

Looking into the 22 Measures to attract foreign investment, what aspects of business environment for foreign investment in China are improved?

In brief

Since early this year, China has released several circulars including 20 Measures to attract foreign investments (the “20 Measures”), the negative list for foreign investments in the pilot free trade zones (PFTZ) (the “2017 PFTZ Negative List”), the new version of Industry Catalogue Guide for Foreign Investment (the “Catalogue”) and Provisional Measures for the Record-filing Administration on the Establishment and Alteration of Foreign-invested Enterprises (FIEs) to further promote foreign investments in China. On 8 August 2017, the State Council issued another new circular setting forth 22 measures to further improve the business environment for foreign investment in China (Guofa [2017] No. 39)¹ (hereinafter referred to as the “22 Measures”). The 22 Measures cover five areas, namely: furthering relaxing the access restriction on foreign capital, formulating fiscal and taxation incentives, improving the comprehensive investment environment for state level economic development zones, facilitating talent entrance and exit as well as optimising business environment.

In detail

The 22 Measures comprised of five areas: two of the measures are related to the relaxation on market access for foreign capitals, six are on the formulation of fiscal and taxation supportive policies, four are on the improvement of the comprehensive investment environment for state level economic development zones, two are on the facilitation of talent exit and entrance, and the remaining eight are on the optimisation of business environment. Combining with the 20 Measures released at the beginning of this year as well as its implementation policies, some provision in the 22 Measures are released to emphasise, supplement and detail the existing policies while some are offering new policies to attract foreign investment. The release of the 22 Measures echoes the state’s major strategies. Our observations are as follows:

Future clarification of the trend to open up certain sectors for foreign investments under the old and new measures

The 20 Measures proposes the opening up of the manufacturing sector, mining sector and service sector. We saw that the commitment is realised in the 2017 Version Catalogue by the opening up of the manufacturing and mining industries to foreign investments and lifting the restriction on foreign investments in service sectors, accounting and auditing, as well as rating service. However, the previous circulars still have not clearly dealt with the opening-up of the telecommunication, internet, banking, securities and insurance sectors.

The 22 Measures once again emphasise the opening up of the banking, securities, insurance, internet (business operations for internet service), and telecommunication (call centre service) sectors to foreign investments and require the relevant departments to specify the timeline and roadmap for implementation. In addition, the 22 Measures also promises to open up several new sectors including the advanced manufacturing sector, such as, the manufacturing of new energy automobiles, vessel design, repair of regional and general aviation aircraft, etc., as well as international marine transport and railway passengers transportation in the transportation sector.

Formulation of the fiscal and taxation supportive policies to complement the state’s ‘major strategy’

Tax deferral treatment on profit distribution used for reinvestment benefits “Made in China 2025” strategy

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One of the most attractive highlights in the 22 Measures is that, profits derived within China by foreign investors that are directly reinvested in the state's encouraged projects are eligible for tax deferral treatment provided that certain conditions are met, which means that it is temporary not subject to withholding income tax (tax deferral treatment for reinvestment). The previous *Income Tax Law for Foreign-Invested Enterprises and Foreign Enterprises* also contained a provision on "reinvestment tax refund" to encourage foreign investors to reinvest the profits derived from China back into the country. Currently the scope of encouraged projects has not yet been specified, however, using the Catalogue as a reference, sectors that welcomes foreign investments are mainly manufacturing sectors, especially high-tech and high-value-added sectors. We believe that the tax deferral treatment for foreign reinvestment will help promote the state's national strategy of "Made in China 2025", and effectively attract foreign capital to invest in the state's key development areas such as high-end manufacturing, intelligence manufacturing, and productive service sectors, etc.

Improving the foreign tax credit policy to support the state's Belt and Road Initiative

Currently, a Chinese tax-resident enterprise (TRE) (including the regional headquarters of a multinational corporation) (MNC) is subject to CIT on income derived from both inside and outside China; and it can claim foreign tax credit within a prescribed limit amount for income taxes already paid overseas. The 22 Measures propose that China will study and formulate relevant tax policies to support the repatriation of qualified overseas income by TREs. After the implementation of the Belt and Road Initiative, more and more enterprises have been going abroad. The tax treatment on Chinese enterprise's offshore income will directly impact their investment's rate of return and development strategy. We believe that this policy will certainly support the development of the Belt and Road Initiative.

Extended scope of Service Outsourcing Demonstration Cities (SODCs) to support China's strategy of 'Created in China' to go global

Currently, China has 31 SODCs² nationwide. Qualified Technology Advanced Service Enterprises (TASEs) in these cities are eligible for a reduced CIT rate of 15%. Meanwhile, the tax deductible cap of staff education expenses is increased to 8% of total wages and salaries. The 22 Measures are released to extend the existing CIT preferential treatment applicable to qualified TASEs in the SODCs to the rest of the country. International service outsourcing business will become an important direction in the next stage of China's economy development, which aligns with the globalisation of the service industry and the Belt and Road Initiative. China's service outsourcing industry has huge market opportunity.

Re-emphasises the importance of the introduction of high-level foreign talents

Under the 20 Measures, it is clarified that China will provide convenience and security for foreigners to start their business in China. In particular, it will provide the same treatment available to China citizens to qualified high-level foreign talents in starting a technological enterprise in China, and such talents and their family can enjoy convenience in visa application. The 22 Measures specifies the facilitated measures for foreign talent's entry and exit from China, including formulating the implementation measures for foreign talent's visa application, expanding the scope of visa issuance, relaxing the visa valid period. It is anticipated that the specification in the 22 Measures will facilitate the implementation by the relevant authority departments.

Optimised the business environment to attend to foreign investor's needs in China

Repatriation of profits and dividends and protection of intellectual property rights have always been the major concerns of FIEs in China. In response, the 22 Measures put forward two provisions, one is to ensure the free repatriation of legal profits derived within China, the other is to centralise the dealing with issues relating to the infringement of copyright, patent and trade mark, etc. so as to improve the intellectual property protection mechanism for FIEs.

Furthermore, it is particularly mentioned in the measures relating to optimising business environment that foreign capital is encouraged to participate in the reform of mixed ownership of state owned enterprises in China and foreign investors are also supported to establish a FIE through M&A transactions by simplifying procedures and relaxing restrictions.

The takeaway

According to the latest statistics released by the Ministry of Commerce, China's effective Foreign Direct Investment (FDI) from January to July 2017 amounts to RMB 485.42 billion, which has decreased by 1.2% on a year-on-year basis. However, FDI in high-tech manufacturing and high-tech service sector continues to grow. Against the backdrop of the slowing down of the overall FDI growth in China and the measures undertaken by developed countries such as European countries and the US to attract foreign investments, it is believed that these policies would create an equal and international business environment to attract quality foreign capital into the country. Besides, we see that in recent years China has concluded free trade agreements, investment agreements with many countries, which has also improved the investment environment.

With China's economic transition and the introduction of a series of national development strategies such as the "Belt and Road" Initiative, "Made in China", "Internet Plus" Strategy, "New-Type Urbanisation", FIEs need to make corresponding adjustments to their investment structure and direction in China so as to seize the emerging opportunities during this new period. FIEs may consider changing their strategies in China by shifting from low-end industry focused perspective to a more high-end industry oriented vision, implementing a "localisation" strategy, participating into China's plan of developing city clusters and urbanisation, etc.

The State Council released the 22 Measures and delegated each measures to the respective authorities for implementation. In terms of the 20 Measures and its implementation measures, the complexity and the implementation schedule of these policies vary from one to another. In particular, certain sensitive and monopolised industries would open up slowly and prudently. To address the above, the 22 Measures were issued to emphasise and specify the requirements for implementation. We look forward to the release of the upcoming detailed implementation measures.

In addition to the guidance to attract foreign capital at the state level, we see that a new wave of opening-up to foreign investment is launched in many cities. Cities, such as Beijing, Shanghai, Zhejiang, Hubei, Jiangsu and Fujian, etc. have issued their version of local policies to attract foreign capital, which includes support FIEs to enter into the old age care service sector, apply for service sector development fund, and encourage foreign capitals to invest into PPP projects in China, etc.

We anticipate that the relevant ministries and local-level governments will release their implementation measures in the near future. FIEs are recommended to pay close attention to the new development in this area and actively initiate dialogue with the local government.

Endnote

1. *Notice Issued by the State Council Regarding Measures on Promoting the Growth of Foreign Capital in China (Guofa [2017] No.39). For more details, please refer to the official website: http://www.gov.cn/zhengce/content/2017-08/16/content_5218057.htm*
2. *According to Caishui [2014] No.59 and Caishui [2016] No.108, currently the 31 SODCs in China include: Beijing, Tianjin, Shanghai, Chongqing, Dalian (Liaoning Province), Shenzhen, Guangzhou, Wuhan, Harbin, Chengdu, Nanjing, Xi'an, Jinan, Hangzhou, Hefei, Nanchang, Changsha, Daqing, Suzhou, Wuxi, Xiamen, Shenyang, Changchun, Nantong, Zhenjiang, Ningbo, Fuzhou, Qingdao, Zhengzhou, Nanning, and Urumqi.*

Let's talk

For a deeper discussion of how this issue might affect your business, please contact Kelvin Lee at +86 (10) 6533 3068 or via kelvin.lee@cn.pwc.com