



DEZAN SHIRA & ASSOCIATES

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China's Covid Policy and Lockdowns Explained

How Businesses Should Adapt

June 2022



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Recent & Current Lockdowns



What is Zero-COVID



Routine Testing

Voluntary or mandatory testing at designated intervals



Movement & Contact Tracing

Government mandated apps on phones to track where citizens have gone and potential contacts



Domestic Travel Restrictions

Entry to or exit from a city or locations limited / restricted



Quarantine

Potential contacts to quarantine at home or government facility and confirmed cases to quarantine at government appointed facility



Lockdown

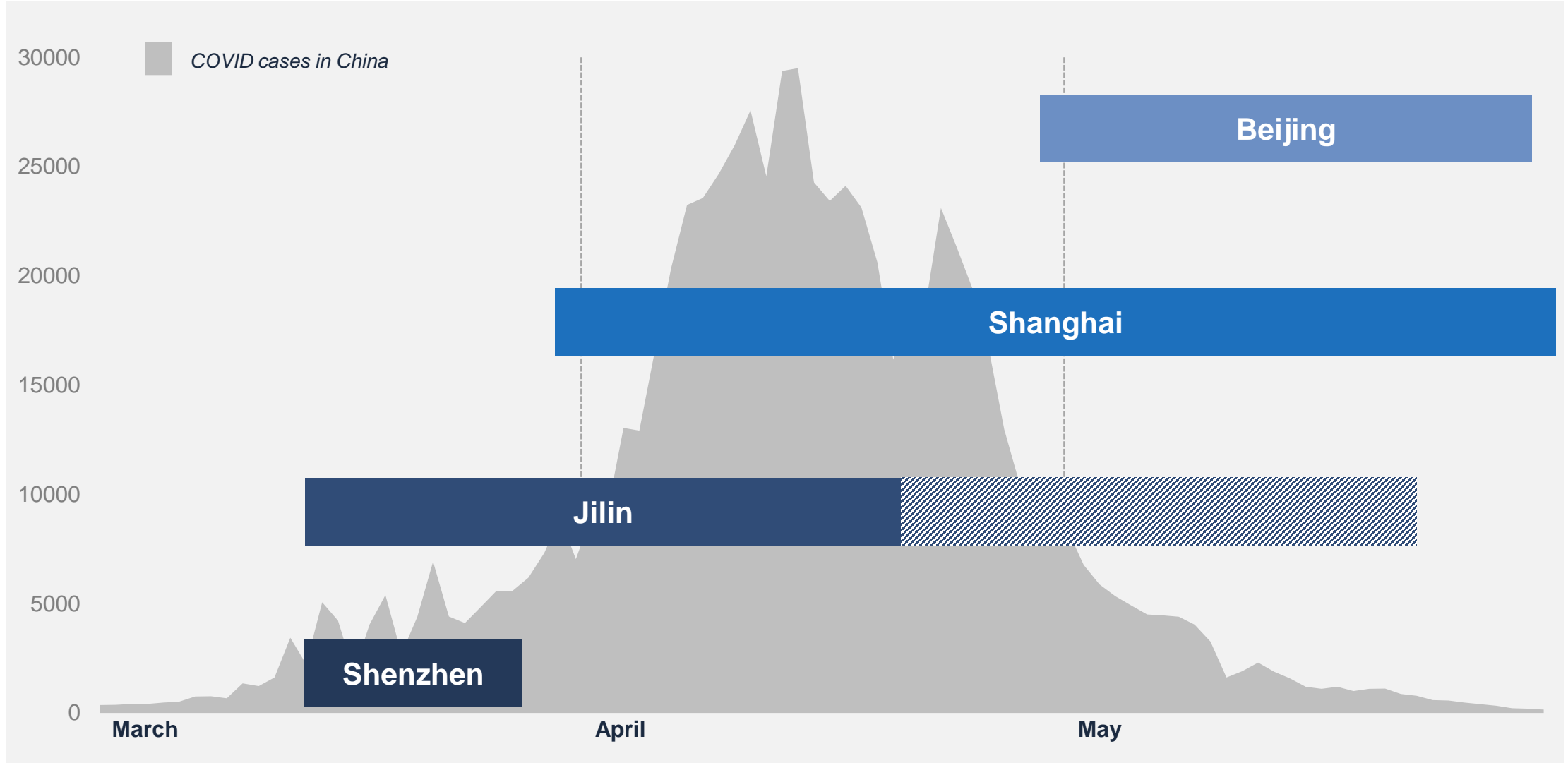
Closing business, limiting movement of citizens w/in a city or designated area



International Travel Restrictions

Flights limited, pre-entry testing and visa requirements, and post-entry quarantine

China Lockdowns *major cities, 2022*



Severity of Lockdowns

Type of Measure	Degrees of Severity
Mass Testing	<ul style="list-style-type: none"> ➤ All residents required to take multiple COVID tests at set times and locations ➤ All residents tested w/ time and location flexible ➤ Only some residents tested
Transport Limits	<ul style="list-style-type: none"> ➤ Private vehicles not allowed on road, taxis / ride hailing stopped, and public transport closed ➤ Buses, subways, and taxis / ride hailing stop running, but private vehicles allowed ➤ Buses, subways, and taxis / ride hailing at reduced capacity or require COVID test
Business Closures	<ul style="list-style-type: none"> ➤ All non-essential businesses required to close ➤ Some non-essential businesses required to close (e.g. restaurants, gyms, movie theatre, etc.)
Border Controls	<ul style="list-style-type: none"> ➤ Residents and private vehicles not allowed to enter and/or leave city ➤ COVID tests required to enter city and/or leave city
Residential Lockdowns	<ul style="list-style-type: none"> ➤ Residents not allowed to leave homes ➤ Residents not allowed to leave neighborhood or district ➤ COVID test required to enter and/or leave neighborhood or district ➤ No door-to-door delivery service or nonresidents not allowed to enter neighborhood

China Lockdowns *major cities, 2022*

	Shenzhen	Jilin	Shanghai	Beijing
Duration	March 14-20	March 14 to May <i>(gradually loosening since late April and largely ended in May)</i>	Since end-March <i>(restrictions mostly lifted June 1)</i>	Since April 22 <i>(restrictions mostly lifted May 31)</i>
Caseload	1,000+ <i>Mid-February to end-March</i>	70,000+ <i>from March to May</i>	600,000+ <i>since early March</i>	1,000+ <i>since April 22</i>
Mass Testing	Yes	Yes	Yes	Yes
Transport Limits	Yes	Yes	Yes	Partial
Business Limits	Yes	Yes	Yes	Partial <i>(applied to residents or businesses in most districts)</i>
Border Controls	Partial <i>(residents could leave w/ negative PCR test and private transport)</i>	Yes	Yes	Partial
Residential Lockdowns	Yes	Partial	Yes	No



Reopening Scenarios



Fast Reopening

Local authorities lift all restrictions at once or w/in a short period (similar to reopenings in 2020)

Slow progress towards zero cases and cautious stance of central and local governments make this less likely



Gradual Reopening

Local authorities that have achieved dynamic zero gradually relax restrictions rather than quickly ending lockdowns.

Staged reopening allows businesses, manufacturers, and logistics to recover, but consumption is still repressed.

This has been preferred method in many recent lockdowns.



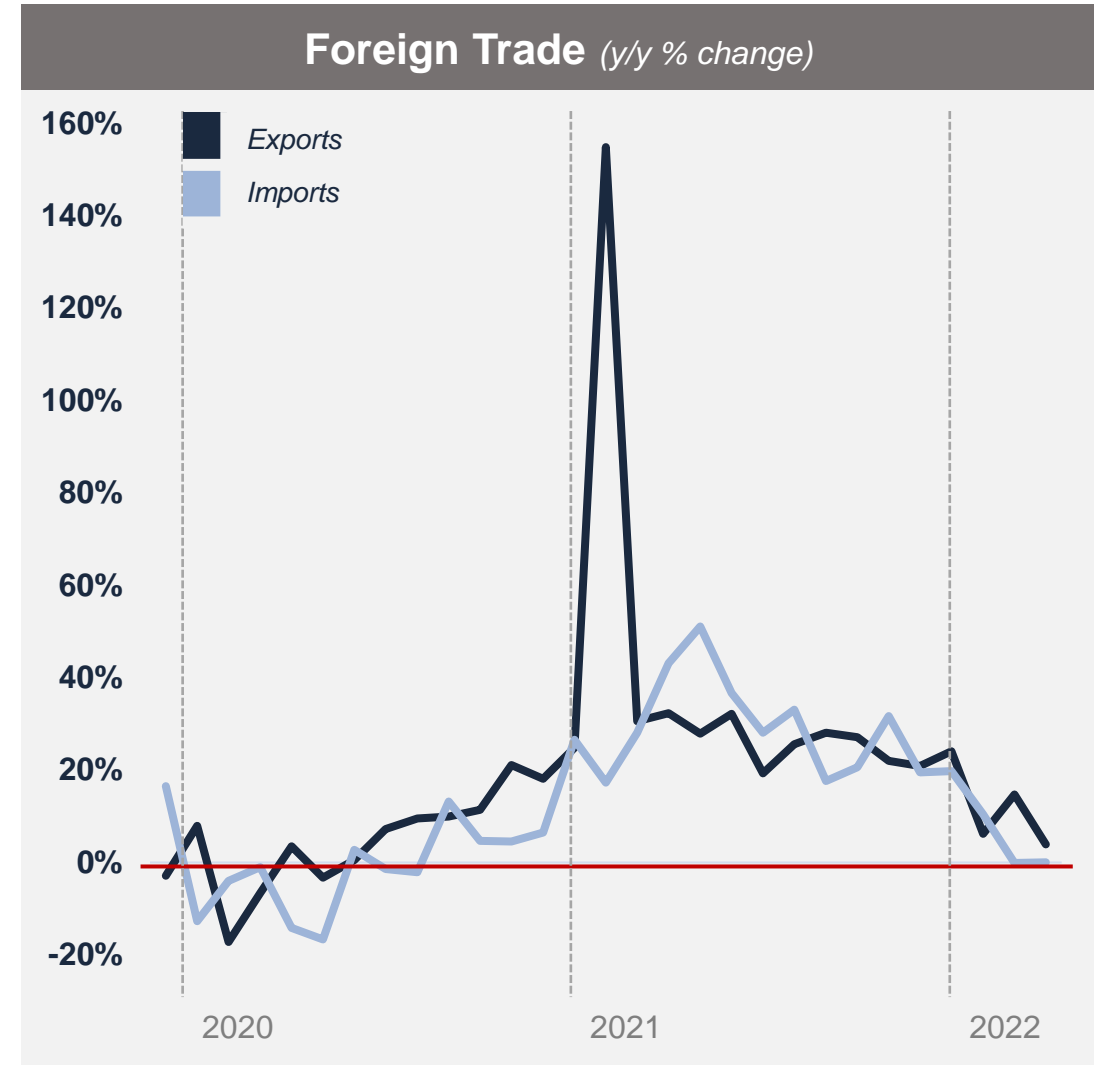
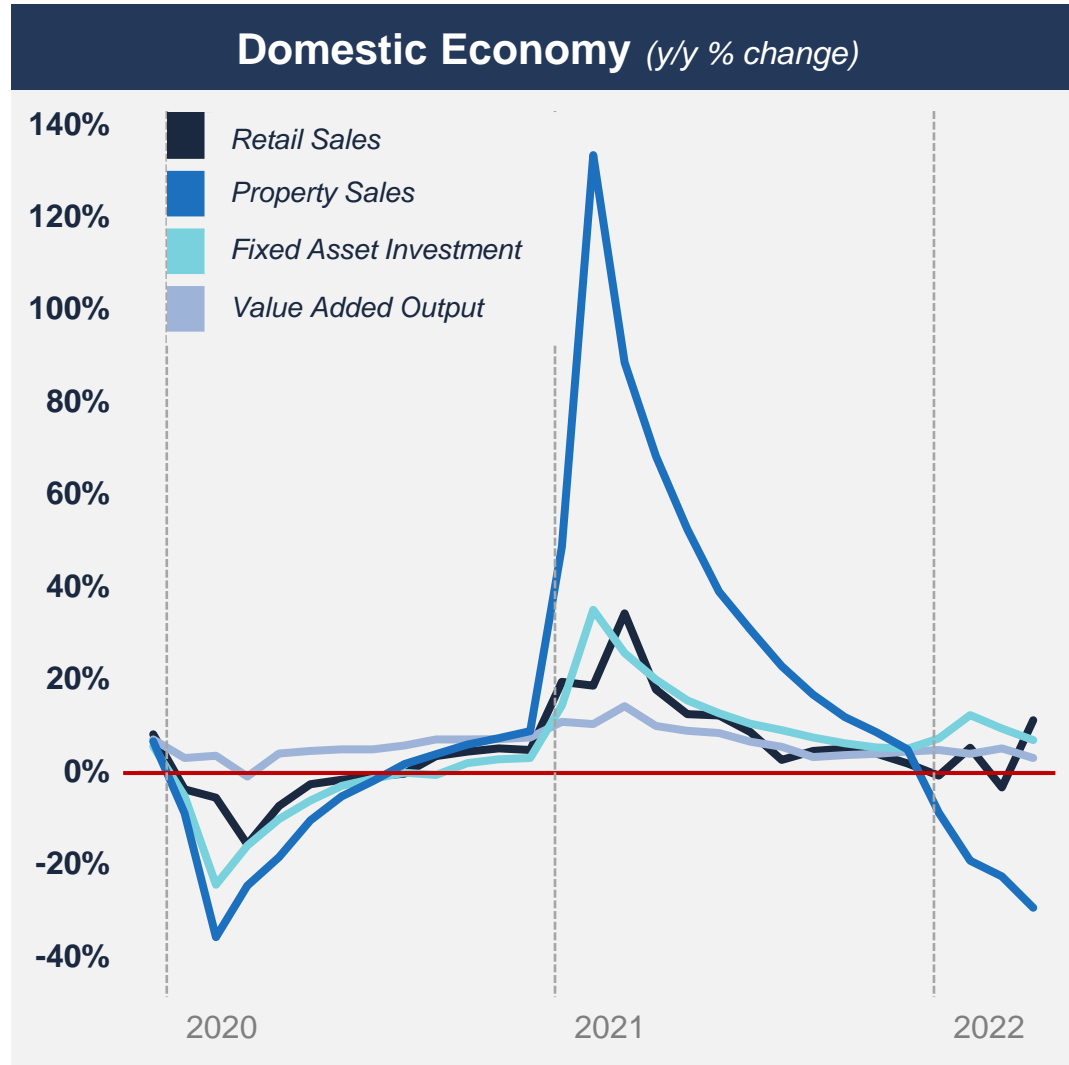
Failed Reopening

Cases begin to continuously rise after a fast or gradual reopening and additional restrictions or lockdown measures are (re)implemented.

Factors leading to this could be new local or new cases / lockdowns in other cities.

Risk of this is low, but some cities have already had to do this so risk is not zero.

Economic Impact of Lockdowns *select monthly economic indicators*



Business Impact of Lockdowns

Operations

Suspension of
Business &
Remote Work

Supply Chain
Disruptions &
Logistics Issues

Closed / Reduced
Production

HR Issues

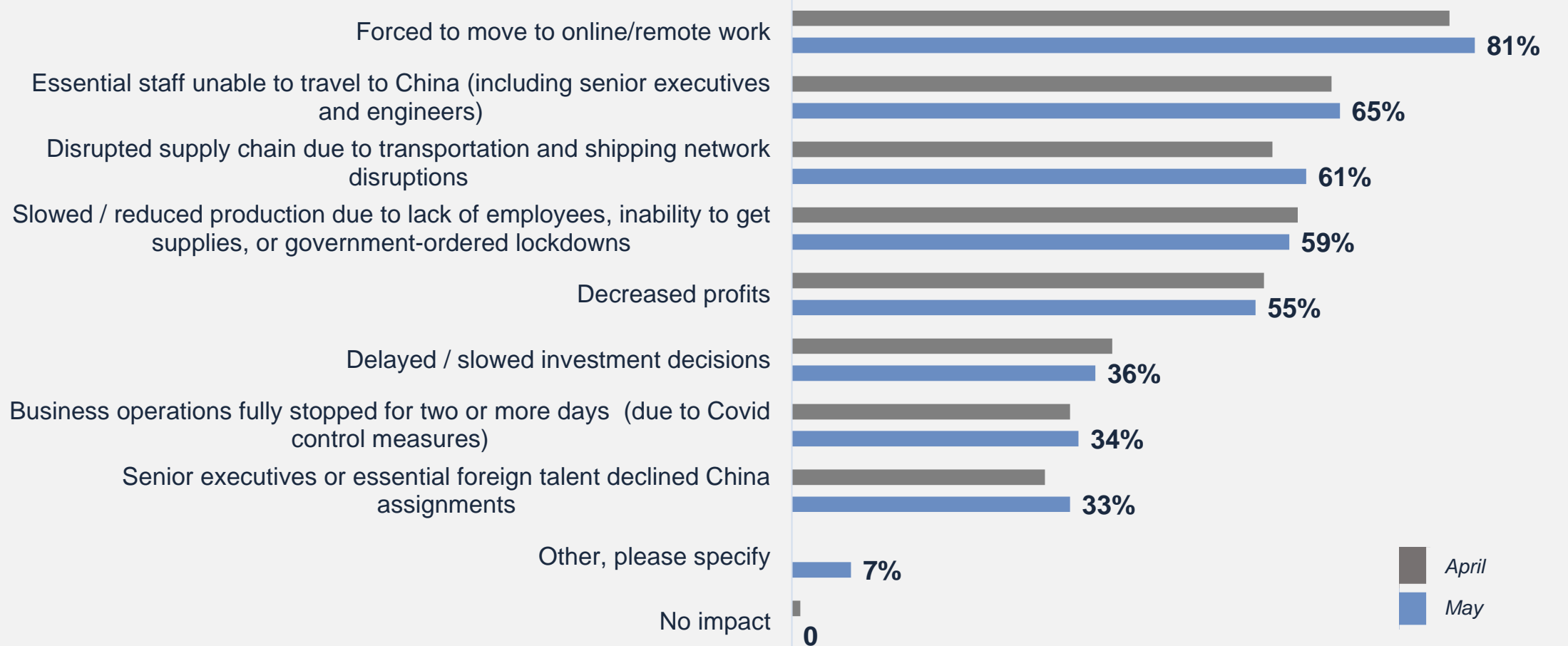
Finance

Reduced Revenue

Delayed / Withheld
Investment

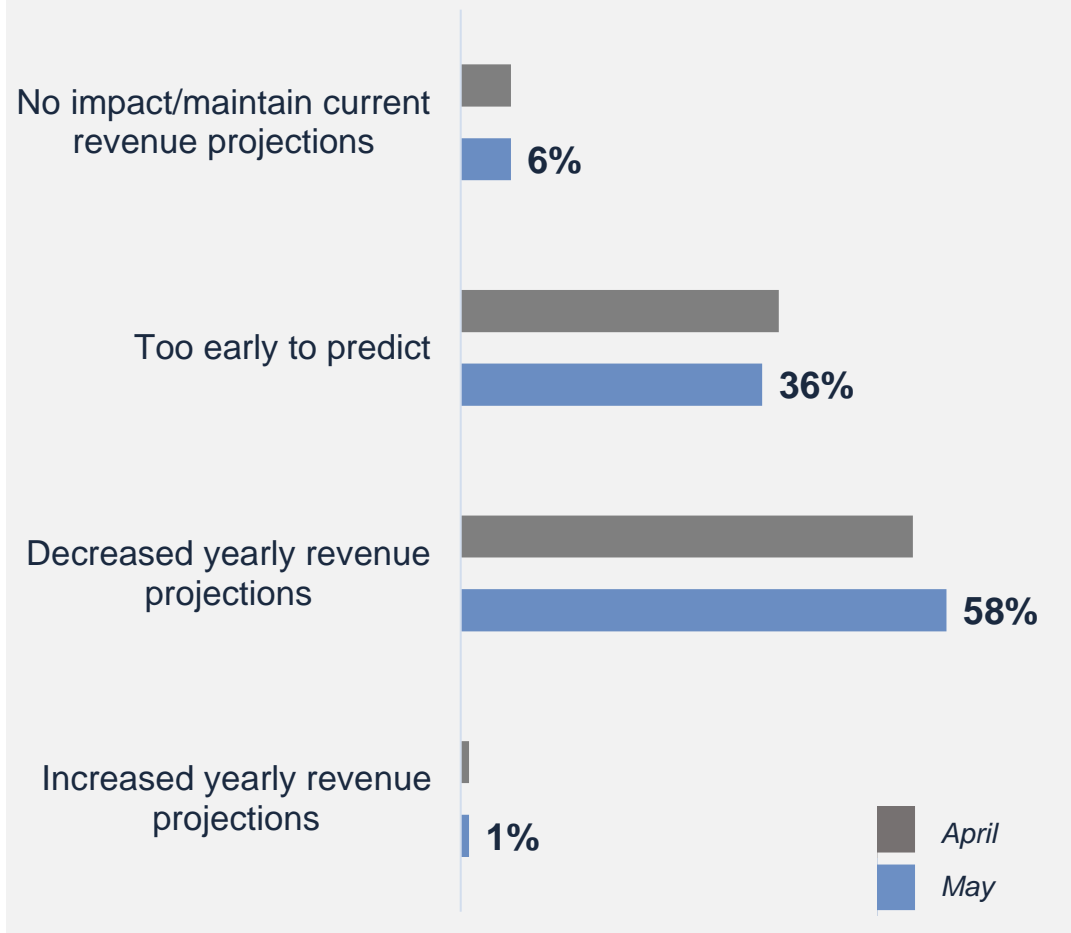
Business Impact of Lockdowns

How has the recent COVID outbreak in China impacted your business?

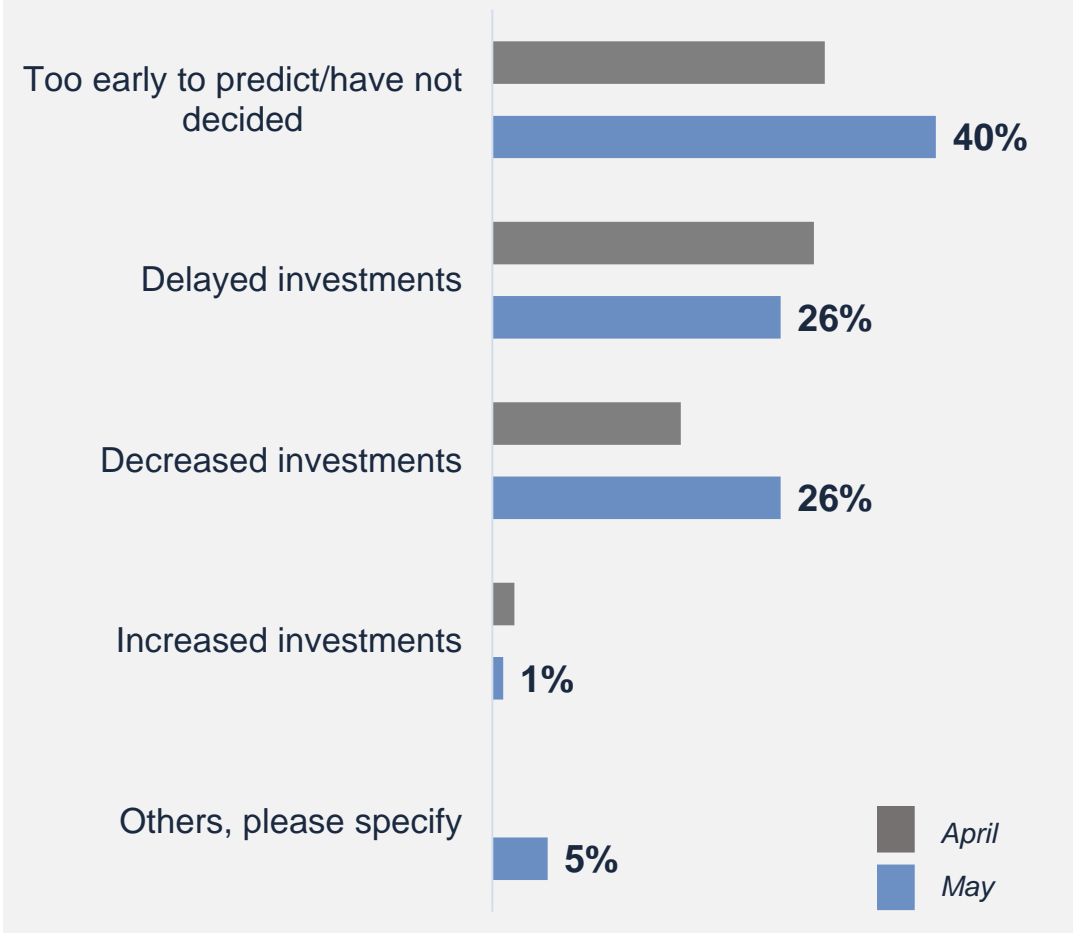


Business Impact of Lockdowns

What impact has recent COVID outbreak in China had on company's revenue projections for 2022?



What impact has recent COVID outbreak in China had on company's investment plans?





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Business Support Measures



Special Pandemic / Lockdown Regulations



**Local-Level
Regulations**

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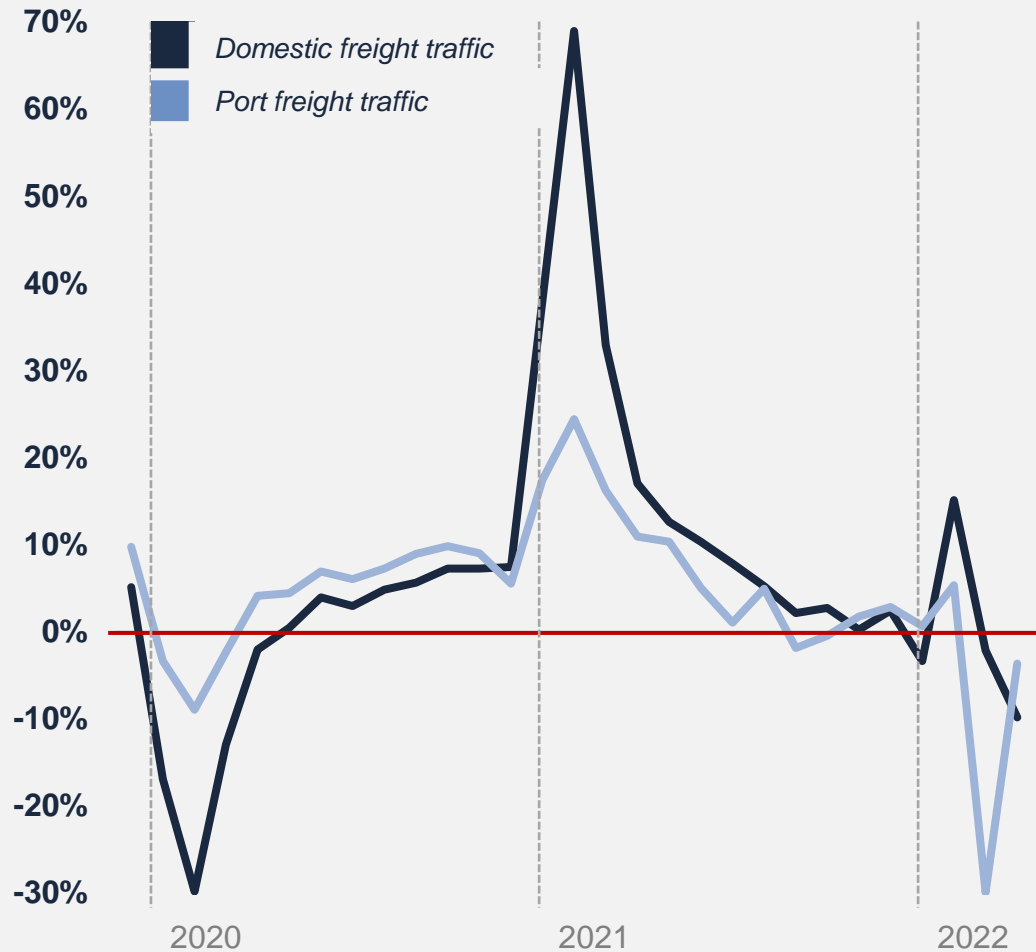


**National-Level
Regulations**

NOTE: local-level and national-level business support policies in the following slide (excluding force majeure section) will be denoted based on above colors

Logistics Support Measures *national*

Freight Traffic *(by volume, y/y % change)*



Logistics Support Policies

- Eliminating Roadblocks
 - Local governments banned from setting up arbitrary COVID checkpoints on highways, or otherwise restricting movement of freight trucks and required to immediately rectify unauthorized blocking or closure of highways, tolls, and roads
 - Creating unified national permit system for truck drivers that must be recognized by local authorities
- Key Industries & Deliveries
 - Prioritize logistics needs of key enterprises, including “whitelist” for key industries
 - Resume orderly last-mile delivery services in areas severely affected by COVID
- COVID Testing
 - Nationally recognized pass to allow truckers transporting essential supplies to cross jurisdictions regardless of any movement restrictions on broader population
 - Mandatory nationwide recognition of nucleic acid test results w/in a 48-hour window

HR Considerations *Shanghai policies*

Employment Situations

- Workers able to provide normal labor via internet or telephone
 - Company should pay normal wages
- Workers able to provide reduced service
 - Employee can be encouraged to take annual leave or another type of leave and receive wages according to provisions of leave
- Workers unable to provide normal or reduced labor
 - Company should consult w/ employee
 - If suspension period is w/in 1 wage payment cycle, normal wages should be paid
 - If suspension period goes beyond one wage payment cycle, normal wage is not required and living allowance can be paid (typically at 70-80% of local minimum wage and specified by local regulations)

Employee w/ COVID

- Suspected or Confirmed Case
 - If employee is considered a patient, disease carrier, suspected patient, close contact etc., which results in inability to provide normal labor, company is required to pay normal wages during quarantine period
- Additional Treatment Period
 - During treatment period an employee must be paid sick leave wages or wages specified by local regulations fore recovery period

HR Considerations *Shanghai policies*

Renewal of Labor Contract

- If employer is unable to conclude or renew labor contract w/ employee in writing in time due to COVID situation or COVID control measures, employer may
 - Use electronic solutions
 - Reasonably postpone conclusion or renewal of written labor contract through negotiation w/ employee
- If employee requests double salary for period of not signing or renewing written labor contract during COVID situation, such request won't be supported by court

Termination

- Company CANNOT terminate employment relationship if employee is legally under lockdown and unable to provide normal labor
- If employee is investigated for criminal responsibility for not cooperating w/ pandemic prevention and control measures of government, employer may terminate labor contract

Company Unable to Pay Wages

- If company is temporarily unable to pay wages on time due COVID situation, after consultation w/ trade unions or employee representatives, payment of wages to employees may be temporarily postponed
- Time of deferred payment generally shall not exceed one month

Government Support Policies *national – select tax incentives*

VAT Credit Rebates

- Full refund of incremental VAT credit on a monthly basis can be claimed by micro and small firms (MSMEs) in all industries and qualified enterprises in the following six industries:
 - Manufacturing
 - Scientific research
 - Electricity, heat, gas, and water supply
 - Software and information technology services
 - Ecological protection and environmental governance
 - Transportation, storage, and delivery services
- Qualified enterprises can apply for full refund of incremental VAT credit on a monthly basis from April 1, 2022
- Qualified enterprises can start to apply for refund of existing VAT credit according to following dates:
 - Micro firms – April 2022
 - Small firms – May 2022
 - Medium-sized enterprises in above industries – July 2022
 - Large enterprises in above industries – October 2022

VAT Exemption for Small-Scale VAT Taxpayers

- Small-scale VAT taxpayers that are subject to a VAT levy rate of 3% will be exempted from VAT payment or prepayment from April 1, 2022 to December 31, 2022
- Taxable sales income that small-scale VAT taxpayers earned before March 31, 2022 will be taxed at a reduced rate of 1% instead of 3%

Government Support Policies *national – select tax incentives*

CIT Reduction for SLPEs

- Corporate income tax (CIT) liability for small and low-profit enterprises (SLPEs) halved for portion of taxable income exceeding RMB 1 million but less than RMB 3 million
- SLPEs can enjoy reduced CIT rate of 20% in combination w/ reduction of tax base
 - 20% CIT rate on 12.5% of taxable income not exceeding RMB 1 million (effective from January 1, 2021 to December 31, 2022); and
 - 20% CIT rate on 25% of taxable income in excess of RMB 1 million but not exceeding RMB 3 million (effective from January 1, 2022 to December 31, 2024)
- As a result of above, effective tax rates for SLPE will be:
 - 2.5% effective CIT rate for portion of taxable income up to RMB 1 million
 - 5% effective CIT rate for portion of taxable income in excess of RMB 1 million but not exceeding RMB 3 million

Super Pre-Tax Deduction on R&D Expenditure for TSMEs

- R&D expenses deduction ratio of technology-based small and medium-sized enterprises (TSMEs) raised from 75% to 100%
- If R&D expenses do not form intangible assets and are included in current profits and losses (on basis of actual deduction) an additional 100% of such R&D expenses can be deducted from taxable income
- If R&D expenses have formed intangible assets, they can be amortized before CIT at 200% of actual cost of intangible assets

Government Support Policies *Shanghai*

Tax Rebates & Reductions

- Further expand VAT rebates extended to companies in 6 key industries to more industries
- VAT rebates for medium-sized and large enterprises can be issued in advance and VAT rebates for all companies should be issued by June 30, 2022
- Companies that cannot pay real estate and urban land use tax can apply for reduction or waiver of real estate tax on property and land for their own use and urban land use tax

Tax Filing & Payment Extension

- Deadline for monthly and quarterly tax returns extended to June 30
- Deadline for paying 2021 CIT extended to June 30
- Taxpayers who have difficulties settling current tax liabilities can either apply for further extension of filing declaration or a deferral of tax payment for up to 3 months

Deferment of Social Insurance & Housing Fund Contributions

- Social insurance contributions delayed in stages for companies in catering, retail, tourism, aviation, and road, waterway, and rail transport industries from April onward
- From April forward, qualified business can defer contributions as follows:
 - Pension and medical insurance can be deferred till end of 2022
 - Unemployment and work-related injury insurance can be deferred up to 1 year
- Late payment fees will be waived during deferred contribution period
- Impacted businesses can apply for deferred contribution of housing fund

Government Support Policies *Shanghai*

Subsidies for Maintaining / Increasing Headcount

- Companies in industries hard-hit by pandemic (e.g. catering, retail, tourism, transport, hospitality, etc.) are eligible RMB 600 subsidy for each staff member if they do not lay off staff or lay off few staff
- One-time subsidy of RMB 2,000 for each of the following persons company employs:
 - Has been unemployed for over three months
 - 2022 graduates from universities in Shanghai
- Companies that employ 2022 graduates from universities in Shanghai can receive RMB 7,800 in tax reductions for each new graduate employed per year w/in 2 years

Subsidies for Staff Training

- Impacted companies and social organizations who provide online vocational training for their staff and employees are eligible for subsidy of RMB 600 for each employee receiving training up to three times in 2022

Government Support Policies *Shanghai*

Reducing Operating Costs

- 10% decrease on average tariff of broadband and private lines for small and medium-sized enterprises (SMEs)
- 3-month waiver of unit domestic waste disposal fees
- 50% reduction of current standard administrative fees for special equipment inspection and testing fees from April to December 2022
- Bidding letters of guarantee (insurance) will be fully implemented in lieu of cash to pay deposits for actions such as bidding, contract performance, and project quality

Rent Reduction & Exemption

- MSMEs and sole proprietorships that engage in production and business activities and rent state-owned property have previously been exempted from rent payments for a period of up to 6 months, w/out requiring them to provide proof of having been impacted by pandemic
- Non-state-owned property owners will also be encouraged to reduce rent for MSEs and sole proprietorships that lease their property for business
- Subletters do not have right to rent exemption and property owners are required to ensure that rent exemption is extended to primary lessee only

Key Tax / Finance Considerations *for lockdown*

Apply Early for Tax Refund

Quickly apply for excess input VAT refund, export refund and other tax rebate items, and quickly withdraw and collect cash; at same time, it is necessary to keep compliant submission and save relevant materials to deal w/ future tax inspections

Make Accurate Subsidy Application

There are various types of financial subsidies, including direct cash subsidies, interest subsidies for reducing burdens. There are different governments such as municipal level and district level, and it is necessary to actively sort out application criteria and maximize tax benefits

Maintain Healthy Cashflow

To make full use of financing channels and preferential financing offered by support policy to enhance cashflow of enterprises, we should also use commercial strategy, such as use of discounts to quickly recover payments, to accelerate cashflow cycle

Documentation for Asset Losses

Losses realized during pandemic period must have complete recording materials, although some materials can be made-up afterwards. All records about losses must be complete to secure deductibility of tax losses from a CIT perspective

Keep Records & Documents

In-kind benefits issued to support employees' daily lives during pandemic will affect CIT. Ensure compliance of benefit arrangements and documents w/ tax laws to avoid unnecessary tax exposure

Make Budget Plans for Donations

Donations made by enterprises may allowed to be deducted on basis of donation receipt or invoices when calculating taxable income for CIT. Analyze tax impacts before donating and make budget plans

Force Majeure China Law



PRC General Principles of Civil Law *Article 153*

- Parties **MAY terminate contract** if force majeure has frustrated purpose of contract
- **Civil liability shall NOT be borne** for failure to perform contract or damage to a third party if it is caused by force majeure, except as otherwise provided by law



PRC Contract Law *Article 117*

- Depending on extent of force majeure, performing party shall be **partially or wholly excused from liability**, except where laws provide otherwise
- Where force majeure occurs after a party has already been late in performing an obligation, said party will not be excused from liability
- Party shall immediately **notify other party** in order to reduce potential losses sustained by other party, and said party shall also provide evidence of force majeure **w/in a reasonable time**

Force Majeure *Extent of Liability*

*Force majeure events do not necessarily exempt whole liabilities for breach of contract
Liability exemption should be dealt w/ differently depending on extent of force majeure*

Impossible to perform contract

- Contract should be **terminated** and liabilities for breach of contract should be exempted

Can partially perform contract

- Parties can **amend** contract terms and partially exempt liabilities for breach of contract

Temporarily prevents performing contract

- Parties can plan for **delayed** fulfillment and performing parties should be excused from liabilities for overdue fulfillment
- If delayed performance has already occurred before force majeure event, above liability exemption will not apply

Force Majeure *Actions To Be Taken*

Actions To Be Taken By Seller

- Assess impact on contract performance
- Determine whether provisions in terms of force majeure are applicable and whether to terminate or change contracts
- Take immediate and effective measures to prevent increase in losses
- Obtain **Certificate of Force Majeure**
- Send written **notices** to buyers / service receivers as soon as possible to confirm facts and propose appropriate solutions
- Proactively negotiate w/ buyers / service receivers and prepare for potential litigation

Actions To Be Taken By Purchaser

- Check w/ suppliers whether their production and operation have been affected by coronavirus outbreak and whether contract performance will be affected – be prepared in case that buyers need to purchase from other channels or slow down their own production and operation accordingly
- In event that buyers / service receivers have foreseen that it is impossible to fulfill contracts due to COVID outbreak, buyers / service receivers can also take initiative to send notices on contract termination to suppliers
- If situation results in buyers / service receivers' failure in receiving goods or services, or making payment, buyers / service receivers should send notices to suppliers as soon as possible

Force Majeure *Certification*

Certification Body *(in China)*

- China Council for the Promotion of International Trade (CCPIT)

Required Application Materials

- Certificates / announcements issued by local governments or institutions
- Notices / certificates on delay or cancellation of sea, land or air transportation
- Export sales contracts, cargo booking agreements, freight forwarding agreements, customs declarations, etc.
- Other related materials



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Outlook





“Our prevention and control policy is determined by the nature and purpose of the Party.

Our policies can stand the test of history, our measures are scientific and effective.

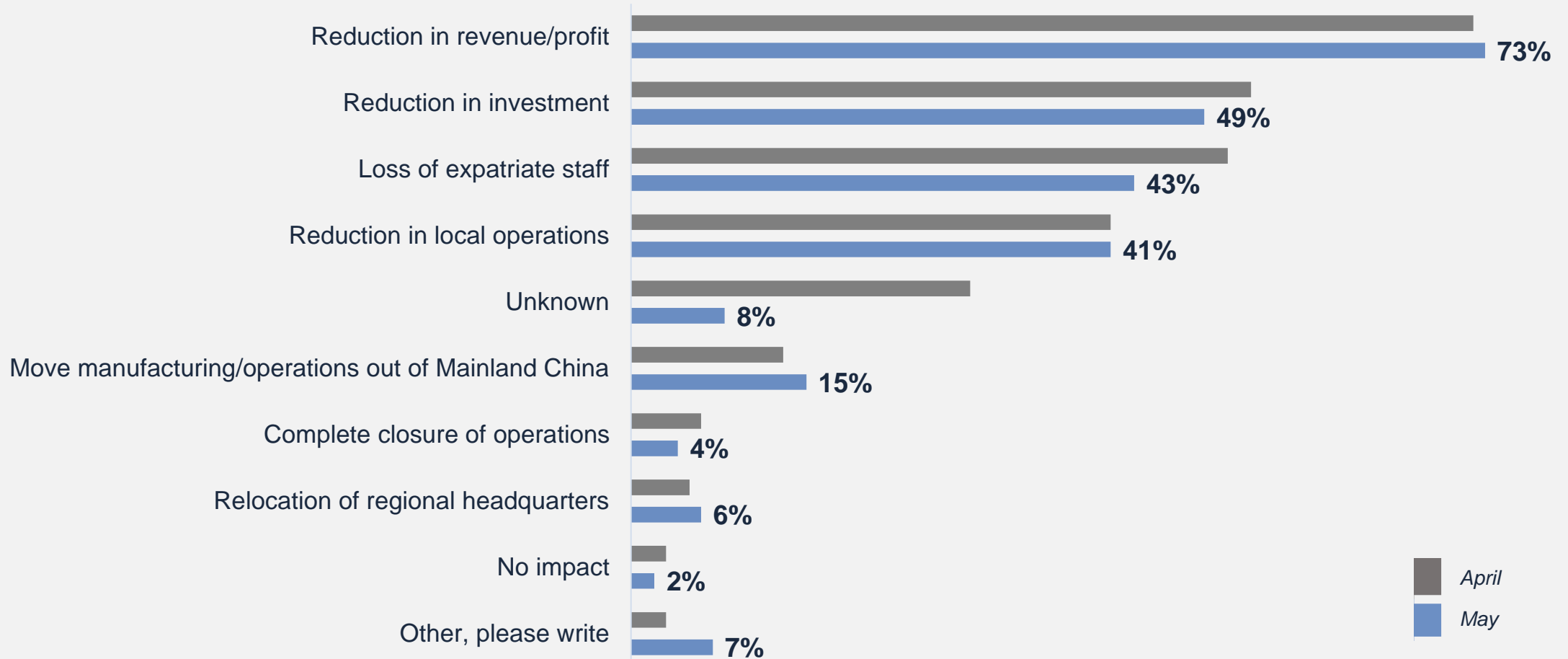
{We will} unswervingly adhere to the general policy of 'dynamic zero-COVID,' and resolutely fight against any words and acts that distort, doubt or deny our country's epidemic prevention policies.“

- Xi Jinping

May 5, 2022

Politburo Standing Committee (PBSC) meeting

If the current COVID-19 restrictions remain in place for the next year, what impact would that have on your company?





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