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HENDERSEN TAXAND

Energy Overview

Since the 18th CPC National Congress in 2012, China has entered a new era for high-quality energy development.

According to Energy in China's New Era published in December 2020, China categorizes energy types into coal, oil, natural gas, electricity, nuclear energy, new energy and renewable energy.

On September 2020, President Xi pledged that China will scale up its intended Nationally Determined Contributions by adopting more vigorous policies and measures, striving to have carbon dioxide emissions peak before 2030 and to achieve carbon neutrality before 2060.

On February 29, 2024, Xi re-emphasized that energy is the lifeline of the economy and industrial development, and China shall vigorously promote the high-quality development of new energy continuously in the upcoming years.

In order to support the development of new energy in China, the country has been implementing a series of preferential policies nationwide for new energy vehicles, energy storage, hydrogen energy, photovoltaics, wind power, and other fields. These preferential policies include but are not limited to financial subsidies, tax reductions and financial support.

From 2019 to 2023, the number of investment and merger transactions in the new energy industry in China were 304, 299, 439, 512, and 647 respectively, showing an overall upward trend.

With a large number of funds pouring in to promote capacity expansion, the scale of the photovoltaic industry continues to grow. However, there is also an oversupply situation, leading to a continuous decline in the prices of photovoltaic products from 2023.

Competition for lithium resources is becoming increasingly fierce, and sodium and hydrogen battery technologies are attracting more attention from companies.

By the end of 2023, the cumulative installed capacity of newly built and operational storage projects nationwide reached 31.39 million kilowatts/66.87 million kilowatt-hours, with an average energy storage duration of 2.1 hours.

Tax Overview

All provinces in China follow the same tax rules to impose income taxes. The major taxes include Value Added Tax ("VAT"), Enterprise Income Tax ("EIT") which needs to be paid when conducting business activities and Individual Income Tax ("IIT"). There is also a consumption tax on some specific types of goods, vehicle purchase tax and resource tax which needs to be paid when extracting natural resources.

China also imposes withholding VAT and EIT on various payments of active and passive natures (e.g., interest, dividends, royalties and labour services) made by Chinese residents to non-residents.

The applicable withholding VAT rate will be all 6%. The EIT rate will be 10% for passive incomes including interest, dividends, royalties, and will be 3.75% to 12.5% for on-shore labour services. Off-shore labour services (if accepted by authority) will not be subject to withholding EIT.

China levies income tax on the world-wide income of persons (including corporations) that are residents of China. This also applies to individuals (including non-residents) earning income from carrying on a business in China.

Taxation of Energy Projects

China has a considerable number of tax preferential policies for energy enterprises, mainly applicable to the following four types of corporations:

- Corporations that support environmental protection;
- Corporations that promote energy conservation;
- Corporations engaged in comprehensive utilization of resources; and
- Corporations that promote the development of low-carbon industries, such as wind resources, hydropower resources, and photovoltaic resource corporations.

Tax preferential policies for major taxes in China include, but are not limited to, the following aspects:

EIT

- **If an eligible** energy service company that carries out an energy performance contracting project meets the relevant provisions of the Corporate Income Tax law, it is entitled to the exemption of corporate income tax from the first year to the third year since the tax year in which the project had its first production and operation income, and it may enjoy a tax reduction by half of the 25% statutory tax rate from the fourth year to the sixth year.

VAT

- Taxpayers selling self-produced electricity products generated using wind resources are eligible for a 50% VAT refund;
- Energy service companies are entitled to exemption of VAT for energy goods/services contracting projects (for e.g., energy management);
- Another tax preferential policy, effective from 2019, which is nationally applicable to all corporations is a taxpayer which meets corresponding requirements may apply for the refund of incremental uncredited input VAT amount.

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Any taxpayer who meets **all** of the following criteria may apply:

- From the tax period of April 2019, the incremental uncredited input VAT for each of six consecutive months (two consecutive quarters if taxed quarterly) is a positive number, and the incremental uncredited input VAT in the sixth month is not less than CNY500,000;
- Its taxation credit rate (in China tax system) is A or B;
- It has not committed fraud for overpaid VAT refund or export refund or falsely issued special VAT invoices for 36 months before its claim for VAT refund; and
- It has not been penalized by tax authorities for two or more times for tax evasion for 36 months before its claim for VAT refund.

Consumption Tax

Batteries made by some kind of new resource are exempted from consumption tax, such as solar cells.

Thin-Capitalization Rule

State Administration for Foreign Exchange ("SAFE") will ask to review whether the Chinese entity has sufficient Foreign Debt Quote ("Quota") balance. The Quota is generally calculated based on the Registered Capital (Paid-in Capital) of the Chinese borrower, as follows.

Registered Capital (X, unit in Million USD)	Maxim Cap for Foreign Loan (Y, unit in Million USD)
0<X<2.1	Y = 3/7 X
2.1<=X<5	Y = X
5<=X<12	Y = 1.5 X
12<=X	Y = 2 X

China has a Thin Capitalization Rule which applies to interest on an excess related party loan. Interest paid to a related corporation is deductible if the debt/equity ratios are observed:

5:1 for financial service enterprises; and

2:1 for non-financial service enterprises

Interest on the debts in excess of the ratios will be non-deductible and cannot be carried forward.

Other Tax Issues To Be Considered

Chinese energy projects are complex and tax-intensive, and often include a variety of taxes. In additional to the major taxes mentioned above, the Chinese government also offers various preferential policies for the following taxes:

New energy automobile industry

- New energy vehicles are subject to a 50% reduction in vehicle and vessel tax;
- Provinces in China have different levels of financial subsidy policies for corporations.
- China has been providing financial subsidies for new energy automobiles since 2010, including but not limited to exempting vehicle purchase tax (expired in 2022) and subsidizing each new energy vehicles with up to CNY 60,000 (expired in 2019).

Mining industry

- Coal (layer) gas required to be extracted by coal mining enterprises due to work safety needs shall be exempted from Resource Tax;
- 30% Resource Tax reduction for mineral products exploited from depleted mines;
- The Resource Tax on shale gas shall continue to be reduced by 30%;
- Part of the land for hydroelectric power stations is exempted from urban land use tax;
- Other taxes may include mineral resources compensation, mining rights usage fee, mining area usage fee, land reclamation fee and other compensation fees.

Relevant Experience

- Hendersen has previously assisted on the spin-off of Alstom China business lines, advising on the restructuring implications in comprehensive detail.
- China tax compliance, advisory and retainer services for SABIC;
- China restructuring, Customs related and repatriation advisory projects for GE Energy;
- TP benchmarks and local files for BP China.

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