

**PRC State Council issues new policies – China continues to be  
interested in foreign investment, but focus will be shifted**

On 6 April 2010, the PRC State Council issued the circular Certain Opinions in Respect of Further Improvement in the Utilization of Foreign Investment (“Circular No. 9”). Circular No. 9 sets the tone for China’s foreign investment policies for the coming years.

As is usually the case with such policy circulars issued by the State Council, Circular No. 9 only provides general policies and guidelines, which must be implemented by the relevant ministries and departments by means of circulars and other regulations. Publication of these regulations can be expected in the near future. The major new developments announced are as follows:

**1. Further Revision of Guideline Catalogue of Foreign Investment Industries Expected**

The Guideline Catalogue of Foreign Investment Industries (“Catalogue”) is a major tool for establishing which industries are open for foreign investment. The current version of the Catalogue dates from 1 December 2007. Under the Catalogue, foreign investment projects are divided into encouraged, permitted, restricted and prohibited categories, depending on the industry sector. Encouraged foreign investment projects have always benefited from certain preferential policies. E.g. production foreign invested enterprises (“FIEs”), which fall into the encouraged category, can import equipment for self-use within their total amount of investment with customs duty exempted. Circular No. 9 confirms this principle, e.g. by expressly allowing the granting of preferential purchase prices, i.e. 70% of the minimum land granting fee as set in the Minimum Land Price Standards, to foreign investment projects that fall into the “encouraged” category and will make intensive use of the land.

Circular No. 9 confirms that in order to meet China’s economic development requirements, foreign investment in new and high technology industries, modern service industries, new energy industries, and environmental protection etc. will continue to be encouraged. In contrast, projects that involve high energy consumption, generate significant amounts of pollution or feature the application of low-end technologies etc. will be prohibited. We, therefore, expect that the 2007 version of the Catalogue will be further revised in the near future.

**2. Multinational Companies Are Encouraged to Set Up Functional Centres in China**

The establishment of regional headquarters and R&D centres has long been supported by the central and regional governments. Circular No 9 further encourages multinational companies to establish other functional centres in China, such as purchasing centres, financial control centres, cost and profit accounting centres etc. Detailed new regulations and policies are expected to be announced in due course.

To encourage the establishment of foreign-invested R&D centres in China, the State Administration of Taxation issued Tax Circular Caishui [2009] No. 115 on 10 October 2009. This circular stipulated that until 31 December 2010, foreign-invested R&D centres meeting the relevant conditions are exempted from import duties and consumption taxes for imports in the interests of scientific and technological development. Circular No. 9 confirms this preferential policy. However, it remains to be seen whether it will be extended beyond the end of 2010.

### **3. Foreign Investment in the Central-Western Region Continues to Be Encouraged**

With the central and western regions of China still lagging behind in the terms of economic development, the Chinese government is keen to attract further investment in these regions. Apart from industry sectors already covered under the Catalogue of Priority Industries for Foreign Investment in the Central-Western Regions, Circular No. 9 stipulates that foreign-invested labour-intensive projects that comply with the applicable environmental protection requirements will be added as industries in which foreign investment is encouraged.

Circular No. 9 also states that both domestically funded and foreign-invested enterprises in Central and Western China which meet the relevant conditions will continue to be entitled to enjoy corporate income tax incentives. These enterprises are currently entitled to a preferential corporate income tax rate of 15% until the end of 2010. Judging from the wording of the circular, this preferential tax rate may be further extended beyond 2010.

### **4. M&A by Foreign Investors Is Encouraged**

In addition to greenfield projects, mergers and acquisitions play an important role in the foreign investment field. Circular No. 9 encourages foreign investors to participate in the reorganization and restructuring of Chinese enterprises via

mergers and acquisitions. However, at the same time, Circular No. 9 also stressed the importance of the anti-monopoly examination and security review in this connection to ensure that mergers and acquisitions by foreign investors do not create monopolies or endanger China's national security. It remains to be seen, how this caveat will be implemented in the future practice.

#### **5. Approval Competence on Foreign Direct Investment to Be Further Delegated**

Pursuant to the Interim Measures on Administration of Verification of Foreign Invested Projects effective 9 October 2004, a foreign-invested project must first be verified by the competent Development and Reform Commission ("DRC"). A project in the encouraged or permitted category with total investment of USD 100 million or above, or in the restricted category with total investment of USD 50 million or above, is subject to the approval of the State DRC. For reasons of efficiency, Circular No. 9 now allows the State DRC to delegate its approval competence to its local counterparts for foreign-invested projects in the encouraged or permitted category where total investment does not exceed USD 300 million, excluding the financial and telecommunications industries. The State DRC has yet to issue relevant regulations for actual implementation.

#### **6. Foreign Invested Enterprises that Meet the Relevant Conditions Are Encouraged to Issue Publicly Traded Shares, Corporate Bonds and Mid-term Notes**

In the past, FIEs were in theory also allowed to issue publicly traded shares. However, in practice few FIEs have received approval to be listed and can issue publicly traded shares. Furthermore, as far as we are aware no FIE has issued any corporate bonds or mid-term notes thus far. The promulgation of Circular No. 9 is a clear signal that the PRC government intends to loosen its restrictions in this area. Given the strong performance of the Chinese stock markets in the past, this presents interesting financing opportunities for FIEs.

#### **7. Grace Period for Capital Contributions of FIEs**

Under PRC law, the registered capital of an FIE must normally be contributed within two years of issue of the business licence. Circular No. 9 expressly allows a grace period to be granted to FIEs whose operations comply with the law but whose registered capital cannot be contributed due to temporary financial difficulties. This policy is designed to retain foreign investors who have suffered from the worldwide economic crisis and still need some time to

recover. Circular No. 9 does not stipulate how long the maximum grace period can be. It is expected that this issue will be dealt with in the detailed implementation regulations, which are in any case necessary.

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