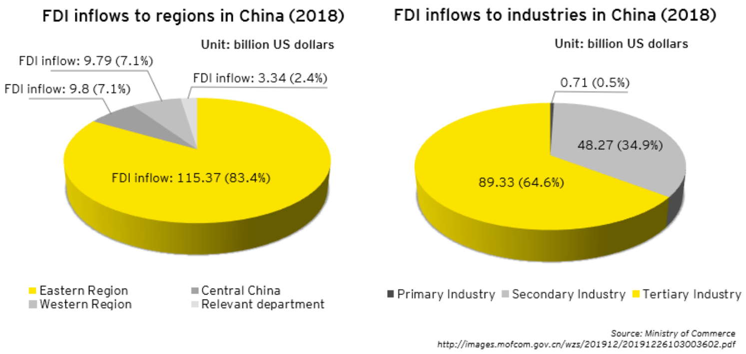


Diagram 10. FDI inflows to regions and industries in China



As early as February when the epidemic was at its zenith in China, Shanghai had taken the lead to launch 36 measures aiming to establish a world-class business environment to boost the confidence of the market and investors. More recently, the Shanghai government further released three local packages (see below for details) to strongly echo the State's strategies and to show determination toward opening-up.

Note:
8. http://fuwu.bjrd.gov.cn/rdzw/information/exchange/Laws.do?method=showInfoForWeb&id=2020625
9. Revenues above RMB20m (US$2.83m)

Shanghai – for a further opening-up of the market

The Shanghai government's policies for FDI attraction are very pragmatic and detailed – which answers many foreign investors' concerns. The government said it will relax the market entry for financial services and new energy vehicles and it will further strengthen the legal protection of intellectual property, support foreign investors' participation in industry standards formulation and promote FIEs' equal participation in government procurement. The Shanghai government also shared that it will allow its subordinated governments at district level to design financial rewards to address certain key foreign investment projects and appropriate incentives to attract talent from overseas.

More details are summarized below:

Policy measures	Key points
Market access	✓ Further relax the market entry for financial industry and new energy vehicles sectors, etc. ✓ Encourage foreign investment into newly opened areas ✓ Achieve greater openness in Shanghai Pilot FTZ and Lingang for key areas including telecommunications, scientific research and technical services, education and health, etc.
Promote foreign investment	✓ Provide one-stop administration services for foreign investment ✓ Promote the settlement of major foreign investment projects which are consistent with the industrial development orientation of National Economic and Technological Development Zones (NETDZs) ✓ Encourage capable NETDZs to establish overseas investment promotion centers ✓ Allow local government at district level to provide financial rewards to key foreign investment projects based on their overall economic and social contribution ✓ Provide incentives to attract talents for key foreign investment projects ✓ Encourage foreign investors to invest more in the high-and-new technology industry.
Facilitate administration	✓ Waive qualified FIEs from documentation submission for pre-verification when they make domestic payments through their capital accounts (e.g. capitals, foreign debts, fund for overseas listing, etc.) ✓ Ease the administration and registration of foreign debts ✓ Allow non-foreign-invested holding companies (非投资性外商投资企业) to set up new subsidiaries or acquire other domestic enterprises with capitals, provided certain criteria are met ✓ Ease foreign exchange process for qualifying expatriates' salary repatriation ✓ Streamline application process for expatriates' work permit ✓ Accelerate the approval of land use application for foreign investment projects
Enhance the protection of legal rights and regulations	✓ Improve the effectiveness of complaint/appeal mechanism and enhance the protection of FIEs' legitimate rights and interests ✓ Strengthen the legal protection of intellectual property ✓ Promote the transparency of foreign investment policies ✓ Support FIEs' participation in industry standards formulation ✓ Promote equal participation for FIEs in government procurement

Shanghai – for a better business environment

Alongside the above-mentioned policies on attracting FDI, Shanghai also stipulated the details within the document entitled, "*Regulation on Enhancing Business Environment*" to optimize many aspects of the business environment[10]. The Regulations took effect on 10 April 2020, and includes 8 chapters and 80 articles.

Business environment optimization

- All entities have equal access to the market as long as they are not in the national negative list
- Involve businesses in policies making process
- The government shall not violate or breach agreements on the grounds of adjustment of administrative divisions, change of leadership, adjustments in administrative functions etc.
- Enhance the protection on IP and effectively invoke the punitive compensation system for IP infringement
- Facilitate business establishment: e.g. new enterprises registration shall be obtained within one working day; promote the use of electronic licenses, electronic signatures and electronic seals
- Minor illegal operating acts may be waived from administrative penalties
- Fully establish a business credit system and provide priority (e.g., simplified administrations) to entities with good credit
- Support reasonable cross-district migration of enterprises; resolve disputes through joint mechanisms at municipal levels
- Improve the diversified dispute resolution mechanism
- Establish a complaint and rights protection mechanism of business environment

Innovation capacities represent a country's core competitiveness. Meanwhile the development of small and medium-sized business is the cornerstone of the economy for general public. In this regard, the Shanghai Regulation reflects its strong support for innovation and SMEs:

Promote innovation

- Full-lifecycle comprehensive financial services may be provided for supporting technology enterprises
- Enhance the cultivation of scientific and technological enterprises
- Qualified technology-based enterprises are encouraged to list on the Science and Technology Innovation Board

Support SMEs

- Policy financing guarantee funds are established to support medium, small and micro-sized enterprises (SMEs)
- A specific target financing guarantee system will be established and improved, (a credit supporting service from the government will be provided for SMEs financing)
- Financial institutions are encouraged to provide unsecured credit loans to SMEs that operate in good faith

Note:
10. http://www.spcsc.sh.cn/n1939/n1944/n1946/n2029/u1ai210610.html

Shanghai – for a more resilient economy

Shanghai government recently introduced *Policy Measures on Expanding Effective Investment and Stabilizing Economic Development*. The measures mainly aim to stabilize investment, help business to recover from the impact of the epidemic and achieve the economic goals of 2020. It includes fiscal measures of offering financial support to business, effective utilization of revenue generated from land use right transfers, land cost reduction for manufacturing businesses as well as the high-quality project investment promotion in key locations (e.g. the new areas of the FTZ, Hongqiao Business District, Yangtze River Delta Region).

Conclusion

It has been an unprecedented period and governments around the world have introduced economic stimulus packages to sustain and back up companies and individuals during this difficult period, as responding to COVID-19 is undoubtedly a top priority on governments' agendas around the globe. Beside those short-term hardship remedies, a country's courageous and persistent strategy for the long-term is also key to bring back market confidence. While in the process of fighting for capital, many governments attract FDIs through offering a range of tax preferential policies, and other measures in improving efficiency in the general business environment and assurance of a level playing field are also imperative.

As a major economy regarded as being under effective control for COVID-19 contagion, China has gradually moved forward on the road to recovery. It has enacted several economic-stimulus measures to help businesses navigate this challenging time.

This Spring, with these newly announced capital attraction measures and business environment enhancement policies, China releases a very strong signal to the market that it will not change its commitment on opening-up and it will only become even more open, expansive and friendlier. With its mature, unique and sizeable market, as well as the unified strategy alongside consistent enforcement by its leadership from central to local, there is no reason to doubt the China market's attractiveness and competitiveness.

Enterprises and investors should closely study the comprehensive preferential measures to seize the chance, and to provide the capital for a good chance to grow in a steady business environment.

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