

China Tax & Investment News



Further Update on the New PRC Corporate Income Tax Law - Transitional Arrangements

Background

For company executives with direct or overseeing functions on China tax reporting, the year 2008 poses challenges. These challenges surface mainly as a result of uncertainties. Despite the release of the PRC Corporate Income Tax Law Implementation Regulations (hereinafter referred to as “the CITLIR”), there are still certain important areas with significant impact on taxpayers for which detailed provisions are still pending.

Included in the uncertainties are the transitional arrangements for old enterprises qualifying for preferential tax rates and/or tax holidays under the Corporate Income Tax Law (the “Old CIT Law”), the detailed qualifying requirements for new tax concessions, and the relevant industry catalogues.

The issuance of two recent tax circulars, Guofa [2007] No.39 and Guofa [2007] No.40, by the State Council on December 26, 2007 deserves a welcome with open arms. Both circulars throw lights on transitional arrangements.

This issue of China Tax and Investment News focuses on what have now been confirmed as eligible for transition.

Transitional Arrangements for Old Enterprises

The statutory income tax rate is 25% under the new Corporate Income Tax Law (the “New CIT Law”), resulting in at least a 10 percentage point increase in tax rates for those enterprises which were eligible for preferential tax treatment under the old law. To ease the stress of a sudden upsurge in tax rates, the New CIT Law provides a gradual phasing in of tax rates increase for enterprises which have completed registrations with the State Administration for Industry & Commerce before March 16, 2007 (hereinafter referred to as the “Qualifying Existing Enterprises”).

Circular 39 provides guidelines on how the transition will be implemented, as follows:

- Gradual Increase in Tax Rates for the Qualifying Existing Enterprises

The Circular confirms that the following tax rates will be applicable to the Qualifying Existing Enterprises currently being taxed at a rate of 15% from 2008 to 2012.

- 2008 – 18%
- 2009 – 20%
- 2010 – 22%
- 2011 – 24%
- 2012 – 25%



No transitional arrangement in tax rates will be accorded to the Qualifying Existing Enterprises currently being taxed at a rate of 24%. Such enterprises are subject to CIT at 25% immediately since January 1, 2008.

- Grandfathering Treatment for Tax Holiday

For the Qualifying Existing Enterprises which have already commenced their tax holidays before 2008, they can continue to enjoy the remaining unused tax holidays until expiry. For those which have not commenced their tax holidays before 2008, their tax holidays are deemed to commence in 2008 and can be utilized until expiry.

- Continuance of Preferential Tax Treatment for Enterprises Established in the Western Region

The Circular confirms the continuance of preferential tax treatment for both domestic and foreign invested enterprises established in the Western Region in accordance with Caishui[2001] No.202 (“Circular 202”) and the relevant investment catalogues and regulations. As a result, domestic and foreign invested enterprises established in the Western Region which are currently taxed at a rate of 15% under Circular 202 can continue to enjoy the preferential tax rate until expiry in 2010. Likewise, domestic and foreign invested enterprises currently enjoying tax holidays under Circular 202 can continue to do so.

- No Double Dipping

If a taxpayer is entitled to both transitional tax benefits and benefits under the New CIT Law, Circular 39 stipulates that there cannot be any double benefits and an election has to be made (by the taxpayer). The choice of benefits, once made, cannot be changed in the future.

Circular 39 comes with a table showing the source of various tax benefits eligible for transition and the details of the preferential policies. Please see attachment 1 for further details.

For your easy reference, we have also prepared a table showing the tax benefits under the Western Region policies eligible for transition. Please see attachment 2 for further details.

Transitional Arrangements for New Enterprises in Special Zones

Circular 40 provides further details regarding the transitional arrangements for High-New Technology companies which are newly established on or after January 1, 2008 in Special Economic Zones (the “SEZs”) or the Shanghai Pudong New Area.

These companies are entitled to a tax holiday of “two-year exemption followed by three-year 50% reduction in tax rate” starting from their *first income-generating year*.

SEZs include Shenzhen, Zhuhai, Shantou, Xiamen and Hainan.

The companies must fulfill the qualifying requirements for High-New Technology enterprises as stipulated in Article 93 of the CITLIR and any other relevant circulars that may be issued in the future on this matter. The taxpayer needs to maintain its High-New Technology status throughout the 5-year period. Otherwise the tax holiday will cease from the tax year of disqualification and will not be reinstated again.

Circular 40 also clarifies that the profits derived by the operations of High-New Technology companies outside the SEZs or the Shanghai Pudong New Area do not enjoy the same tax concession. Those companies must keep separate records for their operations inside and outside the SEZs or the Shanghai Pudong New Area, or no tax holidays will be accorded.

Our Observation

Despite the issuance of these two circulars, there are still a number of unanswered questions regarding the grandfathering of other statutory tax concessions under the Old CIT Law which are not listed in the table attached to Circular 39. For example:

- Tax holidays for export-oriented foreign invested enterprises
- Foreign invested Technologically-Advanced Enterprises
- Reinvestment refund of pre-2008 profits
- Exemption of withholding tax on dividends declared in 2008 in relation to the profits arising from previous years

Article 57 of the New CIT Law, which provides statutory support for transitional arrangements, has made it very clear that all transitions are subject to the regulations to be formulated by the State Council. Unless the State Council, in addition to Circulars 39 and 40, comes up with more circulars, we cannot at this stage assume that previous tax preferences are eligible for transition. The most controversial tax holiday currently not shown in the transition table is the 3-year 50% tax reduction for Technologically-Advanced Enterprises. To date, there is still no clear indication as to whether an enterprise which is defined as a Technologically-Advanced Enterprise under the Old CIT Law but fails to qualify as a High-New Technology Enterprise under the New CIT Law can enjoy the remaining tax benefits under the old regime. We will keep you posted in this regard.

For those enterprises enjoying tax preferences based on local rules and practices instead of the statutes enacted by the central government (e.g., domestic enterprises in Special Economic Zones or the Shanghai Pudong New Area as well as non-manufacturing foreign investment enterprises in the Shanghai Pudong New Area), it is uncertain whether the transitional arrangements would be applicable to them or not. We recommend those companies to approach their local authorities for clarification and confirmation.



Other Points Worth Noting

As we mentioned in our previous edition of China Tax and Investment News, the CITLIR defines the qualification requirements of High-New Technology enterprises. One of the requirements is that the qualifying enterprises must be recognized within the territory of High-New Technology supported by the Chinese Government. We understand that the definitions of High-New Technology territory and the recognition procedures will be jointly formulated by the various ministries together with the State Administration of Taxation (“SAT”) before submission to the State Council for final approval. We believe the definitions of High-New Technology territory would change from the current product-oriented approach, which cannot cover all situations, into a technology-oriented approach. A circular on this highly important subject is under preparation by the authorities. Please stay tuned for further developments.

Pursuant to the new CIT Law, resident enterprises having branches in other locations must prepare and submit a CIT return on a consolidated basis and settle the tax payment accordingly. The CITLIR does not specify whether the tax filing should be done only at the head office location or whether branch tax filings are to be made. We understand the SAT is preparing a circular on detailed arrangements. It appears the SAT’s current thinking is a consolidated tax reporting PLUS certain payment of provisional quarterly CIT at branch level. Again, please stay tuned for further developments.

Attachment 1:

List of Preferential Tax Policies Eligible for Transition

| No. | Source of Tax Preference | Details of Preferential Tax Policies |
|------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | Clause 1 of Article 7 of the Income Tax Law of the People's Republic of China for Foreign Investment Enterprises and Foreign Enterprises ("the Old CITL") | Foreign investment enterprises ("FIEs") established in special economic zones ("SEZs"), foreign enterprises which have establishments or places engaged in production or business operations in SEZs, and manufacturing FIEs established in economic and technological development zones ("ETDZs") shall be eligible for corporate income tax ("CIT") rate of 15%. |
| 2 | Clause 3 of Article 7 of the Old CITL | FIEs established in coastal economic open zones ("CEOZs"), old urban districts of cities where the SEZs or the ETDZs are located, or other regions designated pursuant to the State Council provisions, which engage in energy, transportation, port, dock or other projects encouraged by the State, shall be eligible for CIT rate of 15%. |
| 3 | Clause 1 of Article 73 of Detailed Implementation Rules of the Income Tax Law of the People's Republic of China for Foreign Investment Enterprises and Foreign Enterprises ("the Old CITLIR") | Manufacturing FIEs established in CEOZs, or in the old urban districts of cities where the SEZs or the ETDZs are located, which engage in technology intensive or knowledge intensive projects, projects with a long pay-back period with foreign investment of at least USD 30 million or projects related to energy, transportation and port construction, shall be eligible for CIT rate of 15%. |
| 4 | Paragraph 2, Clause 1 of Article 73 of the Old CITLIR | Sino-foreign equity joint ventures ("EJVs") engaged in port and dock construction, shall be eligible for CIT rate of 15%. |
| 5 | Paragraph 4, Clause of Article 73 of the Old CITLIR | Manufacturing FIEs and FIEs engaged in energy and transport construction projects related to airport, port, railway, highway and power station established in Shanghai Pudong New Area shall be eligible for CIT rate of 15%. |

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| 6 | <p>Approvals Issued by the State Council Regarding Shanghai Waigaoqiao, Tianjin Port, Shenzhen Futian, Shenzhen Shatoujiao, Dalian, Guangzhou, Xiamen Xiangyu, Zhangjiagang, Haikou, Qingdao, Ningbo, Fuzhou, Shantou, Zhuhai, Shenzhen Yantian Bonded Zone [Guohan (1991) No. 26, Guohan (1991) No. 32, Guohan (1992) No. 43, Guohan (1992) No. 44, Guohan (1992) No. 148, Guohan (1992) No. 150, Guohan (1992) No. 159, Guohan (1992) No. 179, Guohan (1992) No. 180, Guohan (1992) No. 181, Guohan (1993) No. 3, etc.]</p> | <p>Manufacturing FIEs in these areas shall be eligible for CIT rate of 15%.</p> |
| 7 | <p>Approval Issued by the State Council Regarding Establishment of the Taiwanese Investment Zones in Fujian Coastal Areas [Guohan (1989) No.35]</p> | <p>Taiwanese investment enterprises established in Xiamen Taiwanese Investment Zone shall be eligible for CIT rate of 15%; manufacturing and non-manufacturing Taiwanese investment enterprises established in Fuzhou Taiwanese Investment Zone shall be eligible for CIT rate of 15% and 24% respectively.</p> |
| 8 | <p>Notices Issued by the State Council Regarding Further Opening-up of Nanning, Chongqing, Huangshi, the Yangtse Gorges Economic Development Zone and Beijing [Guohan (1992) No. 62, Guohan (1992) No. 93, Guohan (1993) No. 19, Guohan (1994) No. 92 Guohan (1995) No. 16]</p> | <p>Manufacturing FIEs established in provincial capitals and riverside open cities shall be eligible for CIT rate of 15% if they engaged in the following projects: I. Technology intensive or knowledge intensive projects; II. Projects with a long pay-back period with foreign investment of over USD30 million; and III. Energy, transportation or port construction projects.</p> |
| 9 | <p>Approval Issued by the State Council Regarding Development and Establishment of Suzhou Industrial Park [Guohan (1994) No.9]</p> | <p>Manufacturing FIEs established in Suzhou Industrial Park shall be eligible for CIT rate of 15%.</p> |
| 10 | <p>Notice Issued by the State Council Regarding Expansion of the Applicable Scope of Tax Preferential Treatments for Foreign Investment Enterprises Engaged in Energy and Transportation Infrastructure Construction [Guofa (1999) No.13]</p> | <p>Effective from Jan 1, 1999, manufacturing FIEs engaged in energy or transportation infrastructure construction projects shall be eligible for CIT rate of 15% nation wide (i.e. not limited to those established in CEOZs, or in the old urban districts of cities where the SEZs or the ETDZs are located).</p> |

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| 11 | Regulations of the Special Economic Zones in Guangdong Province (Implementation approved by the fifteenth Meeting of the Fifth NPC Standing Committee as at August 26, 1980) | Enterprises established in Shenzhen, Zhuhai, Shantou Special Economic Zones, shall be eligible for CIT rate of 15%. |
| 12 | Approval of Establishment of Xiamen Special Economic Zone in Fujian Province [Guohanzi (80) No.88] | Enterprises established in Xiamen Special Economic Zone, shall be eligible for CIT rate of 15%. |
| 13 | Regulations of the State Council on Encouraging Investment and Development on Hainan Island [Guofa (1988) No. 26] | Enterprises (excluding national banks or insurance companies) established on Hainan Island, which engaged in production or business operations, shall be eligible for CIT rate of 15%. |
| 14 | Clause 2 of Article 7 of the Old CITL | Manufacturing FIEs established in CEOZs or old urban districts of cities where the SEZs or the ETDZs are located shall be eligible for CIT rate of 24%. |
| 15 | Notice Issued by the State Council Regarding Establishment of National Travel Resort Trial Areas [Guofa (1992) No. 46] | FIEs established in National Travel Resort Trial Areas shall be eligible for CIT rate of 24%. |
| 16 | Notices Issued by the State Council Regarding Further Opening-up of the Border Cities of Heihe, Yining, Pingxiang, Erlianhaote, etc. [Guohan (1992) No. 21、Guohan (1992) No. 61、Guohan (1992) No. 62、Guohan (1992) No. 94] | Manufacturing FIEs established in border open cities shall be eligible for CIT rate of 24%. |
| 17 | Notice Issued by the State Council Regarding Further Opening-up of the Border Cities and Towns of Nanning, Kunming, Pingxiang, etc. [Guohan (1992) No. 62] | The establishment of Border Economic Cooperation Zones (“BECZs”) were allowed in the qualified cities (counties and towns) of Pingxiang, Dongxing, Wangding, Ruili and Hekou. The export-oriented manufacturing enterprises established in mentioned BECZs shall be eligible for CIT rate of 24%. |
| 18 | Notices Issued by the State Council Regarding Further Opening-up of Nanning, Chongqing, Huangshi, the Yangtse Gorges Economic Development Zone and Beijing [Guohan (1992) No. 62、Guohan (1992) No. 93、Guohan (1993) No. 19、Guohan (1994) No. 92、Guohan (1995) No. 16] | Manufacturing FIEs established in provincial capitals and riverside open cities shall be eligible for CIT rate of 24%. |

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| 19 | Clause 1 of Article 8 of the Old CITL | Manufacturing FIEs with an operating period of 10 years or above shall be eligible to tax holiday of “2-year exemption followed by 3-year 50% reduction in tax rate” from the first profit-making year. |
| 20 | Paragraph 1, Clause 1 of Article 75 of the Old CITLIR | EJVs engaged in port and dock construction projects with an operation period of 15 years or above, shall be eligible to tax holiday of “5-year exemption followed by 5-year 50% reduction in tax rate” from the first profit-making year. |
| 21 | Paragraph 2, Clause 1 of Article 75 of the Old CITLIR | FIEs with an operation period of 15 years or above established in Hainan SEZ and engaged in the infrastructure construction projects related to airport, port, dock, railway, highway, power station, coal mine, irrigation works, etc., or related to the development and operation of agriculture, shall be eligible to tax holiday of “5-year exemption followed by 5-year 50% reduction in tax rate” from the first profit-making year. |
| 22 | Paragraph 3, Clause 1 of Article 73 of the Old CITLIR | FIEs established in Shanghai Pudong New Area and engaged in the infrastructure construction projects related to airport, port, dock, railway, highway, power station, etc., with an operation period of 15 years or above, shall be eligible to eligible to tax holiday of “5-year exemption followed by 5-year 50% reduction in tax rate” from the first profit-making year. |
| 23 | Paragraph 4, Clause 1 of Article 75 of the Old CITLIR | After submitting applications and obtaining approvals from competent tax authorities, FIEs established in the SEZs and engaged in service industries, with an foreign investment of USD5 million or above and an operation period of 10 years or above, shall be eligible to tax holiday of “1-year exemption followed by 2-year 50% reduction in tax rate” from the first profit-making year. |
| 25 | Paragraph 6, Clause 1 of Article 75 of the Old CITLIR | <p>Tax preferential policy for Beijing New Technology Development Trial Zone (“Trial Zone”) should apply to FIEs established in the Trial Zone.</p> <p>New Technology Enterprises established in the Trial Zone shall be eligible to exempt from CIT for 3 years from the date of incorporation. After obtaining approvals from competent authorities, such enterprises shall be eligible for “3-year 50% reduction in tax rate of either 15% or 10%” from the fourth to the sixth years.</p> |

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| 26 | Clause 1 of Article 8 of Tentative Regulations of Corporate Income Tax Law of the People's Republic of China (for Domestic Enterprise) | Enterprises established in autonomous regions shall be eligible for fixed period reductions in tax rates or fixed period tax exemption where the fixed period will not exceed 5 years. |
| 27 | Regulations Issued by the State Council Regarding Encouraging Investment and Development on Hainan Island (Guofa (1988) No. 26) | Enterprises (excluding national banks or insurance companies) established on Hainan Island and engaged in the infrastructure construction projects related to airport, port, dock, railway, highway, power station, coal mine, irrigation works, etc., or related to the development and operation of agriculture, in the development and operation of agriculture, with an operation period of 15 years or above, shall be eligible to tax holiday of “5-year exemption followed by 5-year 50% reduction in tax rate” from the first profit-making year. |
| 28 | | Enterprises (excluding national banks or insurance companies) established on Hainan Island and engaged in manufacturing-oriented industries such as industrial productions, transportation, etc., with an operation period of 10 years or above, shall be eligible to tax holiday of “5-year exemption followed by 5-year 50% reduction in tax rate” from the first profit-making year. |
| 29 | | Enterprises (excluding national banks or insurance companies) established on Hainan Island and engaged in service industries with total investment of USD5 million / RMB20 million or above, with an operation period exceeding 10 years, o tax holiday of “1-year exemption followed by 2-year 50% reduction in tax rate” from the first profit-making year. |
| 30 | Notice Issued by the State Council Regarding Implementation of < Related Policies of National Medium to Long Term Plans for Scientific and Technological Development (2006-2020) > [Guofa (2006) No. 6] | Upon completion of stringent verification, High-Tech Enterprises newly established in the national High-Tech Industrial Development Zones shall be eligible for exemption of CIT for two years from the first profit-making year. |

Attachement 2

Development of Western Region – CIT Preferential Tax Treatments

| No. | Details of Preferential Policies | Applicable Scope |
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| 1 | <p>Domestic and foreign investment enterprises established in the Western Region and engaged in encouraged industries shall be eligible for a reduced CIT rate of 15% for the period from 2001 to 2010.</p> <p>Domestic enterprises engaged in encouraged industries refer to domestic enterprises whose principal operation falls within the Catalogue of Industries, Products and Technologies Currently Encouraged by the State (当前国家重点鼓励发展的产业、产品和技术目录 (2000年修订) and whose revenue from principal operations must be at least 70% of its total revenue.</p> <p>Foreign investment enterprises (“FIE”) engaged in encouraged industries refer to FIEs whose principal operation falls within Foreign Investment Catalogue¹ and Foreign Advantageous Investment Catalogue for Central and Western Region and whose revenue from principal operations must be at least 70% of its total revenue.</p> | <p>These policies apply in Chongqing, Sichuan Province, Guizhou Province, Yunnan Province, Tibet Autonomous Region, Shanxi Province, Gansu Province, Ninxia Huizu Autonomous Region, Qinghai Province, Xinjiang Uygur Autonomous Region, Xinjiang Production and Construction Corps, Inner Mongolia Autonomous Region, and Guangxi Zhuangzu Autonomous Region (all the above-mentioned areas are collectively referred to as “West Region” hereinafter). The preferential policies of Western Region also apply to Xiangxi Tujia and Miao District in Hunan Province, Enshi Tujia and Miao District in Hubei Province, Yanbian Korean District in Jilin Province</p> |

¹ The foreign investment catalog has been amended as at 31 October 2007

Attachement 2

Development of Western Region – CIT Preferential Tax Treatments

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| 2 | <p>Domestic enterprises established in autonomous regions shall be eligible for reduction or exemption of CIT within a prescribed period while FIEs shall be eligible for reduction or exemption of local CIT. The approval procedures of application for reduction or exemption of CIT for central government SOEs should be implemented pursuant to prevailing regulations.</p> | |
| 3 | <p>Western Region enterprises which engage in transportation, electricity, water irrigation, postal and television broadcasting and generate at least 70% of total revenue from the above mentioned businesses, shall be eligible for the following CIT preferential treatments:</p> <ul style="list-style-type: none"> • Domestic enterprises shall be eligible to tax holiday of “2-year exemption followed by 3-year 50% reduction in tax rate” from the commencement date of production and operation.; and • FIEs with an operation period of at least 10 years shall be eligible to tax holiday of “2-year exemption followed by 3-year 50% reduction in tax rate” from the first profit-making year. | <p>These policies apply in Chongqing, Sichuan Province, Guizhou Province, Yunnan Province, Tibet Autonomous Region, Shanxi Province, Gansu Province, Ninxia Huizu Autonomous Region, Qinghai Province, Xinjiang Uygur Autonomous Region, Xinjiang Production and Construction Corps, Inner Mongolia Autonomous Region, and Guangxi Zhuangzu Autonomous Region (all the above-mentioned areas are collectively referred to as “West Region” hereinafter). The preferential policies of Western Region also apply to Xiangxi Tujia and Miao District in Hunan Province, Enshi Tujia and Miao District in Hubei Province, Yanbian Korean District in Jilin Province</p> |

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