



CHINA'S NEW CORPORATE INCOME LAW: The State Council recently publicised two important circulars

Following the passing of China's new Corporate Income Law ("CIT Law") in 16 March 2007 and effective from 1 January 2008, the Chinese State Council has passed and publicised two important circulars on 29 December 2007. The two released circulars are discussed briefly below.

The transitional arrangement for the unification of the New Corporate Income Tax ("CIT") and the Foreign Enterprise Income Tax ("FEIT")

FEIT regime	CIT regime	Phasing-in of CIT rate										
24%	25%	Change will take place on 1 Jan 2008										
15%	25%	The rates will gradually increase in the following manner: <table data-bbox="734 1008 957 1276" style="margin-left: 40px;"> <tbody> <tr> <td>2008</td> <td>18%</td> </tr> <tr> <td>2009</td> <td>20%</td> </tr> <tr> <td>2010</td> <td>22%</td> </tr> <tr> <td>2011</td> <td>24%</td> </tr> <tr> <td>2012</td> <td>25%</td> </tr> </tbody> </table>	2008	18%	2009	20%	2010	22%	2011	24%	2012	25%
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2012	25%											

GuoFa (2007) No.39 - Grandfathering Treatments

This circular mainly addresses the grandfathering treatments available to Old Foreign Investment Enterprises ("Old FIEs"). It provides the detailed rules on the phasing-in of the CIT rate of Old FIEs which are currently enjoying an income tax rate of lower than 25% under the FEIT regime to the statutory rate of 25% within the five-year period. For those FIEs which were subject to 33% FEIT tax, the new applicable CIT rate will be 25% starting from 1 January 2008.

For those Old FIEs which have already commenced their tax holidays before 2008, they can continue to enjoy the remaining unutilized tax holidays until expiry. For those Old FIEs which have not commenced their tax holidays before 2008 due to losses, their tax holidays will be deemed to commence in 2008 and can be utilized until expiry.

In addition, an enterprise, which qualifies for both the grandfathering treatments and the new tax incentives under the CIT Law, is allowed to choose the one which is more preferential but no duplication is allowed and once chosen, it cannot be changed.

GuoFa (2007) No. 40 - Redefinition of High-New Tech Enterprises (HNTEs)

This Circular clarify that the specific regions refer to the five special economic zones (namely, Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) and the New Area of Pudong ("5+1 Zones") and the tax incentive apply to HTNEs established in the 5+1 Zones on or after 1 January 2008.

The tax incentive is in the form of a tax holiday of two-year exemption and three-year 50% tax rate reduction, with the holiday commencing from the first-income generating year (instead of "first-profit making year" which was generally applied under the FEIT regime). The income tax rate for these new HTNEs will be as follows:

No. of years	Tax rates
First 2 years	0%
Next 3 years	12.5%
Thereafter	15%

The qualifying conditions for HNTE are:

- the core proprietary IP rights are owned by the Enterprise
- its products/services fall under the prescribed scope of "High/New Tech Sectors Specifically Supported by the State"
- research and development expenses shall not be less than the prescribed percentage
- income from high/new tech products/services accounts for not less than the prescribed percentage of its total income
- the no. of technicians accounts for not less than the prescribed percentage of the total number of employees of the Enterprise
- Other conditions as prescribed in the administrative measures for the assessment of the High/New Tech Enterprises

In order to avoid the old problem of "registration within the zone but operating outside the zone", the tax holiday is only applicable to profits derived within the 5+1 Zones. Any profits derived outside the 5+1 Zones will not be eligible for the tax holiday. If the new HTNE has operations both within and outside the 5+1 Zones, it has to segregate its income and expenses between the two operations on a reasonable basis. If it fails to do so, then it will not be allowed to enjoy the tax holiday at all.

PwC's observations

The announcement of the detailed rules on the phasing-in of the CIT rate for Old FIEs which are currently enjoying an income tax rate of lower than 25% under the FEIT regime to the statutory rate of 25% over the five year period will now provide statutory support to these FIEs for booking their deferred taxes.

These two State Council circulars are just two of the many circulars and guidelines which are expected to be issued by the Chinese authorities in the near future to further clarify the CIT Law and its DIR.

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