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High-Tech tax concessions in China [06 Jun. 2008 Issues 12]

China's new Corporate Income Tax ("CIT") law provided an effective framework and incorporated various tax concession areas including the encouragement of technology. The tax authorities recently announced the regulations in relation to the incentive policies for Hi-tech ("Hi-tech") enterprises. To better understand these policies we provide below a detailed summary for reference:

The new CIT Law rules that Hi-tech enterprise can enjoy the preferential CIT rate of 15%.

The Implementation Rules for the CIT Law provide that:

Within a tax year, the portion of income from technology transfer that does not exceed RMB 5 million shall be exempt from CIT; the portion of income that exceeds RMB 5 million shall enjoy a 50% reduction.

Hi-tech enterprises refer to enterprises that own core independent intellectual property, and that meet all of the following conditions:

- * Products (services) are within the scope prescribed in the Advanced and New Technology Sectors eligible for key support from the state;
- * The proportion of R&D ("R&D") expenditures to sales revenue is not lower than a prescribed ratio;
- * The proportion of the revenue derived from high and new technology products (services) to the total revenue is not lower than a prescribed ratio;
- * The proportion of the number of R&D personnel to the number of all employees is not lower than a prescribed ratio;
- * Other conditions prescribed by the Administrative Measures for Assessing the Qualifications of Hi-tech Enterprises.

Hi-tech enterprises can enjoy a 50% additional deduction or amortization for R&D expenditures.

If a venture capital enterprise has invested to the small-to-medium-sized hi-tech enterprise that has not been listed on a stock exchange for more than 2



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years, 70% of the amount invested may be set off against its taxable income in the year by which the equity has been held for two years; any amount that is not set off in that year may be carried forward and set off against its taxable income in succeeding tax years.

The State Administration of Taxation (SAT)'s Notice Concerning CIT Prepayment Matters, Guoshuifa [2008] No.17

The SAT clarifies that enterprises which were recognized as hi-tech enterprises before 1 January 2008 should conduct provisional CIT filings based on the standard CIT rate of 25 percent until they are re-recognized as such under the new CIT law.

In order to qualify for the preferential CIT rate of 15 percent, previously-recognized hi-tech enterprises should be re-recognized as such according to the qualifying measures under the new CIT law.

Notice on the Implementation of Grandfathering Relief in respect of Hi-tech Enterprises in Special Economic Zones and Shanghai Pudong New Area, Guofa [2007] No.40

Hi-tech enterprises established on or after 1 January 2008 in six zones can enjoy a five-year tax holiday of two years tax exemption followed by three years 50 percent reduction starting from the first revenue generating year.

The six zones include five special economic zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) and Shanghai Pudong New Area.

Notice on Issuance of the Administrative Measures Governing the Recognition of Hi-tech Enterprises, Guokefahuo [2008] No.172

Recognition criteria

Hi-tech enterprise must meet all of the following criteria:

1). Qualification of the enterprise

* The enterprise should be a resident enterprise that has been established in China (excluding Hong Kong, Macau and Taiwan) for more than one year.

* The enterprise must have owned, for the most recent three years, the independent intellectual property of the core technology used in its major products or services. This independent intellectual property must have been acquired through: self-development, purchase, donation, merger and acquisition, or exclusive licensing with a term of more than five years.

2). Qualified products or services

Qualified products or services should fall within the scope of the Hi-tech Sectors Eligible for Key Support from the State.

3). Technical personnel requirement

More than 30 percent of the enterprise's staff must be technical personnel holding at least a college degree, among whom R&D (R&D) personnel account for more than 10 percent of the enterprise's total employees for the year.

4). R&D expenditures requirement

The enterprise must carry out ongoing R&D activities. Additionally, in the most recent three years, the following details should be met:

Sales of the latest year (RMB) Required proportion of R&D expenditures to total sales:

< 50 million \geq 6%

50 million - 200 million \geq 4%

> 200 million \geq 3%

Furthermore, the R&D expenditures incurred in China must account for more than 60 percent of the total R&D expenditures.

5). Revenue requirement

More than 60 percent of the total revenue for the year must be derived from products or services with hi-tech.

Recognition authorities

Special units designated to administer the recognition process will be established jointly by the Administrative Departments of Science and Technology, and the finance and tax authorities at the provincial level.

Recognition procedures

* Enterprises meeting the requirements for hi-tech enterprises should apply with the recognition authorities.

* Upon reviewing the submissions, specialists with the recognition authorities will issue a recognition opinion.

* The recognition authorities will publish the names of the recognized hi-tech enterprises on a public website for 15 working days. If no objection is received, the applicant will then be granted the Hi-tech Enterprise Certificate.

* Qualification as hi-tech status is effective for three years from the date of issuance of the relevant certificate. Upon expiry, the effective period can be extended for another three years, provided that the enterprise passes the re-recognition review.

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