

4.2 Tax Exemption and Reduction

In a bid to attract foreign investment, the Chinese government has introduced a range of tax concessions to FIEs and foreign enterprises. The following are some of the major preferential policies.

4.2.1 Concessions on Business Tax, VAT and Customs Duty

- (a) Incomes derived by research and development centres established by FIEs and foreign wholly-owned enterprises and incomes derived by foreign enterprises and foreign individuals from technology transfer, technology development and related consultancy and technical services are exempt from business tax.
- (b) The raw materials, auxiliary materials, parts, components, accessories and packaging materials imported by FIEs for the outward processing or assembly of products and for the production of goods for export are exempt from import tariffs based on the quantity of finished products actually processed and exported. Alternatively, import tariffs are levied on the imported materials and parts first and rebates are made later based on the quantity of finished products actually processed and exported.
- (c) FIEs under “encouraged category” are entitled to full VAT rebate on the purchase of domestically-produced equipment within their investment amount if such equipment is listed in the catalogue of duty-free imports.
- (d) Imports of equipment and supporting technologies, accessories and parts for own use by existing FIEs under the “encouraged category”, foreign-invested R&D centres, FIEs with advanced technologies and export-oriented FIEs, are exempt from import tariffs and import-related taxes in accordance with the *Circular of the State Council on the Adjustment of Tax Policy on Equipment Imports*.

4.2.2 Concessions on Corporate Income Tax

(a) Preferential Tax Rate

Enterprises in the following regions (sectors) are subject to corporate income tax at the reduced rate of 15%:

- FIEs in the Shenzhen, Zhuhai, Shantou, Xiamen and Hainan special economic zones;
- Foreign enterprises with establishments or venues in special economic zones and engaged in production and business operations;
- Production FIEs established in economic and technological development zones approved by the State Council and in the Pudong New Area in Shanghai;
- Technology- and knowledge-intensive projects launched by FIEs in old urban districts of special economic zones, economic and technological development zones and coastal economic open areas approved by the State Council with long investment recovery periods and foreign investment exceeding US\$30 million;
- Production FIEs engaged in energy, transportation and port construction projects;
- Production FIEs engaged in export processing in bonded areas;
- Recognised high-tech FIEs in new- and high-technology industrial development zones at state-level approved by the State Council.

Production FIEs in the following regions are subject to corporate income tax at 24%:

- Other types of production FIEs in old urban districts of coastal economic open areas, special economic zones, and economic and technological development zones where the 15% preferential tax rate is not applicable;
- Open coastal cities, open cities along the Yangtze River and in inland and border regions, as well as

other areas designated by the State Council to enjoy the same concessions;

- State tourist resorts.

(b) Exemption and Reduction of Corporate Income Tax

Production FIEs with an operating period of over 10 years (excluding projects for the exploration of petroleum, natural gas, rare metals and precious metals) are eligible for corporate income tax exemption in the first two profit-making years and for reduction by half in the following three years. With the approval of the State Administration of Taxation (SAT), FIEs engaged in agriculture, forestry and animal husbandry and FIEs established in the economically-backward remote and border areas may be levied corporate income tax at the reduced rate of 15%-30% for another 10 years after the expiration of the above said tax exemption and reduction period.

- Sino-foreign joint ventures engaged in port and wharf construction and with an operating period of over 15 years are eligible for corporate income tax exemption in the first five profit-making years and for reduction by half in the following five years.
- Infrastructure projects related to airports, ports, wharfs, railways, highways, power stations, coal mines and water conservancy facilities as well as agricultural development in the Hainan Special Economic Zone with an operating period of over 15 years are eligible for corporate income tax exemption in the first five years and reduction by half in the following five years.
- Infrastructure projects related to airports, ports, railways, highways and power stations in the Pudong New Area in Shanghai with an operation period of over 15 years are eligible for corporate income tax exemption in the first five years and for reduction by half in the following five years.
- The following types of enterprises are eligible for corporate income tax exemption in the first

profit-making year and for reduction by half in the second and third years with the approval of the local tax authorities:

- FIEs engaged in services in special economic zones with foreign investment exceeding US\$5 million and with an operating period of over 10 years;
- Foreign-invested banks, Sino-foreign joint-venture banks and other financial institutions in special economic zones and other areas designated by the State Council with foreign capital investment exceeding US\$10 million and with an operating period of over 10 years.
- Recognised high-tech Sino-foreign joint venture enterprises in state-level high-technology development zones with an operating period of over 10 years are exempt from corporate income tax in their first two profit-making years with the approval of the tax authorities.
- Foreign-invested export-oriented enterprises are entitled to pay corporate income tax at the reduced rate of 15% or 10% following the expiration of the corporate income tax exemption and reduction by half concession if their export value amounts to over 70% of their total output value in the current year.
- Foreign-invested high-tech enterprises are entitled to pay corporate income tax at the reduced rate of 15% or 10% for three years following the expiration of the corporate income tax exemption and reduction by half concession if their status of high-tech enterprises remains unchanged.

(c) Tax Rebate on Re-investment by FIEs

Any foreign investor of an FIE re-investing its profit obtained from the enterprise directly into that enterprise or using the profit as capital investment to establish other FIEs with an operating period of at least five years is, upon approval granted by the competent tax authorities, eligible for a 40% refund of the corporate income tax already paid on the re-invested amount. If the foreign

investor re-invests its profit directly in establishing or expanding an export-oriented or high-tech enterprise in China, the corporate income tax already paid on the re-invested amount will be 100% refunded.

(d) Other Exemptions and Reductions of Income Tax

- The profits of foreign investors derived from FIEs are exempt from income tax.
- The interest revenue of international financial institutions derived from loans to the Chinese government or state banks and the interest revenue of foreign banks derived from loans to Chinese state banks at preferential rates are exempt from income tax.
- Royalties paid to foreign enterprises for their provision of special technologies to China for scientific research, exploitation of energy resources, development of transportation, production of agriculture, forestry and animal husbandry, and development of important technologies, is eligible for income tax at the reduced rate of 10%, with the approval of SAT. For those enterprises that involve advanced technologies or offered favourable terms, income tax will be exempted.
- In the case of FIEs or foreign enterprises with establishments or venues engaged in production or business operations within the territory of China, 40% of their investment in the purchase of domestically-produced equipment can be offset against the incremental corporate income tax of the prior year.
- With the approval of the tax authorities, FIEs that have increased their technological development expenses by more than 10% over the previous year are allowed to offset their taxable income in the current year by 50% of the amount of technological development expenses. The details are laid down in SAT's *Procedures for the Administration of Pre-Tax Deductions of Enterprise Technological Development Expenses*.

- The governments of various provinces, autonomous regions and municipalities have also introduced local income tax exemptions or reductions for those sectors or projects where foreign investment is encouraged.

4.2.3 Individual Income Tax Concession for Foreigners

The following income of foreigners is eligible for individual income tax concession:

- (a) Housing allowance, meal allowance, removal expenses and laundry fees received in non-cash forms or in the form of cash reimbursement can be deducted from the taxable income.
- (b) Travel allowance at reasonable levels can be exempt from individual income tax.
- (c) The portion of home visit allowance, language training fees and children's education expenses at reasonable level can be deducted from the taxable income.
- (d) Dividends and bonuses received from FIEs can be exempt from individual income tax.
- (e) Any foreign individual who resides in China consecutively or accumulatively for not more than 90 days (or 183 days for those from countries that have signed tax treaties with China) in a tax year is exempt from individual income tax if his wage or salary is not paid or borne by his employer in China and is not borne by a resident establishment or permanent venue of his employer in China.
- (f) With the approval of the competent tax authorities, any foreign individual who resides in China for more than a year but less than five years, his wage or salary during his duration of work outside China and paid by the non-China employer, may be exempt from individual income tax.

4.2.4 Tax Concessions for Central and Western Regions

FIEs under the “encouraged” category in the western region that enjoy the “two-year exemption and three-year reduction by half” tax concession are eligible for corporate income tax at the reduced rate of 15% for three more years following the expiration of the said concession. FIEs recognised as high-tech or export-oriented enterprises with an export value amounting to over 70% of their annual output value in the current year are eligible for a 50% reduction of corporate income tax during this three-year period, however the reduced tax rate cannot be below 10%.