

China sheds further light on corporate income tax preferences

Additional guidance on newly issued catalogs qualified for tax preferential treatments just announced

Executive summary

The new Corporate Income Tax Law (CITL) and CITL Implementation Regulations (CITLIR) effective from 1 January 2008 brought in a new set of Corporate Income tax (CIT) preferences, including tax credit for the purchase of qualified equipment, reduction in revenue for qualified recycling businesses, tax holidays for qualified public infrastructure projects, tax exemption or reduction for qualified agriculture, forestry, animal husbandry and fisheries projects (hereinafter referred to as Primary Sector Projects), and so on.

A couple of weeks ago, the Ministry of Finance (MOF), the State Administration of Taxation (SAT), the National Development and Reform Commission and the State Administration of Work Safety jointly published five catalogs for CIT preferential treatments. All five catalogs had found their way into three of our earlier editions of China Tax & Investment News (Issue No. [2008014](#), [2008017](#) and [2008019](#)).

On 23 September 2008, the MOF and the SAT once again jointly issued three new circulars to provide further guidance on the five catalogs. You can access to each of the three circulars via the following links:

[Caishui \[2008\] No. 46](#) (Circular 46)

[Caishui \[2008\] No. 47](#) (Circular 47)

[Caishui \[2008\] No. 48](#) (Circular 48)

The above three circulars carry the same message: all five catalogs can be subject to amendments in accordance with social and economic developments in the future.

The circulars impose a fixed starting date, viz., 1 January 2008, and restrict tax incentives to the purchase of qualified equipment or the implementation of public infrastructure projects approved after that date. The circulars also reiterate the importance of separate bookkeeping for qualified projects.

The SAT issued a circular, Guoshuihan [2008] No. 850 (Circular 850), on 17 October 2008 to confirm that the SAT and other competent authorities have been working together to come up with the scope of certain Primary Sector Projects. In the meantime, the local tax authorities can temporarily rely on the procedures as stated in the Administrative Measures of Tax Exemption and Reduction (Trial) issued in 2005 to handle the application of tax exemption and reduction for those projects.

This issue summarizes the salient points of Circulars 46, 47 and 48 and 850, and highlights uncertain areas which demand company executives' attention.

Salient points of Circulars 46, 47 and 48

Common requirement

All three circulars stipulate that the MOF and the SAT together with other competent authorities may adjust the listings of equipment or projects in the five catalogs in the future in line with economic and social development.

Other specific requirements

- ▶ Conditions apply regarding eligibility for tax incentives in respect of infrastructure projects and purchases of environmental protection, energy and water conservation, and production safety equipment. Tax benefits will only be given to companies commencing qualified public infrastructure projects approved after 1 January 2008, or purchasing qualified equipment and putting it into use on or after that date.

Similarly, tax incentives with respect of recycling businesses will only be given to companies that start to use resources listed in the Catalogue of Recycling Businesses Qualified for CIT Preferential Treatment (2008 edition) as main raw materials to manufacture qualified products on or after 1 January 2008.

- ▶ Companies must keep separate books and records for qualified public infrastructure projects and/or separately book revenue associated with qualified recycling businesses in order to enjoy the relevant tax holidays and/or revenue reduction.
- ▶ For qualified public infrastructure projects, the tax incentive is a tax holiday (three years of exemption and three years of a 50% reduction) starting from the "first income generating year". According to Circular 46, the first income generating year refers to the year in which income is derived for the first time after the construction of the public infrastructure is completed and put into operation.
- ▶ In relation to environmental protection equipment, energy and water conservation equipment and production safety equipment, the tax incentive is a tax credit based on 10% of the qualified equipment investment amount to be set off against the tax payable for the year of purchase. The following should be adhered to in computing the tax credit:
 - a. Qualified equipment investment amount refers to the purchase price plus value-added tax (VAT) appearing on the official sales invoices (i.e., fapiao). Notwithstanding, VAT already refunded in accordance with relevant rules and regulations (for instance, VAT refund for the purchase of domestically produced equipment) will not be counted as the part of the investment amount, nor will costs for transporting, installing and testing the qualified equipment.
 - b. Tax payable for the year concerned is equal to the annual taxable income of a company multiplied by applicable tax rate and from which any taxes reduced or exempted in accordance with tax preferential policies or transitional arrangements are subtracted.
 - c. Companies utilizing self-raised funds or bank loans to purchase qualified equipment are eligible for tax credit. However, if governmental appropriations (财政拨款) are used for the purchase of equipment, the amount invested will not qualify for this tax concession.
 - d. If a taxpayer enjoying the tax credit transfers or leases out the qualified equipment within 5 years from its first date of use, tax credits previously given will be clawed back. The transferee however can be entitled to a tax credit of 10% of the investment amount (i.e. purchase price plus any VAT stated on the sales invoices issued by the transferor). In other words, entitlement to the qualified equipment tax credit is not restricted to new equipment.

Primary Sector Projects

Circular 850 emphasizes the need for tax bureaus to implement the CIT exemption or reduction applicable to Primary Sector Projects in accordance with the CITL and CITLIR. For projects certainly eligible for tax exemption, any CIT paid should be refunded in due course.

Details of certain eligible Primary Sector Projects, including agricultural product preliminary processing (农产品初加工), and so on, are currently under discussion among the SAT and relevant competent authorities and will be announced soon.

Local tax authorities should follow the procedures stipulated in Guoshuifa [2005] No. 129 (Circular 129) in handling the application of tax exemption or reduction applicable to Primary Sector Projects. Circular 129 is accessible via the following URL:

<http://202.108.90.146/guoshui/action/GetArticleView1.do?id=3247&flag=1>

Our observations

As various catalogs of tax incentives are subject to revision based on the country's social and economic development, companies which can enjoy tax credits, reduction in revenue and/or tax holidays for now may not automatically be eligible to the same tax concession(s) in the future. Company executives should stay tuned for any latest updates on the five catalogs in order to ascertain their companies' eligibility for the relevant preferential tax treatment(s) for each year.

In addition, as all five catalogs could be subject to change, companies and industry groups may be able to articulate their interests to the competent authorities in order to influence the determination of future scope of the five catalogues.

Although all five equipment and project catalogues and relevant clarifications have been issued by the Chinese government, the detailed administrative procedures for the application of the specific tax concessions are still pending.

In addition, as stated in Circular 850, the SAT and other relevant authorities are working together to sort out the detailed scope of some Primary Sector Projects which are eligible for tax exemption or reduction for release in due course.



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