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Unified Corporate Income Tax Law in the PRC

On 16 March 2007 the National People's Congress ("NPC") announced the new PRC Unified Corporate Income Tax Law (the "CIT law"), to be effective from 1 January 2008.

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Under the new CIT law, PRC domestic enterprises and foreign investment enterprises ("FIEs") will be subject to ONE corporate income tax regime, instead of two different sets of regulations as at present.

By introducing the new income tax law, the PRC government aims to provide a level playing field for both domestic enterprises and FIEs. While a unified income tax law will help to promote fair competition between domestic enterprises and FIEs, the comparatively low level of the new tax rate will still

enable China to remain an attractive country for foreign investors, relative to other countries. Extracted below are the key points of the new CIT law.

TAX RATE

The income tax rate is to be reduced from the current 33% to a unified rate of 25% for all enterprises in China.

TAX DEDUCTION

The new CIT law unifies the standard of tax deduction. Both domestic enterprises and FIEs will be subject to the same treatment on the tax deductibility of their expenses.



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EXISTING PREFERENTIAL TAX TREATMENTS FOR FIES

Some of the tax holiday and preferential tax treatments currently available to FIEs will no longer be available or will be changed after 1 January 2008, including:

- For production FIEs, (2+3) tax holiday – tax exemption for the first 2 years and 50% tax deduction for the following 3 years.
- For export-oriented FIEs, 50% tax deduction.
- For production FIEs adopting advanced technologies, 50% tax deduction for an additional 3 years right after the (2+3) tax holiday.
- For special economic zones, economic technological development zones, coastal economic open cities and similar, preferential tax rates of 15% or 24%.
- Reinvestment refund on income tax paid.

A grandfather provision in the new CIT law allows for gradual phasing out of existing preferential tax treatments for FIEs, with staged increase of tax rates over a 5-year transitional period. For certain special infrastructure projects, however, the transitional period could be up to 10 years.

NEW PREFERENTIAL TAX TREATMENTS

Under the new CIT law, certain new preferential tax treatments will be available:

- For high-tech enterprises, the tax rate will be 15%.
- For enterprises engaged in agriculture, forestry, stockbreeding and fishing as well as infrastructure projects, there will be retention of tax benefits.
- For environmental protection projects, there will be tax exemption or deduction on revenue.
- For purchase of equipment and machinery to protect the environment, save energy and water, and improve safety in the production process, there will be special tax deduction.

NEW CONCEPT OF 'TAX RESIDENCE'

The new CIT law introduces a new 'tax residence' concept. In relation to this, the worldwide income of enterprises resident in the PRC, that is, whose effective management and control take place in the PRC, will be subject to PRC income tax, regardless of their place of incorporation (whether incorporated in the PRC or otherwise).

WITHHOLDING TAX

The new CIT law reiterates that withholding tax on dividends, interest, royalties and capital gains will be levied at a rate of 20%.

Currently the withholding tax rate on the above-mentioned passive income streams is reduced to 10% for both domestic enterprises and FIEs, except for dividends paid to foreign investors by FIEs, which are exempted from withholding tax.

Whether the existing preferential tax treatment on withholding tax will be maintained under the new tax law is not known. No detailed information on this has yet been released.

For ease of reference we present below a comparison of withholding tax rates under different tax treaties between China and certain other countries, and between the Mainland and the Special Administrative Regions of Hong Kong and Macau.

Withholding Tax Rates on			
Country/ Region	Dividends	Royalties	Interest
Barbados	5%	10%	10%
Mauritius	5%	10%	10%
Singapore	7% / 12%	10%	7% / 10%
United States	10%	10%	10%
Hong Kong	5% / 10%	7%	0% / 7%
Macau	10%	10%	7% / 10%

Using a Hong Kong company to invest in China helps to reduce withholding tax. For more details on this option please refer to our Tech News Vol. 3, No. 4 issued in September 2006 on double tax arrangement between China and Hong Kong.

SUMMARY

The Ministry of Finance and State Tax Bureau are finalizing implementation regulations for the new CIT law. These are expected to be announced at the end of the year.

More detailed explanations of the new tax law will almost certainly be provided at that point.

Tricor strongly recommends early discussion with tax advisers to evaluate the impact of the new CIT law on the income tax for your company's existing or proposed PRC investments, before implementation of the law.



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