SOVEREIGN

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We are delighted to introduce China Focus, a monthly newsletter that is dedicated to keeping clients up-to-date with the latest business issues effecting new market entrants and established foreign enterprises in China. Each issue will include news and analysis of government, legal and fiscal developments, as well as practical advice on doing business in China.

In conjunction with our regular China Industry Reports, which provide information and analysis on key emerging markets in China, and our annually-updated Market Entry Handbook, this newsletter will equip our clients with the knowledge they need to optimise their market opportunities in China.

Shanghai's Free Trade Zone – What's happening now?

The Shanghai Free Trade Zone (SFTZ) was launched to great fanfare in September 2013. Having been expanded to include Lujiazui Financial Area, Jinqiao Export Processing Zone and Zhangjiang High Tech Park, it now covers an area of 120 square kilometers.

From the outset, there have been uncertainties about the real benefits for foreign investors in setting up in the SFTZ. For example, despite some rumours in the early days of the SFTZ, there are no clear tax advantages for foreign companies who choose to set up there. Many foreign investors appear to have taken a wait and see approach – of the approximately 6,000 companies registered in the SFTZ in 2013, only around 6% were foreign invested. Today that number hovers around 30,000 companies with 16% foreign invested.

Though uncertainty still exists there are some clear improvements for foreign investment given that restrictions have been removed or amended in the areas of real estate, banking, medical institutions, and shipping and cargo handling. Additionally, in a bid to liberalise the legal services industry, a pilot plan was introduced at the end of 2014 allowing local and foreign law firms to operate jointly under a cooperative agreement.

Along with promoting financial and regulatory reforms, the SFTZ also aims to simplify establishment procedures for foreign invested companies. All application procedures can now be handled by the Administration of Industry & Commerce (AIC) within the SFTZ, while companies wishing to set up outside have to deal with numerous different agencies and authorities. Another advantage is that companies in the SFTZ have the option of utilising a relatively inexpensive virtual office, which may be particularly attractive to smaller firms. This is not permitted outside the SFTZ.

Undoubtedly there are benefits for certain industries in the SFTZ, such as the streamlined customs procedures that operate within the zone. However, the initial exuberance with which the announcement of the SFTZ was greeted has abated and it is clear that setting up there may not be as advantageous as some may have anticipated. Companies considering establishing in the SFTZ should assess the costs and benefits of doing so.

With more than ten years' experience of assisting companies with their corporate structuring and site location analysis, Sovereign China can assist you to determine which location would be the best to establish a legal entity in China.

China's 13th Five-Year Plan (2016-2020) – Stable, Upward Growth

China's central government has been using five-year plans since 1953 as a tool to map out economic development strategies, set growth targets and launch economic reforms. China's 13th Five-Year economic development plan went into effect on 6 March 2016.

The 13th Five-Year Plan focuses on stable growth through reforms to key economic sectors, as well as social reforms. In some ways, it is an extension of many of the reforms that began in 2015 – such as reforms to the country's one-child policy and restructuring inefficient sectors of the economy such as steel production. The Plan also reaffirms "the new normal" for economic growth. The Plan sets GDP growth targets at 6.5% in order to "build a moderately prosperous society" by 2020. Although this is still ambitious from a global perspective, it is a much lower target than in previous years.

The Plan focuses on several key areas, which include:

- Innovation: to shift from heavy industry to more information-intensive areas. The R&D sector is targeted to account for 2.5% of GDP by 2020.

- Green development: to develop environmental technology industries further as the government intends to cut CO_2 emissions by 18%, as well as reducing other pollutants.

- Opening Up: increased international co-operation and leadership, which has already begun to take shape in the form of the Asia Infrastructure Investment Bank, which started operation on 25 December 2015, and the "Belt and Road Initiative". China is also expected to further accelerate the liberalisation of the financial sector – including capital markets, banking and insurance – and the social services sector, such as aged-care, healthcare and education.

- Closing Social Gaps: aimed at closing the massive welfare gap between rural and urban households. Investment is expected to improve rural infrastructure, including roads, access to water, power and Internet.

Although the Five-Year Plan does not identify specific opportunities for foreign companies, it does provide a guide to the key sectors that stand to benefit. For example, we expect to see opportunities in healthcare, aged care, child products and other industries targeted in the Plan.

Companies that are considering approaching the market will need to first gain a comprehensive knowledge of the market and any associated risks. Sovereign China can assist you to assess the opportunities and challenges that will apply to your industry. Please contact us at China@sovereigngroup.com.

Local Tax Incentives for Foreign Investment

In 2009, shortly after China began to reform its national incentive programmes so as to target sectors in which it wanted to encourage foreign investment, there was a noticeable downturn in foreign direct investment (FDI). As competition to attract FDI increased, many local authorities decided to introduce their own, unsanctioned, incentive programmes.

Today, many 2nd tier cities, as well as districts and counties on the periphery of Shanghai, Beijing and Shenzhen, are still offering incentives to attract new entrants and established foreign invested enterprises to their localities. While these location-based tax incentives may seem enticing, it is essential that foreign investors should confirm their validity before making any commitments.

In December 2014, China's State Council moved to reassert its authority over the tax incentives offered to foreign investors by declaring any unsanctioned incentive programmes to be invalid with immediate effect and liable to claw backs. The announcement provoked a furious reaction from both local authorities and foreign investors. To avoid jeopardising future foreign investment into China, the State Council therefore amended its original decision. It chose instead to "grandfather" all current local tax incentive programmes for foreign investors and to require local authorities to include provisions for phase-out.

Although local tax incentives remain, these measures have significantly restricted them moving forward. Foreign investors should therefore ensure that the tax incentives they are being offered by local authorities are sanctioned at the State level and find out what provisions have been introduced for their expiration.

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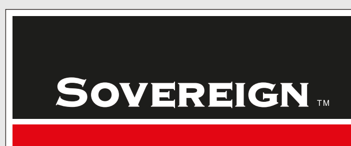

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