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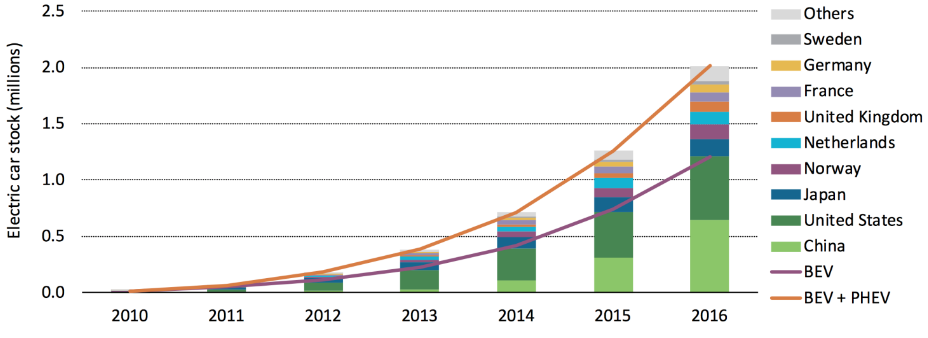
Electronic Vehicles in China: the rise of the new leader

Saro Capozzoli, Giovanni Maria Guidotti – Jesa

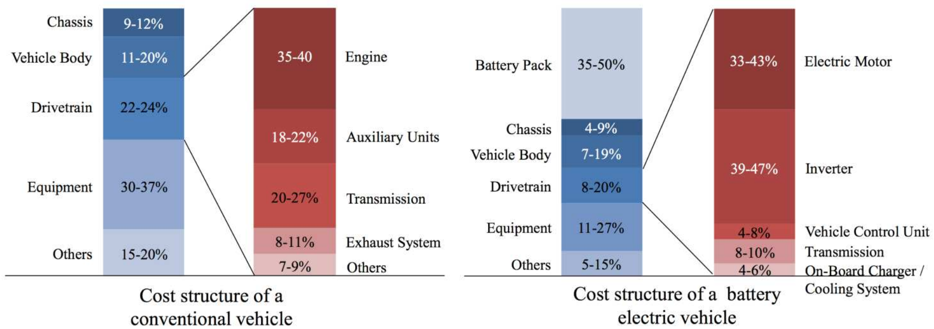
The registration of new electric cars reached a peak in 2016, with over 750.000 sales worldwide, as reported by *International Economic Development Council - IEDC*. Norway was the most virtuous country, achieving the highest market share in terms of electric cars deployment with 29%. China had a market share of 1.5%, similar to that of France and the United Kingdom. In the same year, China was also the largest electric car maker, accounting for more than 40% of the electronic vehicles' (EVs) sold worldwide, more than double the amount sold in the United States.
The global electric car stock surpassed 2 million vehicles in 2016, after exceeding the 1 million thresholds the year before.



Graph Source: International Economic Development Council

In 2015, China overtook the United States as the country with the largest stock worldwide, accounting for approximately a third of the global total. With more than 200 million electric two-wheelers, 3-4 million low-speed electric vehicles and more than 300 thousand electric buses, China is also by far the global leader in the electrification of other transport modes.

According to findings of a research financed by the *Technische Universität Munchen* and the *Singapore National Research Foundation,* a quick comparison with conventional vehicles shows how the cost structure of EVs is heavily influenced by the price of batteries that can reach 50% of the total cost and skews it. However, this number is supposed to decline in the next years due to a decrease in battery costs, and this will shrink the current price gap between EVs and conventional vehicles. In the upcoming years, this situation will likely lead to an increase in the EVs' market share against the one of conventional vehicles.

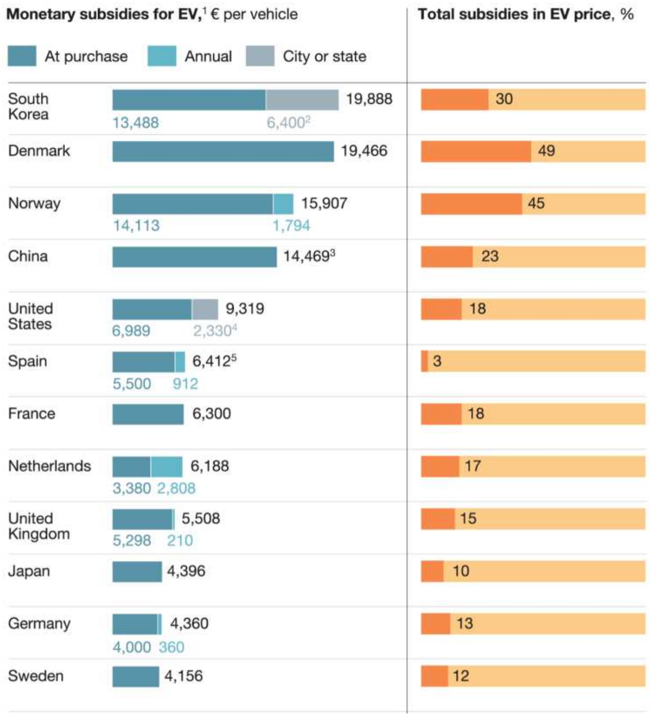


Graph Source: "An Overview of Costs for Vehicle Components, Fuels and Greenhouse Gas Emission."

China is the fastest-growing market in Asia, with its combination of high population, low oil production and heavy government involvement. As reported by McKinsey, in 2016, 507,000 EVs and Plug-in Hybrid EVs (PHEVs) were sold in China, which represents 53% increase since 2015. This shows how the country is taking the lead against Europe (with 222,200 vehicles sold, equal to 14% increase) and the United States (157,130 sold, 36% increase).

The increasing prominence of China in this industry is a crucial matter: indeed, the population probably has no other possible option than driving EVs. The number of conventional vehicles in China is growing steadily, and this will bring problems related to air pollution and energy independence; at the same time, it is not realistic to restrain the transportation choices for citizens. The combination of the sheer size of China population (1.3 billion) and the rise in per capita incomes is translating into a growing demand for personal transportation: already in 2016, China was the largest auto market in the world, with 28 million vehicles produced. Thus, EVs seem the best option.

In the last 15 years, the government has invested more than $15 billion in areas related to EVs-production, with aiming at reaching 7 million of annual sales in EVs and PHEVs by 2025. This is supported by the great subsidies the government has offered so far, amounting to an average of approximately 15,000€ per vehicles, one of the highest worldwide (and ahead of countries such as the USA, Germany and Japan).



Graph Source: McKinsey

The government's support has four goals, indicated as below:

- To create a world-leading industry that would produce jobs and exports;
- To build up energy security to reduce oil dependence (mainly from Middle East);
- To reduce urban air pollution;
- To reduce carbon emissions.

So far, it seems that the Chinese aim to give birth to local champions has been reached. Important gains have been made across all dimensions of the supply side of EVs: Chinese OEMs accounted 43% of the global EVs production in 2016, and leading Chinese EVs manufacturers are all ranked among the global top ten. In addition, the country's share of lithium-ion battery-cells reached 25% last year (mainly at the expense of Japanese players). The EVs market in China is getting extremely hot: 25 new models were introduced last year, for a total range of 75 models available. This is the most of any market globally.

Still, this could not be enough, as China could soon place even more pressure on the industry. Indeed, according to the new Car Policy document (Chapter III, Point 24) producers will be required to sell at least a certain amount of EVs and PHEVs in the upcoming years. The quota will be 8% of the cumulative number of vehicles sold in 2018, and will then rise to 10% in 2019 and 12% in 2020. The producers that will not be able to reach it will face the serious risk of having their licenses revoked. The ratio behind this strategy is to tide up an industry plagued by many small firms that cheated the government in order to get subsidies by affirming to be EVs producers. The final aim would therefore be to consolidate the industry, hence facilitating the life of the local champions.

Nevertheless, the quotas met much criticism from Western producers that deem them as way too ambitious to reach. The disapproval reached politics highest levels, with the German Chancellor, Angela Merkel, personally discussing the matter with the Chinese Premier, Li Keqiang, last June. While sources close to the matter affirmed that Merkel and Li found an agreement on delaying the quotas introduction for at least one year (thus starting in 2019), the latest draft published by the China's Ministry of Industry and Information Technology (MIIT) left the provision unchanged. How the issue will end is still uncertain. It may be only an internal phase out between China's political leadership and the MIIT; on the contrary, if the quotas will be confirmed, they will cause serious repercussions to Western producers. While some, like Volkswagen AG, are said to be able to meet the quotas, there could be fatalities in the industry. A quick switch to EVs production would not be easy to execute, and the technological and IP requirements could make even acquisition of local producers not a viable way.

As our Founder, Mr. Saro Capozzoli, recently told to the Italian newspaper *Linkiesta*, "Things here (in China) are moving much faster than Europe can expect. Either Western producers change quickly, or they will risk to exit soon from the market". Producers will be better off by starting preparing themselves.

Regulation of disabled workers in China: what should companies know?

Saro Capozzoli, Giulia Canciani Graziani – Jesa

Source: www.twothirdsoftheplanet.com

In the last decades, China has changed and developed its behaviour and attitude towards disabilities, especially regarding its disabled workforce. Before the 80s', it was common to refer to the disabled as "*can fei*" (残废), that means "the handicapped and useless".

A slow but effective process has brought important changes in the way Chinese society treats disabled people, prevalently thanks to the efforts and social involvement of people within the disabled community. Also the government supported initiatives for the disabled community.

In 1982, the *Constitution of the People's Republic of China* ensured protection to people with disabilities: *art. 45* states that "Citizens of the People's Republic of China have the right to material assistance from the State and society when they are old, ill or disabled. The State develops social insurance, social relief, and medical and health services […] The State and society help make arrangement for the work, livelihood and education of the blind, deaf-mutes, and other handicapped citizens."

Definition of "disability" according to the Chinese legislator

In 1990, the *Law of the People's Republic of China on the Protection of Disabled Persons* gave a first precise definition of *disability*. *Art. 2* refers to a disabled as "one who suffers from abnormalities or loss of a certain organ or function, psychologically or physiologically, or in anatomical structure and has lost, wholly or in part, the ability to perform an activity in the way considered normal. The term *disabled persons* refers to those with visual, hearing, speech or physical disabilities, mental retardation, mental disorder, multiple disabilities and/or other disabilities."

Furthermore, the Constitution establishes that disabled citizens shall have the same rights as non-disabled ones in the political, economic, cultural and social environments, in family life and other aspects (*Art. 3*). The State shall provide the disabled with special assistance. This special assistance shall be provided by adopting supplementary methods and supportive measures to alleviating, or eliminating, the effects of disabilities, as well as external barriers to make sure the disabled persons' rights are realized (*Art. 4*).

Incentives for companies hiring disabled workers

The Government's involvement in the disabled people's rights led to the *IV Chapter of the Law on the Protection of Disabled Persons*, which refers to disabled people's employment.

Art. 33 guarantees two main advantages to companies hiring disabled employees:

1. Tax reduction or exemption (that are analyzed below);
2. Priority or exclusivity in producing products that local governments and departments determine as suitable to be manufactured by disabled workers.

Tax incentives

In China, nowadays, there are three main types of tax incentives for companies hiring disabled workers:

Tax incentives for hiring Disabled Staff			
Tax Type	Benefit	Policy	Scope
Corporate Income Tax (CIT)	Exemption	Salaries paid to disables employees are eligible for a 200 percent deduction of CIT	National
Individual Income Tax (IIT)	Reduction	Income tax levied on the salary of a disabled employee is reduced	National, but the deduction amount differs from region to region
Value Added Tax (VAT)	Exemption	Taxable services provided by disabled persons are VAT exempt, but with a limit of RMB 35,000 per year	National

Source: www.chinabusinessreview.com

Nevertheless, not every kind of company can enjoy tax incentives: companies' eligibility depends on their size and location.

Corporate Income Tax (CIT)

The *Corporate Income Tax Law* (2007) makes it possible for companies to deduct a non-disabled employee's annual salary from profits taxed by CIT; while for a disabled employee, the salary can be deducted for double its value.

Art. 3 of the *Notice on Policies concerning Corporate Income Tax Incentives* for Employment of Disabled Persons, Cai Shui (2009) No. 70, issued by the MOF and the SAR on April 30, 2009 and effective on January 1, 2008, sets the standards that a company must accomplish in order to benefit from the doubled salary deduction:

1. The enterprise must sign an employment or service contract with a duration of at least one year
2. The salary shall not be less than the minimum wage prescribed by the country or district government where the enterprise is located
3. The company has to pay for any kinds of social insurance for employees according to requirements of the government

Individual Income Tax (IIT)

Any disabled person in China is eligible for tax deduction, but rules differ from region to region.

Generally speaking, IIT deductions are higher when the salary is lower and are lower when the salary is higher.

City	IIT Deductions for Disabled persons in the main Chinese provinces
Beijing	30% of deduction for disabled workers
Shanghai	Maximum deduction: 5640 RMB
Guangzhou	Deduction 50% (income < 60.000 RMB) Deduction 40% (60.000 - 100.000 RMB) Deduction 30 % (100.000 - 150.000 RMB) Deduction 20% (150.000 - 200.000 RMB) Deduction 10% (income > 200.000 RMB)
Nanjing	Deduction 100% (Income < 5.000 RMB) Deduction 50% (5.000 - 20.000 RMB) No deduction (Income > 20.000 RMB) Maximum deduction: 20.000 RMB

Value-Added Tax (VAT)

To be eligible for VAT exemption, a company must meet all the 3 requirements for CIT exemption. Plus, a company must fulfil additional requirements that are:

- At least 25% of the total workforce must be disabled;
- At least 10 employees of the total workforce must be disabled.

This means, generally, that only large companies can obtain the VAT exemption.

Minimum quota to hire disabled employees

The P.R.C. *Disabled Persons Security Law* and the *Rules of Employment of Disabled Persons* set at 1.5% the minimum quota of disabled employees that a company must hire. The rate can be different, but never lower, from province to province. For example, the quota is 1.6% of a company's workforce in Shanghai and 1.7% in Beijing.

In 2015, the P.R.C. Ministry of Finance, the P.R.C. State Tax Bureau and the China Disabled Persons Federation, issued the *Methods on Levying, Use and Management of Disabled Persons' Employment Security Fund*. These rule that, if a company does not reach the quota, it must pay a fee into a fund named "*Baozhang Jin*". In other words, a company can decide either to hire the disabled worker's mandatory quota or pay (avoiding paying salaries to disabled workers). As a matter of facts, many companies prefer to pay the fee, making it one of the main reasons for low disability employment rate in China.

Nevertheless, companies with less than 3-year activities that employs less than 20 employees are exempted from the application of the quota.

How to calculate the fee amount:

Payable amount = [number of total staff of the previous year (term of one year or more) × rate required by the local government – number of hired disabled persons] × average annual salary of the employees in the previous year.

Disability policies' aim

The main aim of disabled workers related policies is to lead the country to a point where every company will either hire disabled employees or contribute to the disabled persons' employment security fund.

Companies that refuse to take any of the above mentioned solutions can refer to *Rules of Employment of Disabled Persons.* These mention that the competent administrative authority may give companies a warning and ask them for rectification within a prescribed time limit. For each day of delay in the fee's payment, the company may be required to pay an extra fee: 0.5% per day of delay.

What should companies do?

As discussed above, a company that operates in China has to deal with a large number of variables related to employment and taxation. The best decision for one company may not be efficient for another company. Differences are related to diverse elements, such as the province in which the company operates, its employees' number, and its turnover.

A general overview of Chinese Laws is not enough to take the right strategic decision, because every company has different features and needs while facing a unique context and situation. Because of this, the most appropriate strategy to pursue an efficient and tailored solution is to rely on a consulting company, capable of giving the proper advising service, sharing knowledge on the complicated Chinese business environment. In this way, it can be possible not only to adapt to the fast changing Chinese policies but also to take advantage from the trade-off between hiring a disabled worker and paying a fee to the *Baozhang Jin* fund. Relying on experts can be a proficient way to take an active and rewarding role.

CONTRIBUTORS:

Saro Capozzoli
Scott Sun
Giovanni Maria Guidotti
Giulia Canciani Graziani
Beatrice Bin

For inquires and suggestions regarding this newsletter or for any other concerns, please contact us anytime at:

saro@jesa.com.cn
alessandra@jesa.com.cn

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SHANGHAI's Headquarters

LANE 112 FENYANG ROAD – House 4
200031 SHANGHAI - CHINA
Tel +86 21 64331555
Fax +86 21 62880072

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Saudi Arabia, Mongolia, Chile, Finland