Renewed commitment

China is showing its dedication to the renewable energy sector through amendments to legislation and the creation of incentives for domestic usage, while importation of renewable energy equipment continues to face difficulties

Beijing's focus includes the solar energy sector

Recent amendments to national legislation, and new incentives at both the national and local levels, demonstrate China's deepening commitment to developing renewable energy technology, equipment production, grid connections and exports. The domestic renewable energy industry will benefit from further clarification of requirements and increased government planning, support and investment incentives. The recent changes do not fundamentally reduce the difficulties faced by prospective importers of renewable energy equipment into China, or the likelihood of foreign political resistance to China's surging exports.

Renewable Energy Law amendments

Amendments to the *PRC Renewable Energy Law* (Pending Amendments), which were adopted in December 2009, will take effect on April 1 2010 with retroactive application from January 1 2006. (The original *PRC Renewable Energy Law*, effective from January 1 2006, was surveyed in *Renewable Energy Law Encourages a Hundred Flowers to Bloom*, CLP April 2006.) The changes clarify existing requirements on grid connections, pricing and cost-sharing arrangements, renewable energy development funds, and development and utilisation plans.

National tax incentives

The national level authorities have offered further support for the renewable energy sector by issuing, at the end of 2009, a tax circular (Circular 166) that clarifies requirements for environmental services companies to obtain tax incentives under the *PRC Enterprise Income Tax Law*. Qualifying energy projects are entitled to a six-year tax holiday, in which no corporate income tax is payable for the first three years, and in which a 50% reduction applies for the remaining three years.

Shanghai and Beijing investment incentives

Shanghai and Beijing have recently passed legislation to encourage renewable energy development. The *Certain Provisions on Promoting the Development of New Energy Industry in Shanghai*

(Shanghai Incentives), provide various incentives to increase new energy investment in Shanghai, including subsidies and reductions in red-tape.

The scope of Beijing's legislation only encompasses solar energy development. The 2010 *Guiding Opinion on the Expedition of Solar Energy Exploitation and Utilisation and the Promotion of Industry Development* (Beijing Incentives) provides subsidies for six types of solar energy development projects in Beijing.

The key combined effects of this various new legislation will be to:

- expand tax incentives and subsidies for the development of renewable energy technology;
- increase government funding for renewable energy research and development;
- update the subsidy framework for renewable energy purchases;
- update grid operators' obligations to provide grid coverage and develop so-called smart grid technology; and
- increase central-level planning, co-ordination, and supervision of renewable energy development and utilisation plans.

Grid connections

Under the existing law, grid operators are required to provide grid-connection services and technical support to renewable energy enterprises, but grid operators have resisted bearing the interruptions and expense of upgrading their grid equipment. The Pending Amendments maintain this requirement, and impose on grid operators additional obligations to expand storage capacity and coverage and to develop and apply advanced technologies such as smart grids (Article 14). In turn, renewable energy operators are obligated to uphold safety standards, while all renewable energy sources connected to grids must "conform to technical standards [of the distributor]".

China's renewable energy policies must strike a difficult balance between a variety of both domestic and foreign constituencies

Neal Stender, Orrick Herrington & Sutcliffe

Compulsory energy purchases

Purchasing requirement changes in the Pending Amendments are subtle but potentially important. Under the existing law, distributors of electricity, gas, heat and liquid fuels are required to purchase the "entire amount" of the output of renewable energy service providers, although implementation of this requirement has often been undermined by grid connection difficulties. The Pending Amendments tie this requirement to national benchmarks for renewable energy development and utilisation, which will be set by annual regulations. The benchmarks will specify a proportion of the total energy generated (both renewable and non-renewable) that must be composed of renewable energy. The regulations will also provide guidance on priority of energy transmission on grids.

Penalties

The Pending Amendments do not alter the penalty provisions of the existing Renewable Energy Law (see 2006 Renewable Energy Law, Articles 28-31). Distributors that breach their obligations to purchase renewable energy (or to provide grid connections or other related services) as required by national mandates, are required to provide compensation for the economic losses of the generator and may be subject to an additional fine of up to the same amount if the breach is not rectified within the prescribed time (Article 29).

Support funds

The Pending Amendments reaffirm the existing law's provisions on renewable energy development support funds, while extending the scope of rural and pasturing area funds to include non-residential usage (Article 24). The source of renewable energy development funds (to be disbursed by the treasury department of the Ministry of Finance) is specified in the Pending Amendment as surcharges to be levied on end-users nationwide.

Development and utilisation plans

The Pending Amendments clarify the contents of plans for medium/long-term development and utilisation of renewable energy, which are administered by central level authorities. Under the Pending Amendments, these plans must contain provisions concerning the following items: (i) development objectives; (ii) principle responsibilities; (iii) district planning; (iv) key projects; (v) monitoring of implementation progress; (vi) construction of power grids; (vii) co-ordination of grid facilities; (viii) services and systems; and (ix) security measures (Article 9).

The Pending Amendments call for additional central-level co-ordination and supervision of development and utilisation plans. Under the Pending Amendments, a record filing must be made to the central level authorities for all renewable energy projects that have been approved locally (Article 8). Additionally, the relevant departments under the State Council are required to formulate policies to attain the objectives specified in the central government's medium- and long-term plans for renewable energy development. But this increased central-level supervision is balanced to some extent by new requirements that central-level authorities take into account "local factors", along with "reasonable planning and priority", in formulating such policies.

National tax incentives

Circular 166 clarifies requirements for certain environmental services companies to obtain a six-year tax holiday, in which no corporate income tax is payable for the first three years, and in which a 50% reduction applies for the remaining three years. In order to qualify, renewable energy projects must qualify as "technology upgrades for energy savings and emission reductions". These incentives were originally made available under Article 27 of the Enterprise Income Tax Law and Article 88 of its 2007 implementing regulations.

Other pre-existing national tax incentives relevant to the

renewable energy sector (which were set forth in various laws and regulations, and are conveniently repeated in the Shanghai Incentives) are as follows:

- Increased allowable pre-tax deduction for income tax purposes of up to 8% of the employee salaries for employees' education fund (applicable only to advanced technology service enterprises and expiring at the end of 2013);
- Exemption from business tax of revenue generated from technology consulting and/or services.
- Exemption from corporate income tax of 100% of income generated from technology transfer/licensing up to Rmb5 million within a tax year, and a deduction of 50% of income tax for revenues exceeding Rmb5 million;
- Exemption of import duty on equipment imported for a new-energy enterprise's own use, if the new-energy enterprise is categorised as an encouraged project under the Foreign Investment Industry Guidelines.
- Reduced corporate income tax rate of 15% to qualified "high and new technology enterprises" (as long as the qualification remains) or "advanced technology service enterprises" (expiring at the end of 2013). (For more details, see *Tax Preference Guideline Provides Objective Scrutiny for High/New-tech Enterprises* in CLP October 2008.)

Local incentives

In Shanghai, and more recently in Beijing, the municipal governments have issued additional incentives with local variations. Beijing focuses on specific types of solar energy projects, while Shanghai more broadly encourages investment in a broader scope of renewable energy sub-sectors. The key aspects of each set of incentives are detailed below.

The Beijing Incentives support six types of solar energy projects, which include 20,000 kW photovoltaic rooftop projects, thermal-solar water-heating projects and rural projects whereby inhabitants of rural areas are eligible to obtain subsidies for purchases of solar-powered equipment for agricultural purposes. Specific details are not yet available on Beijing incentives for other projects including solar educational campus and nightscape lighting projects.

The Beijing Incentives build upon earlier national-level incentives (see *Interim Measures for the Administration of Financial Subsidies for Solar Energy Photovoltaic Building Applications* and *Implementation Opinions Concerning Acceleration of the Promotion of Solar Photovoltaic Building Applications*, both issued in March 2009 by the Ministry of Finance and the Ministry of Housing and Urban and Rural Development) that are aimed at increasing the installation of certain kinds of photovoltaic equipment in buildings, with priority for schools, hospitals and other public buildings. The Beijing Incentives expand this support to include urban residential and commercial buildings and agricultural households. Although China is active in manufacturing generating solar equipment for export, the domestic market has been slower to embrace these technologies.

The Shanghai Incentives are aimed at increasing investment in green energy and encouraging multi-nationals to set up regional headquarters in Shanghai. Companies eligible for special treatment under the Shanghai Incentives must be registered in Shanghai and have a business scope encompassing at least one of the following areas: research and development, manufacturing and implementation of nuclear power, wind power, solar power, integrated gasification combined cycle (IGCC) power station and intelligent power networks.

Government support for the renewable energy industry seems likely to continue in view of China's energy needs

Specific Shanghai incentives include:

- relaxed approval requirements for investment in new-energy projects construction;
- incentives to attract high-end professionals, including simplified procedures for obtaining Shanghai residence and favourable individual income tax policies;
- increased government financial support for the new-energy sector, in terms of both subsidies and the facilitation of private support;
- assistance for new-energy enterprises to obtain international production registrations;
- government funding/subsidies for the development of networking equipment for wind power, nuclear power, IGCC and intelligent power; and
- special funds to support projects in "innovative" and/or "high/new technology" industries and keyed to intellectual property protection, including patent application subsidies of up to Rmb30,000 for "each application in each country".

Outlook

Government support for the renewable energy industry seems likely to continue in view of China's energy needs, growing environmental consciousness, and desire to avoid over-reliance on oil imports. But China's renewable energy policies must strike a difficult balance between a variety of both domestic and foreign constituencies, as highlighted by the tensions so prominently displayed at the recent global climate conference in Copenhagen. Another source of tension is China's policies favouring domestically produced renewable energy equipment over imports, along with its recent surge in exports. These are likely to increase related trade frictions, and to increase resistance to allowing China to continue increasing its exports of renewable energy equipment. Participants in these markets will need to be attentive to these tensions and potentially abrupt changes in market access. Notwithstanding these short-term challenges, in the long run China's continued efforts to expand all stages of the renewable energy supply chain is a very positive development that will support progress towards a lower-carbon global economy.

Neal Stender, Joel Stark, Forrest L Ye and Anita Gu,
Orrick Herrington & Sutcliffe