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# *Asia Pacific Tax Newsalert*

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## *Qianhai – An attractive Chinese location for foreign investment*

### *In brief*

The State Council of China recently confirmed the preferential policies and tax incentives for the Qianhai Modern Services Industry Cooperation Zone (Qianhai)<sup>1</sup>. These policies and incentives, which could benefit multinationals seeking to invest in China, were issued through a notice, Guohan [2012] No. 58 (Notice 58) on June 27, 2012.

Since 2008, most tax incentives for foreign invested enterprises have been removed, and the remaining tax incentives mainly are granted to high-tech enterprises and enterprises located in western region of China. Alternatively, Qianhai located in Shenzhen, a coastal city in Southern China, may be attractive to multinationals from both a geography and a tax perspective. In fact, Qianhai is designed specifically for modern service industries such as finance, modern logistics, information technology, etc.

### *Highlights of the preferential policies and tax incentives*

The policies and incentives apparently were designed to attract investments from modern services industries, especially those in the financial services sector.

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<sup>1</sup> Qianhai is located at west of Shenzhen and is an area of approximately 15 sq km.

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## Preferential policies

Notice 58 encourages the development and delivery of innovative financial services and products in Qianhai on a trial basis, with emphasis on:

- certain forms of cross-border RMB lending and RMB bonds issuance;
- establishment of equity investment funds (including private equity), especially 'fund-of-funds';
- relaxation of investment thresholds for Hong Kong-based financial institutions to invest in Qianhai;
- innovative development of financial products/services and exchanges/trading platforms for new developed financial products/services; and
- establishment of regional headquarters for multinational financial institutions.

Notice 58 also encourages cooperation in the education, legal, medical and telecommunication services between Qianhai and Hong Kong.

**Tax incentives** – The tax incentives offered under Notice 58 include:

Types of Tax	Tax Incentives
<b>Corporate Income Tax (CIT)</b>	Qualified enterprises <sup>2</sup> will be eligible for a reduced CIT rate of 15% on their taxable profits.
<b>Individual Income Tax (IIT)</b>	Overseas 'talents' and 'professionals in short supply' (collectively 'qualified expat talents') working in Qianhai will receive an IIT rebate from the Shenzhen municipal government to equalize their effective income tax burden. Such rebate will be exempt from IIT.
<b>Business Tax (BT)</b>	Qualified logistics companies that are registered in Qianhai may apply a net basis for BT reporting.

## PwC observations

### Which tax incentives are helpful?

The reduced 15% CIT rate (versus the current standard 25% rate) for qualified enterprises established in Qianhai will likely attract investment to the zone.

China's IIT burden on employment income is quite high in general (i.e., progressive rates from three percent to 45%) when compared to other jurisdictions in the region, especially Hong Kong (capped at 15%) and Macau (capped at 12%). The IIT rebate policy provided in Qianhai should attract qualified expat talents to work in the zone.

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<sup>2</sup> In order to enjoy the 15% CIT rate, an enterprise must be listed in the upcoming Catalogue for Encouraged Industries in the area.

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## Other business opportunities

Apart from the tax incentives, businesses may also find the following features appealing when considering investments in Qianhai.

- Qianhai is positioned as an 'experimental zone to facilitate China's long-term strategy for financial reform and open up the financial services sector, in particular to advance the internationalization of the RMB. Certain innovative financial services and products (especially those denominated in RMB and related to capital items) may be introduced in the zone. Finance companies might appreciate a first mover advantage by investing in the zone before expanding into China's broader financial services market.
- The notice encourages Qianhai to explore mechanisms for channelling overseas RMB back to China. In particular, enterprises/projects in Qianhai will be allowed to borrow RMB loans from Hong Kong-based financial institutions and issue RMB bonds in Hong Kong within the State Council-approved quotas in order to support development in Qianhai. Such investors could take advantage of the lower financing costs in the Hong Kong financial markets. On the other hand, foreign/Hong Kong investors will have more investment channels for RMB that is currently pooled offshore.
- Qianhai is located in Shenzhen which is adjacent to Hong Kong. Hong Kong service providers will be allowed to establish wholly-owned international schools and hospitals in the zone. This accessibility and convenience could make Qianhai a favorable location for expat talents.

## Uncertainties

### *Effective term*

The announcement in the notice does not mention a starting date or term for the preferential policies and tax incentives. However, these policies will likely remain effective at least through December 31, 2020.

### *Industries catalogue*

The notice broadly lists the modern services sectors that will be supported in Qianhai. The detailed Catalogue of Encouraged Industries for Qianhai has not yet been formulated and approved by the relevant government bodies.

### *Implementation details for IIT rebate*

How will taxpayers compute the IIT rebate? Will the IIT burden of the qualified expat talents be reduced to levels on par with their liability if they worked in Hong Kong or Macau? Will the tax residents from Hong Kong, Macau and other overseas jurisdictions be eligible for the same level of rebate? Also unclear is the definition and scope of 'qualified expat talents'. Hopefully the Chinese government soon will provide detailed implementation rules and clarify the remaining uncertainties.

## Conclusion

With a clear definition of its position, Qianhai is expected to leverage the comparative advantages of both Shenzhen and Hong Kong. As reported in a news media, 37 companies/groups (among which 18 are from the financial service sector) have

signed memoranda of interest to invest in Qianhai during a business promotion conference held by the Shenzhen government on July 16, 2012. We expect the Chinese authorities at both the state and municipal levels to launch a series of implementation measures in the future. We will monitor developments and share additional insights as warranted.

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Solicitation.

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