Investing In China: Incentives Offered By Local Governments

By David Carnes

China's national government offers a tempting variety of financial incentives designed to lure

inbound foreign investment, some of which were introduced by this author in the article "Investing in China: Tax Incentives". However, additional incentives offered by provincial and local governments significantly sweeten the investor's overall incentive package. These incentives tend to become more generous as one moves westward from the investment−saturated coastal provinces to China's heavily populated interior, allowing the investor to cash in on China's fierce domestic competition.

Central China's Henan province, for example, offers manufacturing−oriented Foreign Invested Enterprises (FIEs) 100% waivers of business tax and a variety of local administrative fees. Furthermore, FIEs engaged in technology transfer, development work, and related consulting may apply for a full refund of business tax already paid.

Municipal governments, however, are often even more generous than provincial governments. Although various incentives are offered by Chinese municipal governments, the city of Zhengzhou (a metropolis of about 4.4 million people in central China) makes a good case study, if for no reason other than that the author is more familiar with its policies.

Zhengzhou rewards local FIEs in various ways:

Tax Breaks for Local Reinvestment of Profits Local FIEs that reinvest their profits within Zhengzhou will receive a 30% refund of the locally retained portion of corporate income tax actually paid on these reinvested profits (the national government offers an even bigger tax refund applicable to the nationally retained portion).

Investment in "Pillar" Industries and State−owned Enterprises Zhengzhou offers a three−year, 50% refund of the locally retained portion of corporate income tax paid on FIE funds invested in certain designated "pillar industries". It also offers a financial incentive for investing in and reorganizing provincially administrated state−owned enterprises, and this incentive is magnified if the FIE retains a certain percentage of the enterprise's original employees after reorganization.

Inward Remittance of Export Earnings Zhengzhou offers export incentives in the form of cash payouts of approximately 0.2% to 0.5% of every dollar of hard currency export earnings remitted inward (the highest payouts are reserved for the export of technologically advanced products).

Matching Funds The Zhengzhou municipal finance administration will provide one−to−one matching funds for the international market development funds of small and medium−sized export enterprises that are supervised at the provincial level (whether an enterprise is supervised at the provincial level or the national level depends on how much money has been invested in the enterprise, i.e., its "Registered Capital").

Anti−Dumping Insurance Zhengzhou will assist FIEs in responding to anti−dumping initiatives, and will also subsidize expenses arising from participation by exporting enterprises in anti−dumping responses, as long as these initiatives are not otherwise subsidized by national and provincial authorities (which they often are). It may seem strange for an American company to establish a subsidiary in China, be

sued for dumping by the United States, and then receive subsidies from the Chinese government for the expenses necessary to defend against the suit, but it's possible.

Interest Subsidies for Loans Secured by Tax Refund Accounts. Zhengzhou will subsidize an amount equal to 70% of the interest due on loans secured by a tax refund account. If the FIE has no such loans, Zhengzhou will grant a subsidy equal to 50% of the interest that would have been paid on such a loan had it been taken out - the Zhengzhou municipal government will even provide the fund from which the interest is subsidized. Enterprises with an export volume of five million US dollars or more in the previous year that are verified by the National Tax Bureau to have increased tax refunds due for the current year will enjoy a 100% interest subsidy.

Export Incentives An export enterprise with either (i) a yearly export volume of at least ten million US dollars or more and actual export growth of more than 25% over the previous year, or (ii) a yearly export volume of at least five million US dollars, actual export growth of more than 40% over the previous year, and inward remittances from exports of at least 80%, will be designated a "Zhengzhou City Advanced Foreign Exchange Generating Export Enterprise" and awarded 30,000 RMB (roughly $3,500 US dollars) as long as it has not committed any serious regulatory violations during the same year.

Although a few of the foregoing incentives represent relatively small payouts, they are numerous and can make a significant difference when combined with the broad range of incentives offered by the national government.

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Investing In China: Tax Incentives

By David Carnes

The People's Republic of China offers a variety of tax breaks and financial incentives to encourage inbound investment.

National government incentives vary based on how much money you are investing and whether or not your project is located in one of China's special economic zones; local incentives vary by jurisdiction according to relative bargaining power. The tendency in recent years has been for China's central and western provinces, who have been starved of foreign investment in comparison with well−fed coastal cities like Shanghai and Beijing, to offer incentive packages that are considerably more generous than those offered to foreign investors `back east'. The national government is now actively encouraging foreign investors to pour money into China's relatively undeveloped hinterlands in order to spread wealth more evenly throughout the country and stem the flow of economic migrants to the coast.

China's standard corporate tax rate is set at 30%. However, in certain locations the rate can decrease dramatically. Enterprises located in certain areas designated as "open to foreign investment" pay only 24%. The favored children among overseas investors, however, are enterprises located in national−level economic and technical development zones, such as certain industrial parks like Suzhou Industrial Park (near Shanghai) and California Industrial City (in central China). They enjoy a permanent corporate tax rate of only 15% − but even that rate only kicks in during the sixth profit−making year. The rate is zero for these enterprises during their first two profit−making years, and rises to only 7.5% for the following three years, before returning to 15% for the sixth year. Any enterprise classified by the P.R.C. government as a "Technologically Advanced Enterprise" or an "Export Oriented Enterprise" (an enterprise with an export value of at least 70% of its production value during any given year) enjoy a corporate tax rate of only 10% for their sixth through tenth profit−making years.

China offers further tax incentives for enterprises that reinvest their profits domestically, and these incentives operate in addition to rather than in replacement of the above tax incentives. In particular, enterprises that reinvest their profits to increase their own capital or to establish or invest in another foreign invested enterprise in China are eligible for a refund of 40% of the corporate taxes already paid on those reinvested profits. The refund rate rises to 100% if the enterprise in which profits are reinvested is classified as a Technologically Advanced Enterprise or Export Oriented Enterprise. This refund must be returned, however, if the reinvested finds are withdrawn within five years.

The foregoing description is not exhaustive − China offers various other investment incentives. That was the good news; the better news is that incentives are offered not only by the national government but also by provincial and local governments that compete fiercely with each other for a slice of China's lucrative foreign investment pie. But that's another article.

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