# GBA Digest

**Issue 03**
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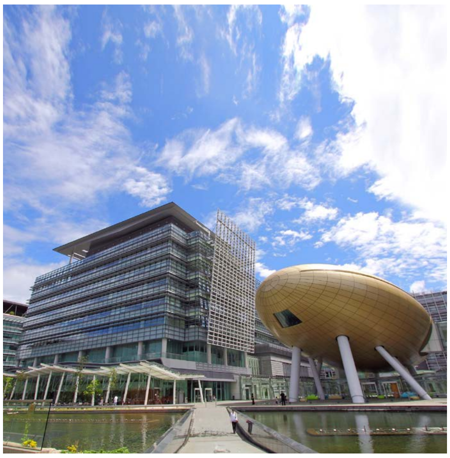
# Technology



**It's time for tech innovation capabilities across the GBA to soar despite headwind**

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**Guangdong-Macao In-Depth Cooperation Zone in Hengqin to pilot QFLP scheme**

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FOREWORD

# Technology and innovation as dual engines to accelerate the building of a world-class bay area

**Gerry Yuan**
Central Business Development Leader,
Southern Region (Chinese Mainland), Deloitte China
geyuan@deloitte.com.cn

2022 marks the 25th anniversary of Hong Kong's return to the motherland, as well as the fifth year since the signing of the *Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Greater Bay Area.* Today, with ongoing challenges from the pandemic and geopolitics, technology and innovation are top priorities in accelerating the transformation of the Greater Bay Area ("GBA") into a world-class bay area. This new era of technological evolution and digital transformation also presents new opportunities and challenges.

In this issue of *GBA Digest*, we first look back to 2021, when the GBA's economy surged. Shenzhen's GDP exceeded RMB3 trillion, Dongguan GDP broke the trillion yuan mark for the first time, and Hong Kong's economy showed its vitality with GDP growth of 6.4%. Add in Guangzhou and Foshan, these five cities together form a "trillion yuan economic circle" in the GBA.

We then look ahead to the rest of 2022, positing a relatively optimistic view of China's overall economic prospects. There are favorable factors such as the Regional Comprehensive Economic Partnership Agreement ("RCEP") that will benefit the GBA growth, although COVID-19 remains an ever-present challenge. Hong Kong looks set to become a more attractive financing location for technology and innovation companies; and the Hengqin Plan, Qianhai Plan, and Northern Metropolis Development Strategy should enhance the opening-up and innovation vitality in the GBA's services sector.

The market-driven innovation powered by the private sector is the most outstanding advantage of the GBA. The strength of the Shenzhen-Hong Kong-Guangzhou technology cluster is now even more prominent, ranking second in the World Intellectual Property Organization's Global Innovation Index 2021. As technology and innovation capacity improves, technological and industrial innovation hubs including Qianhai in Shenzhen, Hengqin in Zhuhai, Nansha in Guangzhou, and the Shenzhen-Hong Kong Innovation and Technology Cooperation Zone at the Lok Ma Chau Loop are forming an innovation value chain in the GBA.

However, while the technology and innovation industry in the GBA moves towards a new journey of deeper development, it is important for us to explore how to strengthen cooperation and synergy between GBA cities to stimulate greater growth in the innovation sector.

This issue of *GBA Digest* explores how this will be driven by upgrading technology and innovation partnerships and developing digital platforms.

Last but not least, joining Shenzhen, Zhuhai and Guangzhou, the Guangdong-Macao In-depth Cooperation Zone in Hengqin has recently launched the Qualified Foreign Limited Partnership ("QFLP") pilot scheme effective at the end of January 2022. With venture capital as an important driver of technology and innovation development, QFLP policies are set to further open up cross-boundary, two-way investment to provide high-quality financial support for technology and innovation businesses in the GBA. Featured in this current issue, we are happy to bring you our expert point of view about the policies under the QFLP pilot in Hengqin.

What is past is prelude. Despite ongoing challenges, the GBA's prospects remain bright.

# The Trillion Yuan Economic Corridor: Assessing the Greater Bay Area's Economic Outlook for 2022

**Sitao Xu**
Deloitte China Chief Economist
sxu@deloitte.com.cn

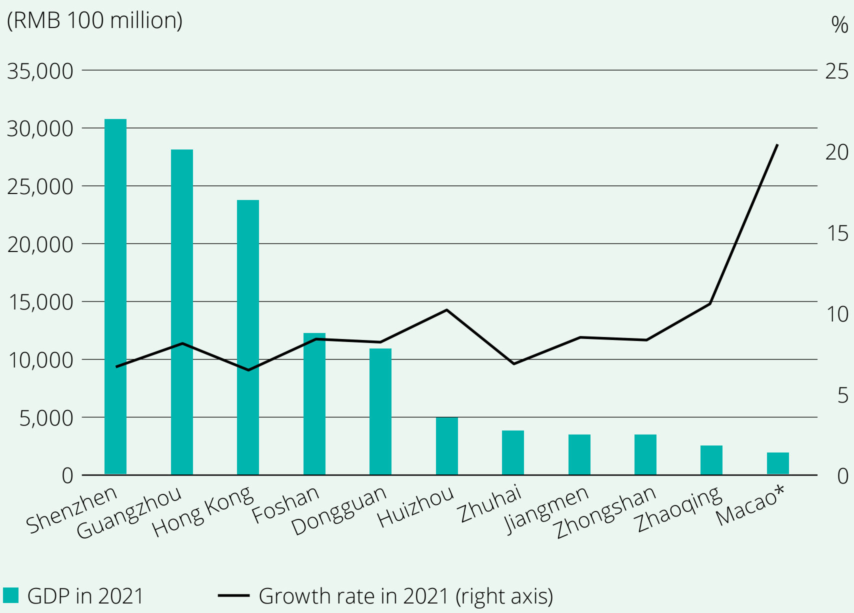
**Claire Rao**
Assistant Manager, Deloitte Research
clrao@deloitte.com.cn

The economy in Guangdong-Hong Kong-Macao Greater Bay Area ("GBA") flourished in 2021: Shenzhen's GDP exceeded RMB 3 trillion, Dongguan's GDP broke the trillion yuan mark for the first time, and Hong Kong posted a strong recovery with GDP growth of 6.4%. Along with Guangzhou and Foshan, these five cities together have formed a "trillion yuan economic circle" in the GBA.

Looking ahead into 2022, China's overall economic outlook is relatively positive, with encouraging macro policies and the Regional Comprehensive Economic Partnership Agreement ("RCEP") coming into effect to benefit the economic development of the GBA, although COVID-19 remains an ever-present challenge.

At the same time, Hong Kong is set to become a more attractive financing location for technology and innovation companies with the expected return of Chinese Concept Stocks. These developments, along with the Hengqin Plan, Qianhai Plan, and Northern Metropolis Development Strategy focusing on integrating Guangdong, Hong Kong, and Macao, will enhance the opening-up and innovation vitality in the GBA's services sector.

**Figure: Economic performance of GBA cities in 2021**




Source: Wind, Census and Statistics Department of Hong Kong, IMF, Deloitte Research
*Macao data are projections released by the IMF in October 2021

**China's optimistic economic outlook and macro policies favor the GBA**

In 2021, China's economy grew 8.1%. In this year's Report on the Work of the Government, the expected economic growth target is set at 5.5% in 2022, which could help boost market confidence. A further resurgence of COVID-19 remains a substantial risk. However, given the wealth of experience gained from global pandemic response strategies, there is no need to be overly pessimistic about virus mutations' impact on economic recovery.

In 2022, the GBA economy will benefit from active macro policies and RCEP. Despite a slowdown in exports, growth should sustain its momentum through the next few quarters. The consumer sector will maintain its resilience thanks to structural factors including consumption upgrading, the strong consumption confidence of younger generations, and low interest rates. In real estate, national policies are emphasizing the need to precisely resolve the debt crisis and promote a virtuous, healthy development cycle, which also fulfils residents' demand for high-quality housing.

Given this background and the political agenda for the 20th National Congress of the Communist Party of China ("NCCPC"), China's macro policy this year will focus on "stability", especially maintaining employment and keeping expectations in check. Given the GBA's fiscal performance outperforms the national average, and the many advanced infrastructure projects across the region, including the Shenzhen Pilot Demonstration Zone under the "parallel development" scheme, active fiscal policies could boost the GBA's economic growth.

In addition, the GBA, as China's major center for manufacturing and foreign trade, will enjoy more export advantages under RCEP, which came into effect on 1 January 2022. Most manufacturers in the GBA focus on sectors with complex chains that depend on the international division of labor, including electronics, IT equipment, electrical appliances, and machinery, while some manufacture home appliances and toys that rely on raw materials imported from ASEAN countries. Cumulative rules of origin under RCEP provide flexibility and convenience for enterprises with manufacturing chains across Asia-Pacific as they can enjoy preferential treatment under regional trade agreements. Meanwhile, the steady recovery of the global economy will provide a powerful overseas demand driver for the GBA.

The fifth wave of the pandemic in Hong Kong is harming the economy and livelihoods, presenting a stiff challenge to economic recovery. As soon as the pandemic is back under control, consumption and investment demand should regain their vitality and a reopening of the Mainland border will become more likely, injecting more impetus into the economy. In addition, as a relief measure for people and businesses, the Hong Kong SAR Government will again issue consumption vouchers to accelerate economic recovery and further encourage the public and merchants to be acclimated to electronic payments, which will promote development of the digital economy.

**Attract technology and innovation companies to raise funds in HK and empower industry development in the GBA**

Recently, the regulatory risk for US-listed Chinese Concept Stocks is escalating due to the SEC's announcement of rules implementing the Holding Foreign Companies Accountable Act in December 2021, which has triggered fears of potential delistings of Chinese Concept Stocks in the US. At the same time, with the maturing ecosystem in Hong Kong set to cultivate innovative and new economy companies and the support from the new listing regime for overseas issuers, Hong Kong will attract more dual primary and secondary listings of Chinese Concept Stocks. Its recently launched Special Purpose Acquisition Company (SPAC) listing mechanism will also attract Asian high-growth companies or privatized Chinese Concept Stocks to list as SPAC M&A targets. The return of Chinese Concept Stocks will not only further enhance Hong Kong's position as a "super-connector" between Mainland and international capital markets, but also help promote Hong Kong as a desirable location for technology and innovation companies to raise funds, optimizing the GBA's financing ecosystem.

**Accelerate integration of Guangdong, Hong Kong and Macao, and promote opening-up and innovation in the services sector**

Development initiatives were rolled out in H2 2021, including the Hengqin Plan, Qianhai Plan, and Northern Metropolis Development Strategy. All prioritize institutional innovation through unprecedented reforms, especially of management mechanisms, key production factor flows, and financial cooperation.

The Hengqin Plan has distinctive characteristics that promote the convergence of rules and standards, cross-boundary collaboration, and convenient access to financial services. It also aims to introduce Macao's advantages in systems and market openness into Hengqin and build a super metropolitan area that drives and leads regional development. The Qianhai Plan aims to accelerate flows of key factors including talent, capital, funds, technology, and data, establish a modern services sector that meets international standards and connects with Hong Kong and Macao, and enhance collaboration in innovation between Hong Kong and the Mainland. The Northern Metropolis Development Strategy focuses on facilitating cooperation in technology and innovation between Hong Kong and Shenzhen, constructing a roadmap for developing an international technology and innovation center encompassing land planning, infrastructure design, and industry development.

As the integration of Guangdong, Hong Kong and Macao continues to deepen, the modern services sector in the GBA will achieve high-quality growth, through more empowerment of technology and innovation, talent upgrades, and greater synergy among innovation mechanisms.

For instance, enterprises can explore collaboration models across Guangdong and Hong Kong with "incubation" and "acceleration" hubs in different locations. On the one hand, they can use their entities in Hong Kong to connect with global resources and manage front-end project introduction and initial incubation. On the other hand, science and technology industrial parks in Guangdong can focus on accelerating the development and cultivation of companies after incubation. Stakeholders in the industry ecosystem must seize this opportunity to drive high-quality development with innovation breakthroughs.

# It's time for tech innovation capabilities across the GBA to soar despite headwind

**Jenson Zhao**
Deloitte China National Fast Program Leader
jindzhao@deloitte.com.cn

**Iris Li**
Deloitte Research Senior Manager
irili@deloitte.com.cn

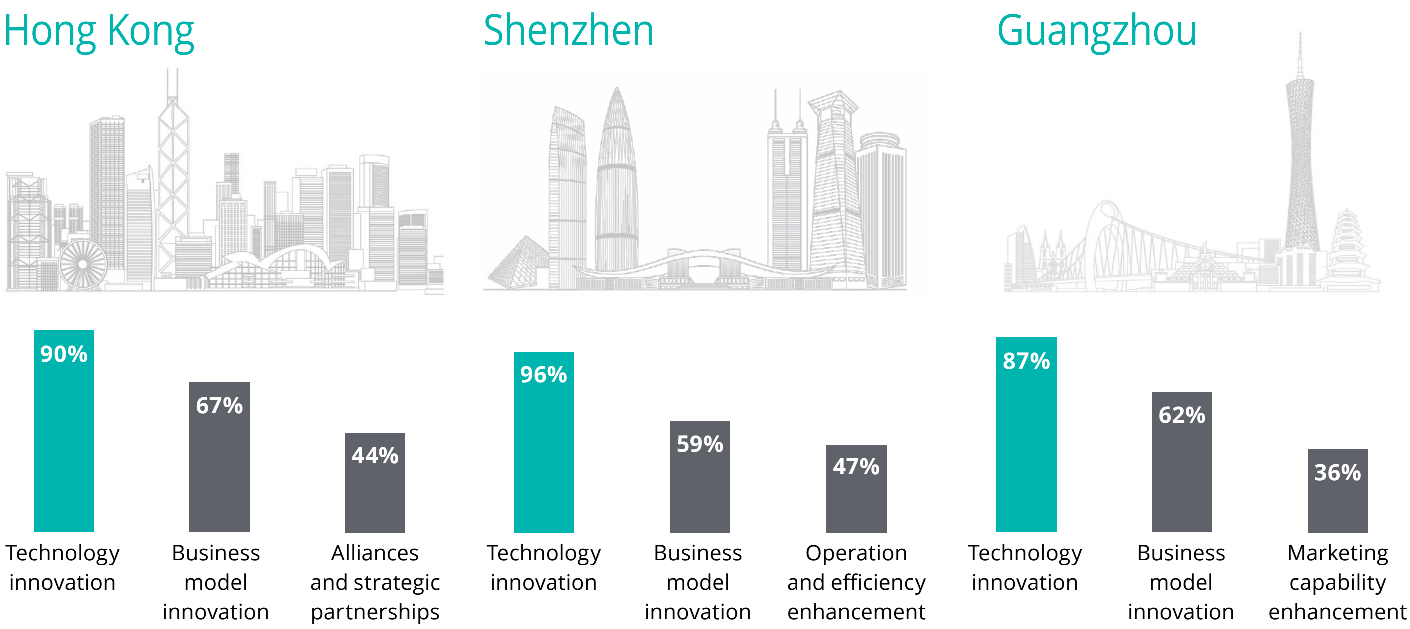
Since 2017, when the research and development plan of the Guangdong-Hong Kong-Macao Greater Bay Area City Cluster was outlined in the Report on the Work of the Government, and 2021's 14th Five-year Plan advocated the active, steady development of the Greater Bay Area ("GBA"), the GBA development roadmap has made substantial progress.

As a key engine of China's economy and a national innovation and technology hub, the GBA has strong capabilities to drive innovation. The Shenzhen-Hong Kong-Guangzhou technology cluster also demonstrates outstanding, comprehensive strengths, ranking as the second largest in the world according to the Global Innovation Index 2021 from the World Intellectual Property Organization ("WIPO"). This recognizes the results of GBA development in technology and innovation in recent years. Following the steady growth of technology and innovation capabilities in the GBA, Qianhai in Shenzhen, Hengqin in Zhuhai, Nansha in Guangzhou, and the Shenzhen-Hong Kong Innovation and Technology Cooperation Zone at Lok Ma Chau Loop have created the foundations to support the development of an innovation value chain across the GBA. However, as the region's technology and innovation sector moves towards a new stage of deeper development, it raises the question of how to strengthen cooperation and synergy between GBA cities to stimulate greater growth in innovation. Deloitte suggests starting with two goals: upgrading technology and innovation partnerships and developing digital platforms.

**Establish effective partnerships**

According to a survey of tech companies by the Deloitte Tech Fast Program, tech companies in Hong Kong, Shenzhen, and Guangzhou believe technical advances can guarantee their long-term development. This is why they view "technology innovation" and "business model innovation" as the key factors in maintaining rapid growth. Notably, 44% of Hong Kong respondents said "alliances and strategic partnerships" have a significant impact on their development, more than in Shenzhen (16%) and Guangzhou (20%). In addition, Hong Kong respondents are more concerned about "difficulty in finding partners" as a barrier to development. In a survey on innovation and entrepreneurship in Hong Kong, 63% of Hong Kong start-ups said they are interested in expanding to GBA cities, but more than half also said doing business across different systems can be challenging. The issue of how to coordinate cooperation and alliances between tech companies in Hong Kong and Shenzhen has become key to the further enhancement of the GBA's technology innovation capabilities.

**Figure: The Top 3 reasons tech companies pursue rapid growth**




Alongside the development in Qianhai and deepening cooperation between Shenzhen and Hong Kong, successful examples of industry cooperation should be replicated in more surrounding cities and areas to become the center of regional growth.

It is important that GBA policymakers think deeply about how to optimize the coordination of the surrounding environment and industry structures to develop higher-level new partnerships and provide room for organic improvement in different sectors, including technology, finance, logistics, and advanced manufacturing. Whereas, Hong Kong technology and innovation companies are keener to establish corporate collaboration and innovation partnerships and expect a more open and inclusive environment for technological innovation. Helping them establish business partnerships with Mainland companies in the GBA will efficiently promote the further enhancement of technology innovation capabilities across the Greater Bay Area.

**Accelerate the development of digital platforms in the GBA**

Digital platforms help companies (especially small and medium-sized enterprises) establish new channels to expand into global markets. Comprehensive services available on digital platforms, including information, trade negotiation, payment and settlement, and customs clearance, can reduce costs and improve the efficiency of business transactions. Many “little giant” companies in the GBA face challenges in obtaining information and attracting investment and financing. However, these companies can develop integrated digital platforms with finance, technology, and industry capabilities to complete supply-demand matching to identify overseas demand and integrate into global industry chains and supply chains.

China is entering the next stage of digital transformation, where digital assets and related services will be integrated into people’s daily lives, businesses, and society. Digital networks will become platforms and channels to connect everything. The number of smart industrial and technology parks in the GBA has grown gradually in recent years, and it is essential to use these parks as a launch pad, continue the development of smart networks across the GBA, and establish an industry development network with the characteristics of the GBA. Only by doing so can the region’s cluster of industrial and technological parks optimize resource efficiency and drive further enhancement of the GBA’s technology and innovation capabilities!

**Industry sharing: COVID-19’s impact on Hong Kong startups**

The pandemic has triggered many companies to accelerate their digital transformations and create a “new normal”. In Hong Kong, COVID-19 has created new obstacles for start-ups, according to a Deloitte survey. Nearly half of respondents face difficulties in customer interaction, and about one-third have seen problematic declines in revenue. Having said that, the pandemic has also prompted companies to assess the importance of digitalization more deeply. More than 50% of respondents said companies have already developed strategies to improve their digital capabilities via long-term investments. Digitalization not only helps relieve companies from the challenges of the pandemic, but also helps them unleash their technology and innovation potential.

**Respondents suggested**···

| | |
|---|---|
| 70% | COVID-19 accelerated digital transformation |
| 60% | COVID-19 provided an opportunity to review and refine business priorities |
| 59% | Due to COVID-19, the company took bold action to tap into new markets or develop new businesses |
| 54% | COVID-19 made the company view digital capability development as a long-term investment |
| 44% | COVID-19 caused fundamental changes in business model |

Source: *Innovation Revitalizes Hong Kong’s Economic Growth 2021*

# Guangdong-Macao In-Depth Cooperation Zone in Hengqin to pilot QFLP scheme

**Tony Yao**
Deloitte China Tax Director
heyao@deloitte.com.cn

**Policy Background**

The Qualified Foreign Limited Partnership (QFLP) pilot scheme ("QFLP Pilot") is now extended to the Guangdong-Macao In-depth Cooperation Zone in Hengqin ("Macao-Hengqin Zone"), according to the official announcement on 29 December 2021, *namely The QFLP Pilot Scheme (Provision) for the Macao-Hengqin Zone*. This key implementation initiative of the *General Plan for Development of the Macao-Hengqin Zone* aims to encourage foreign investors to establish multi-currency venture capital ("VC") and private equity ("PE") funds in China through foreign-invested equity investment enterprises, and introduce services from foreign entities to support the development of the Macao-Hengqin Zone more effectively.

Since Shanghai initiated the first QFLP pilot scheme in in 2011, Beijing, Shenzhen, Zhuhai, Guangzhou, and Hainan then introduced similar programs, and QFLP now plays an essential role in attracting foreign investors to participate in equity investment in China.

When the Macao-Hengqin Zone's QFLP Pilot took effect on 29 January 2022, it established a cross-boundary, two-way investment channel to attract domestic and foreign asset management institutions and provide high-quality financial services to support its development.

**Institutions specified in the QFLP Pilot**

Foreign-invested equity investment enterprises under the QFLP Pilot include equity investment management firms and equity investment funds.

**1. Foreign-invested equity investment management firms ("QFLP managers")** are invested and established in the Macao-Hengqin Zone by foreign natural persons, enterprises or other organizations ("foreign investors"), with the core businesses of establishing or managing equity investment funds as trustees.

**2. Foreign-invested equity investment funds ("QFLP funds")** are invested and established in the Macao-Hengqin Zone by foreign investors to raise funds privately from domestic and foreign investors and invest in domestic, non-publicly traded equity.

An institution under the QFLP Pilot can be incorporated as a company or partnership, complete the PE manager registration and the PE record-filing at the Asset Management Association of China ("AMAC"). They fall under regulations including the *Interim Measures for the Supervision and Administration of Private Investment Funds, Several Provisions on Strengthening the Regulation of Private Investment Funds, Measures for the Registration of Private Equity Fund Managers, and the Record-filing of Funds (for Trial Implementation).*

**Comparing the QFLP pilot schemes in the Macao-Hengqin Zone, Shenzhen Qianhai and Hainan Free Trade Port**

The QFLP Pilot issued by the Macao-Hengqin Zone has the following similarities and differences from QFLP pilot schemes[1] in Shenzhen Qianhai and Hainan Free Trade Port, both of which have become popular investment destinations in Southern China in recent years:

| Region / Policies | Macao-Hengqin Zone | Shenzhen Qianhai | Hainan Free Trade Port |
|---|---|---|---|
| **Required qualification of executives of QFLP managers** | At least 2 executives meet the following requirements at the same time:<br>1. More than 5 years of experience in equity investment or equity investment management business<br>2. At least 2 years of experience in executive positions<br>3. Experience in domestic equity investment or domestic financial institutions<br>4. No prior convictions, violations or pending litigation concerning economic disputes within past 5 years; with good personal credit records | No specific requirement | At least 2 executives meet the following requirements at the same time:<br>1. More than 5 years of experience in equity investment or equity investment management business<br>2. At least 2 years of experience in executive positions<br>3. Experience in domestic equity investment or domestic financial institutions<br>4. No prior convictions, violations or pending litigation concerning economic disputes within past 5 years; with good personal credit records |
| **Investment scope of QFLP fund** | 1. Equity interests in non-listed companies<br>2. Non-publicly issued or traded shares of listed companies<br>3. Convertible bonds, market-based and law-based debt-to-equity swaps, and shares of equity funds<br>4. Participation in share placements as original shareholders of listed companies<br>5. Other related businesses as permitted by regulators or registration and filing authorities | 1. Equity interests in non-listed companies.<br>2. Non-publicly issued or traded common shares of listed companies, including directed issuance of new shares, bulk transactions, and transfers by agreement<br>3. Participation in share placements as original shareholders of listed companies<br>4. Provide management advice to the invested entities<br>5. Other businesses permitted by the CSRC or AMAC | Domestic non-publicly traded equity |
| **Restrictions on the investment scope of QFLP fund** | Follow the rules stated in Special Administrative Measures (Negative List) for Foreign Investment Access, while investment should be made to real industries or infrastructure projects for the development of the Macao-Hengqin Zone according to the Catalogue of Industries for Encouraging Foreign Investment; business affairs must not in breach of laws and regulations | Follow the laws, regulations and rules applicable to foreign investment; no investment shall be made in prohibited sectors according to the negative list for the foreign investment, unless it satisfies the conditions stipulated in the negative list; investment in sectors outside the negative list will be administered according to the principle of consistency between domestic and foreign investment | 1. Restricted sectors for foreign investment according to the state law<br>2. Trading of secondary market shares and corporate bonds, except for investment targets approved by the governing authorities including the Hainan Local Financial Supervision and Administration Bureau, Hainan Office of CSRC, Haikou Central Sub-branch of the PBOC, and the Market Supervision Administration of Hainan Province<br>3. Trading of futures and other financial derivatives<br>4. Investment in "non-self-use" real estate<br>5. Invest with non-self-owned funds<br>6. Providing loans or guarantees for non-invested enterprises<br>7. Business affairs in breach of laws and regulations |

1. Shenzhen issued the *Measures of Shenzhen City for the Pilot Program of Foreign-invested Equity Investment Enterprises* in January 2021, and the Hainan Free Trade Port issued the *Interim Measures for Hainan Province on Domestic Equity Investment for Qualified Foreign Limited Partners (QFLP)* in October 2020.

| Policies \ Region | Macao-Hengqin Zone | Shenzhen Qianhai | Hainan Free Trade Port |
|---|---|---|---|
| **Scenarios for reference** | Investors from Hong Kong SAR, Macao SAR, or Taiwan region engaged in equity investment and equity investment management activities in the Macao-Hengqin Zone | Investors from Hong Kong SAR, Macao SAR, and Taiwan region, and Chinese citizens live overseas that invest and establish equity investment entities and equity investment management firms in the city | Investors from Hong Kong SAR, Macao SAR, and Taiwan region, and Chinese citizens live overseas that invest and establish foreign-invested equity investment entities in the province |
| **Highlights of financial and tax incentives** | 1. Reduced corporate income tax (CIT) rate at 15% for eligible companies in the Macao-Hengqin Zone<br>2. CIT exemption on income derived from new foreign direct investments (FDI) in tourism, modern services, and high-tech businesses established in the Macao-Hengqin Zone<br>3. Local and foreign high-end and scarce talents working in the Macao-Hengqin Zone are eligible to tax exemption on the portion of individual income tax (IIT) that exceeds 15% of the taxable income<br>4. Special talent rewards in Hengqin New Area[2] | 1. Reduced CIT rate at 15% for eligible companies in the encouraged industries in the Qianhai Shenzhen-Hong Kong Cooperation Zone<br>2. Foreign high-end and scarce talents (incl. talents from Hong Kong, Macao and Taiwan) working in the GBA are eligible to subsidies in the form of tax rebate equivalent to the differences between the IIT payables in Mainland and Hong Kong at the rate of 15%<br>3. The Several Measures to Support the Development of the Financial industry in Shenzhen stipulates the incentives for settlement, management of assets at certain scale, management fee income, as well as subsidies for purchase and rental of office premises, and supporting policies to attract mega-sized equity investment funds | 1. Reduced CIT rate at 15% for eligible companies in the encouraged industries registered, and with substantial business activities, in Hainan Free Trade Port (FTP)<br>2. New FDI incomes derived before 2025 from tourism, modern services and high-tech businesses established in Hainan FTP are exempted from CIT<br>3. High-end and scarce talents working in the Hainan FTP are eligible to tax exemption on the portion of individual income tax (IIT) that exceeds 15% of the taxable income<br>4. QFLP managers may enjoy local preferential policies for settlement in key industrial parks<br>5. Equity investment management talent may apply for recognition as high-level talent in Hainan Province according to relevant regulations, to enjoy preferential policies on talent settlement, car and house purchase, spouse employment, school enrollment, medical care, and housing security. |

2. According to the *Measures for Rewarding Special Talent in Hengqin New Area (Zhu Heng Xin Ban [2020] No. 14)* released in July 2020, Hengqin New Area rewards individuals who work in Hengqin-registered companiess that meet certain conditions and whose annual individual income tax payable is more than RMB10,000 according to a certain percentage that ranges from 20% to 40%. The income items covered by the refund include salary, business income, dividend, bonus, and income from equity transfer.

**Fiscal and Tax Support Policies of the Macao-Hengqin Zone**

The *General Plan for the Development of Macao-Hengqin Zone* ("General Plan") specifies that domestic and foreign high-end and scarce talent working in the Macao-Hengqin Zone are eligible to tax exemption on the portion of IIT that exceeds 15% of the taxable income, with a list of talents eligible to the tax incentives in place for management. Indeed "modern financial industry" is covered in *The Scarce Talent Catalogue of Macao-Hengqin Zone* released in 2021 by the Office of Preregistration of High-end and Scarce Talent. The above preferential treatment is applicable to domestic and foreign investment managers under QFLP.

In seeking individual income tax benefits, entities should consider:

- The types of income to which the relevant benefits apply, whether they include investment income from individual follow-on investments and percentages of excess income;
- Whether the policy has specific requirements for individuals' qualifications or job level; and
- Any specific requirements if the actual operation and management activities of the equity investment enterprise do not occur in a fixed location.

There are a series of industry support policies, including financial incentives for settlement and operation, designed to gather high-quality private equity fund managers and attract private equity funds to the Zone.

**Conclusion**

As an important initiative of the Macao-Hengqin Zone to support the development of the modern financial industry and innovative cross-boundary financial management in Macao, the QFLP Pilot has a low threshold, few restrictions, wide investment directions, flexible exit mechanism, and a low cost of trial and error. It has the potential to further open up cross-boundary asset management channels, encourage social capital to set up multi-currency private equity funds in the Macao-Hengqin Zone, promote the use of foreign capital to support its development, and stimulate its innovation vitality.

Compared to other common options for foreign investments in China, such as foreign investment companies and foreign-invested VC enterprises, QFLP's more lenient establishment requirements and broader investment scope make it worth consideration. Fiscal and tax policies are also a key concern when selecting a business location, and these aspects of the Macao-Hengqin Zone are attractive and can be reasonably planned for, and applied for, in the context of an investor's investment management operations.

## Contacts

**DAVID WU**
Vice Chairman,
National FSI Leader, Deloitte China
davidwjwu@deloitte.com.cn

**FREDDIE CHUI**
National FSI Clients & Industries Leader
Deloitte China
fchui@deloitte.com.hk

**MARTIN WONG**
FSI Southern Region (Chinese Mainland) Leader
Deloitte China
martinwong@deloitte.com.cn

**CHARLOTTE SHEN**
China Research Center for Financial Services Leader
Deloitte China
charshen@deloitte.com.cn

**EDWARD AU**
Southern Region Managing Partner
Deloitte China
edwau@deloitte.com.hk

**SIDNEY CHENG**
Macau Office Managing Partner
Deloitte China
sidcheng@deloitte.com.mo

**ROBERT LUI**
Government Affairs Unit Southern Region Leader
Deloitte China
rolui@deloitte.com.hk

**GERRY YUAN**
Central Business Development Leader
Southern Region (Chinese Mainland)
Deloitte China
geyuan@deloitte.com.cn

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