

Corporate Income Tax Reduction and Exemption

The reductions and exemptions of the income tax of the enterprises with foreign investment and foreign enterprises mainly include the following items:

1) The enterprises with foreign investment of a production nature scheduled to operate for a period of not less than ten years shall, from the year beginning to make profit, be exempt from income tax in the first and second years and allowed for a fifty percent reduction of income tax from the third to fifth years if these enterprises with foreign investment are engaged in machine-building and electronics industry, energy industry (excluding oil and natural gas exploitation), metallurgical industry (excluding exploitation of rare metals and precious metals), chemical and building material industries, light industry, textiles and packaging industries, medical apparatus and pharmaceutical industries, agriculture, forestry, animal husbandry, fishery, water conservancy industries, communications and transportation industries (excluding passenger transportation), the development of science and technology, geological survey and industrial information consultation and maintenance and repair service for production equipment and precision instruments that are directly at the service of production, and other industries that are recognized by the State (e.g. construction, installation, assembly project design and provision of labor services for projects, feeding, breeding, plantation industry, research and development of production technology, and provision of direct services as transportation and storage for clients with taxpayers' own means of transportation or storage facilities). The newly established software enterprises may enjoy this preferential treatment without restriction or operational period.

2) The enterprises with foreign investment in middle and western areas which are encouraged by the State may enjoy 15% rate on enterprise income tax for three years after the expiration of statutory tax holidays of two years exemption and three years reduction. If they are the export-oriented enterprises as ruled by the State, they may enjoy 10% rate on their enterprise income tax.

The enterprises with foreign investment set up in the State specified western part and other part of China mainly engaged in the State encouraged industries may, upon application of enterprise and approval by the tax authorities, enjoy a lower rate of 15% for their enterprises income tax during the period from 2001 to 2010 if the main business income is over 70% of the total income of the enterprises. Newly set up enterprises engaged in transportation, electric power, water conservancy, posting, radio and TV broadcasting with operational period over 10 years and the income from above business over 70% of the total income may, upon application of enterprises and approval by the tax authorities, enjoy tax exemption from the first to the second years and half reduction from the third to the fifth years starting from the first profit making year.

3) The profits obtained by the foreign investors from the enterprises with foreign investment

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may be exempt from the income tax.

4) Where the foreign investors re-invest the profits earned from the enterprises with foreign investment into the same enterprises to increase the registered capital or where the foreign investors invest the profits as capital to open another enterprise with foreign investment with operation lasting more than 5 years, 40% of the enterprise income tax paid on the re-invested profits may be rebated upon approval by the competent tax department. In case of operation of the re-investment lasting less than 5 years, the tax rebated should be paid back to the tax offices (this is not applicable to the situation that the foreign investors transfer this re-investment to the companies with which the foreign investors have the relation of direct or indirect ownership or 100% shareholding in the process of re-organization of company groups for the purpose of reasonable businesses).

The enterprise income tax paid on the re-invested profits may be all rebated for the foreign investors who directly re-invest in China to open or expand the export-oriented enterprises or advanced technology enterprise with operation lasting more than 5 years. Where ht above enterprises have not met the criteria for export-oriented enterprises of have not been recognized as advanced technology enterprises within 3 years after commencement of production or business operation, 60% of the enterprise income tax rebated should be paid back.

Before the end of 2010, where the foreign economic organizations as investors invest the after-income tax profits they received from China as the capital to open the integrated circuit production enterprises, sealing and packaging enterprise or software production enterprises in west part of China with the operational period not less than 5 years, 80% of the income tax paid on the re-investment may be rebated. In case of withdrawing the investment in less than 5 years after the re-investment, the income rebated shall be pursued back.

Where, according to the resolution of the board of directors, the enterprises with foreign investment make re-investment by use of the public reserves or development fund, reserve funds withdrawn from the after-tax profit by rules to increase the registered capital of the enterprises, the part belonging to the foreign investor may enjoy re-investment tax rebate also.

The formula for computing the re-investment tax rebate is:

Tax rebate = Re-investment amount / (1-Total of the previous Enterprise Income Tax rate and local income tax rate) * Previously applicable Enterprise Income tax rate

Where the foreign investors use the after – tax profits of one tax year from enterprises with foreign investment to make one or multiple direct investment, the accumulated re-investment amount for tax rebate should be limited to eh amount computed by the following formula:

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Limit of re-investment amount = (Taxable income of the tax year of the after – tax profit of the enterprise with foreign investment – Enterprise Income tax amount actually paid by the enterprise with foreign investment in the year) * Percentage of equity or distribution percentage of the foreign investment in the year

5) After the expiration of the statutory tax exemption and reduction period, the enterprises with foreign investment engaged in production for exports may be eligible for half reduction of the enterprise income tax computed at the statutory tax rate for the current year if the value of exportation of the year amounts to more than 70% of the total annual production. The enterprises located in Special Economic Zones and Economic and Technological Development Zones and other enterprises already liable to 15% rate on their enterprise income tax may enjoy 10% rate if they meet the conditions.

6) After the expiration of the statutory tax exemption and reduction period, the advance technology enterprises with foreign investment which are verified by the relevant competent department to remain the advance technology enterprises may be eligible for half reduction of the enterprise income tax computed at the statutory tax rate within 3 years. The enterprises with a rate lower than 10% after the half reduction may enjoy 10% rate.

7) The interest on loans made to the Chinese Government and Chinese State bank by international financial organizations (like IMF, World Bank) shall be exempt from income tax.

8) The interest on loans made at a preferential interest rate to Chinese State bank by foreign banks shall be exempt from income tax.

9) The royalties earned by foreign enterprises for the supply of technical know-how in scientific research, exploitation of energy resources, development of the communications industries, agricultural, forestry and animal husbandry production and the development of important technologies may be free from the tax where the technology supplied is advanced or the terms are preferential.

10) The interests, rentals, royalties and other income derived from within China by the foreign enterprises having no establishment or place in China or having establishment or place in China which however has nothing to do with the above income shall be subject to 10% rate except for those foreign enterprises enjoying tax exemptions.

11) The dividends, interest, rentals, royalties and other income derived by foreign enterprises from Special Economic Zones (like Shenzhen, Zhuhai, Shantou, Xiamen and Hainan Economic Zone), Economic and Technological Development Zones (refer to the Economic

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and Technological Development Zones set up in various cities as approved by the State Council), Coastal Economic Open Zones (refer to the city, county and districts approved by the State Council as coastal economic open zones) and other open areas approved by the State may be eligible for a reduced rate if 10% or exemptions. In addition, for those who provide fund or equipment with special preferential terms or transfer advanced technology, further income tax exemption or reduction may be available at the discretion of the Provincial Governments or Municipal Governments where their establishments are located.

12) The enterprises with foreign investment of production nature engaged in energy, transportation and port construction and the eligible integrated circuit manufacturing enterprises may, upon approval by the State Administration of Taxation, enjoy a reduced rate of 15% on their enterprise income tax.

13) The Sino-foreign joint ventures engaged in port and dock construction are allowed for a 15% rate for their enterprise income tax. Among them, those with the operational period exceeding 15 years may, upon the approval by the SAT offices at provincial level where the enterprises are located on their applications, enjoy exemption from enterprise income tax from the first profit-making year to the fifth year and reduction in enterprise income tax by 50% from the sixth to the tenth year.

14) 15% rate may be applicable for the enterprise with foreign investment established in Special Economic Zones, the foreign enterprises having establishments or places in Special Economic Zones engaged in production or business operation and the enterprises with foreign investment of a production nature in Economic and Technological Development Zones.

15) 24% rate may be applicable for the enterprises with foreign investment of production nature established in Coastal Economic Open Zones, in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located, and in the open cities approved by the State Council and for the enterprises with foreign investment established in National Tour and Holiday Resorts.

16) 15% rate may, upon approval by the State Administration of Taxation, be applicable for the enterprises with foreign investment of production nature established in the Coastal Open Economic Areas, the Special Economic Zones, or in the old urban districts of cities where the Economic and Technological Development Zones are located, which are engaged in technology intensive or knowledge intensive projects with foreign investment over US \$30 million and with long return period.

17) Foreign bank, banks with Chinese and foreign joint investment and other financial institutions established in the Special Economic Zones and other areas approved by the State Council may be eligible for 15% rate on enterprise income tax if the capital input by the

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foreign investors or the operating funds of the branches appropriated by the head office exceeds US \$10 million and the period of operation exceeds ten years. Moreover, these taxpayers may apply and, upon approval by the local competent tax offices, enjoy income tax exemption for the first year and 50% tax reduction for the second and third years starting from the year of making profits.

18) 15% rate may be applicable for the enterprises with foreign investment recognized as new and high technology enterprises, which are established in the State New and High-tech Industry Development Zones approved by the State Council. Among them, Chinese-foreign joint ventures scheduled to operate for a period of not less than ten years shall, from the year beginning to make profit, be exempt from income tax in the first and second years.

19) The enterprises with foreign investment established in the Special Economic Zones and engaged in service industry may, upon approval by the local competent tax office, be exempt from enterprise income tax for the first profit-making year and eligible for 50% reduction of the tax for the second and third years if the foreign investment exceeds US \$5 million and the operational period is more than 10 years.

20) The enterprises with foreign investment of a production nature established in the Bonded Zones approved by the State Council engaged in export processing business may enjoy 15% tax rate.

21) At the application of the enterprises and upon approval by the tax authorities at provincial level, the enterprises with foreign investment engaged in the projects encouraged by the State may enjoy periodical exemption and reduction on the income derived from the additional investment projects beyond the original contracts if they meet one of the following conditions:

a. The increment of the new registered capital due to the additional investment reaches to 60 million US \$ or more.

b. The increment of the new registered capital due to the additional investment reaches to 15 million US \$ or more and 50% or more of the original registered capital of the enterprises.

22) For the sectors and projects encouraged for foreign investment, the exemption or reduction of local enterprise income tax on Foreign Enterprise Income Tax may be determined by the People's Government of province, Autonomous Region or Municipality Directly under the State Council in consideration of the practical situation. At present, most areas grant tax reduction or exemption to the enterprises with foreign investment, mainly to the enterprises with foreign investment of production nature. The holiday period is normally synchronized with the exemption and reduction of Enterprise Income Tax.

The enterprises with foreign investment should pay back the enterprise income tax reduced or

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exempt it their actual operation lasts less than the length of time specified by law unless they have been incurred heavy losses due to natural disasters and unexpected accidents.

Where the enterprises with foreign investment engaged in the investment items in line with the rules of the State Council purchase China-made machinery within the Total investment, 40% of the China-made machinery investment may be credited against the increase of the enterprise income tax of the year of purchases of the machinery over that of the previous year. Where the increase of the enterprise income tax is not enough to offset the investment, the balance of the investment may be carried forward to the subsequent year (on the basis of the enterprise income tax in the year before the year of purchasing the machinery) with maximum of five years. For the enterprises with foreign investment enjoying enterprise income tax exemption and reduction in accordance with the relevant laws and administrative regulations, the credit period during tax holiday may be properly prolonged with a maximum of 7 years.

Where the enterprises with foreign investment purchase China-made machinery beyond the total investment to utilize advanced and suitable new technology, new craft, new equipment and new materials for transforming the present facilities and production technology for the purpose of improving economic efficiency and product quality, diversifying products, updating products, expanding exportation, decreasing costs, saving energy, optimizing comprehensive use of resources, tackling waste residue, waste water and waste gas and labor protection, 40% of China-made machinery investment may also be credited against the increase of enterprise income tax of the year of purchasing the machinery over the enterprise income tax of the previous year.

In case of transfer or lease of the China-made machinery said above within 5 years after purchase, the enterprise income tax already credited should be paid back on the time of transfer or lease.

The foreign enterprises having establishment or places in China engaged in production or business operation may obtain enterprise income tax credit on their purchase of China-made machinery in reference to the rules described above.

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