

March 2007

If you have any questions on the issues raised, please contact:

Beijing

Jon Eichelberger
Tel: +86 10 6535 3868
e-mail: jon.eichelberger@bakernet.com

Shanghai

Brendan Kelly
Tel: +86 21 6105 5950
e-mail: brendan.kelly@bakernet.com

Hong Kong

Michael Olesnicky
Tel: +852 2846 1716
e-mail: michael.olesnicky@bakernet.com

Steven Sieker
Tel: +852 2846 1048
e-mail: steven.sieker@bakernet.com

Jacqueline Shek
Tel: +852 2846 2154
e-mail: jacqueline.shek@bakernet.com

www.bakernet.com

Beijing
Suite 3401, China World Tower 2
China World Trade Centre
1 Jianguomenwai Dajie
Beijing 100004, PRC
Tel: +86 10 6535 3800
Fax: +86 10 6505 2309

Hong Kong
14/F Hutchison House
10 Harcourt Road
Central, Hong Kong
Tel: +852 2846 1888
Fax: +852 2845 0476

Shanghai
Unit 1601, Jin Mao Tower
88 Century Avenue, Pudong
Shanghai 200121, PRC
Tel: +86 21 6105 8558
Fax: +86 21 5047 0020

Decree of Chairman of the People's Republic of China No. 63

The Enterprise Income Tax Law of the People's Republic of China was adopted at the Fifth Session of the 10th National People's Congress on March 16, 2007 and is hereby promulgated. It will come into effect on January 1, 2008.

Hu Jintao, Chairman of the People's Republic of China
March 16, 2007

Enterprise Income Tax Law of the People's Republic of China (Adopted at the Fifth Session of the 10th National People's Congress on March 16, 2007)

Table of Contents

Chapter One	General Provisions
Chapter Two	Taxable Income
Chapter Three	Tax Payable
Chapter Four	Tax Incentives
Chapter Five	Withholding of Tax at Source
Chapter Six	Special Tax Adjustments
Chapter Seven	Administration of the Levy and Collection of Tax
Chapter Eight	Supplementary Provisions

CHAPTER 1. GENERAL PROVISIONS

Article 1. In the People's Republic of China ("PRC"), enterprises and other organizations that derive revenue (hereinafter referred to as "Enterprises") are the payers of enterprise income tax and shall pay enterprise income tax in accordance with this Law.

This Law does not apply to individually-owned enterprises or partnership enterprises.

Article 2. Enterprises are divided into resident Enterprises and non-resident Enterprises.

A "resident Enterprise" as referred to in this Law is an enterprise established in the PRC, or an enterprise that is established under the laws of a foreign country (region) but whose place of effective management is located in the PRC.

A "non-resident Enterprise" as referred to in this Law is an enterprise that is established under the laws of a foreign country (region) and whose place of effective management is not located in the PRC but that has an establishment or place in the PRC, or that does not have an establishment or place in the PRC but derives income from sources within the PRC.

Article 3. A resident Enterprise shall pay enterprise income tax on both its PRC-sourced income and its non-PRC-sourced income.

A non-resident Enterprise that has set up an establishment or place in the PRC shall pay enterprise income tax on the PRC-sourced income derived by such establishment or place and on income arising outside the PRC that is effectively connected with such establishment or place.

A non-resident Enterprise that does not have an establishment or place in the PRC, or that has an establishment or place in the PRC but whose income is not effectively connected with such establishment or place, shall pay enterprise income tax on its PRC-sourced income.

Article 4. The enterprise income tax rate is 25 percent.

The tax rate applicable to the income of non-resident Enterprises described in the third paragraph of Article 3 of this Law is 20 percent.

CHAPTER 2. TAXABLE INCOME

- Article 5. The taxable income of an Enterprise shall be its total revenue for the tax year less its non-taxable revenue, tax-exempt revenue, deductions and prior-year losses that may be made up.
- Article 6. The currency and non-currency revenue derived by an Enterprise from all sources shall be the total revenue of the Enterprise. This includes:
- (1) revenue from the sale of goods;
 - (2) revenue from the provision of labor services;
 - (3) revenue from the transfer of property;
 - (4) dividends, profit distributions and other returns on equity investments;
 - (5) interest;
 - (6) rent;
 - (7) royalties;
 - (8) donations; and
 - (9) other revenue.
- Article 7. Of the total revenue, the following revenue is non-taxable revenue:
- (1) government allocations;
 - (2) fees for administrative operations and contributions to government funds where such fees and contributions are charged according to law and subject to government financial administration; and
 - (3) other non-taxable revenue specified by the State Council.
- Article 8. Reasonable expenditures actually incurred by an Enterprise in connection with the deriving of revenue, including costs, fees, taxes, losses and other outlays, may be deducted when the Enterprise calculates the amount of its taxable income.
- Article 9. An Enterprise may deduct donations made for the public benefit in an amount of up to 12 percent of its total annual profit in calculating its taxable income.
- Article 10. The following expenditures may not be deducted when an Enterprise calculates its taxable income:
- (1) dividends, profit distributions and other returns on equity investments paid to investors;
 - (2) enterprise income tax payments;
 - (3) fines for late payment of taxes;
 - (4) fines, penalties and losses resulting from the confiscation of property;

- (5) donations other than those prescribed in Article 9 of this Law;
- (6) sponsorship;
- (7) non-approved payments from reserve funds; and
- (8) other payments unrelated to the generation of revenue.

Article 11. In calculating its taxable income, an Enterprise may deduct the depreciation of its fixed assets where such depreciation has been calculated in accordance with regulations.

The following fixed assets shall not be depreciated:

- (1) fixed assets that have not been placed into service, other than buildings and structures;
- (2) fixed assets leased in by means of an operating lease;
- (3) fixed assets leased out by means of a finance lease;
- (4) fixed assets that have been fully depreciated but that are still in service;
- (5) fixed assets that are unrelated to business activities;
- (6) land that has been independently valued and booked as a fixed asset; and
- (7) other non-depreciable fixed assets.

Article 12. In calculating its taxable income, an Enterprise may deduct the amortization of its intangible assets where such amortization has been calculated in accordance with regulations.

The following intangible assets shall not be amortized:

- (1) self-developed intangible assets where expenditures for the same have already been deducted when calculating taxable income;
- (2) self-created goodwill;
- (3) intangible assets that are unrelated to business activities; and
- (4) other non-amortizable intangible assets.

Article 13. In calculating its taxable income, an Enterprise may deduct the following expenditures where the Enterprise has treated these expenditures as prepaid expenses to be deducted over the long term in accordance with regulations:

- (1) expenditures relating to the alteration* of fully depreciated fixed assets;
- (2) expenditures relating to the alteration* of fixed assets that have been leased in;
- (3) expenditures relating to the overhaul of fixed assets; and
- (4) other expenditures that must be deducted over the long term.

- Article 14. The cost of assets invested by an Enterprise [outside the Enterprise itself] may not be deducted for the purpose of calculating taxable income during the period of the investment.
- Article 15. An Enterprise that has used inventory or has sold inventory may deduct the cost of such inventory in calculating its taxable income, provided that the cost of such inventory is calculated according to regulations.
- Article 16. When an Enterprise transfers assets, the net value of the assets may be deducted for the purpose of calculating taxable income.
- Article 17. When an Enterprise calculates the amount of its enterprise income tax on a consolidated basis, losses incurred by its business establishments outside the PRC may not be used to offset profits from its business establishments in the PRC.
- Article 18. Losses incurred in a tax year by an Enterprise are allowed to be carried forward to subsequent years and to be made up by income from subsequent years, provided that the maximum period during which such losses may be carried forward shall not exceed five years.
- Article 19. With respect to the income of a non-resident Enterprise described in the third paragraph of Article 3 of this Law, the amount of taxable income shall be calculated according to the following method:
- (1) in the case of income from dividends, profit distributions and other returns on equity investments to shareholders, interest, rent and royalties, the taxable income shall be the entire amount of revenue;
 - (2) in the case of income from the transfer of property, the taxable income shall be the entire amount of revenue less the net value of the property;
 - (3) in the case of other income, the taxable income shall be calculated by reference to the relevant formula specified in the two paragraphs above.
- Article 20. Detailed measures regarding the specific scope of, and the standards for, revenue and deduction, as well as the tax treatment of assets prescribed in this Chapter, shall be issued by the finance department and the department in charge of taxation under the State Council.
- Article 21. In calculating the amount of taxable income, if the method by which the Enterprise handles its financial affairs and accounting is inconsistent with tax laws and administrative regulations, the amount of taxable income shall be calculated in accordance with the tax laws and administrative regulations.

CHAPTER 3. TAX PAYABLE

- Article 22. The amount of tax payable by an Enterprise is equal to the Enterprise's taxable income times its applicable enterprise income tax rate, less the amount of allowable reductions, exemptions and credits pursuant to the provisions of this Law regarding tax incentives.
- Article 23. Income tax on the following income paid outside the PRC by an Enterprise may be credited against the tax payable for the current period, provided that the amount of the tax credit shall not exceed the amount of tax payable on such income pursuant to this Law; the amount exceeding the credit limitation may be used as an additional credit during each of the subsequent five years after the available tax credit for such year, subject to the credit limitation, has been applied to the creditable tax for such year:
- (1) non-PRC-sourced taxable income of a resident Enterprise;
 - (2) taxable income derived from outside the PRC by the establishment or place in the PRC of a non-resident Enterprise that is effectively connected with such PRC establishment or place.
- Article 24. In the case of non-PRC-sourced dividends and profit distributions that are distributed to a resident Enterprise by a foreign enterprise directly or indirectly controlled by the resident Enterprise, the portion of the income tax actually paid outside the PRC by the foreign enterprise that is attributable to such dividends, profit distributions or other returns on equity investments may be used by the resident Enterprise as a foreign income tax credit and credited up to the tax credit limitation specified in Article 23 of this Law.

CHAPTER 4. TAX INCENTIVES

Article 25. The state offers enterprise income tax incentives to industries and projects that are eligible for key support from the state or whose development is encouraged by the state.

Article 26. The following income of an Enterprise is exempt from tax:

- (1) interest income from treasury bonds;
- (2) dividends, profit distributions and other returns on equity investments from one resident Enterprise to another resident Enterprise that meet the [relevant] conditions;
- (3) dividends, profit distributions and other returns on equity investments derived from a resident Enterprise by a non-resident Enterprise with an establishment or a place in the PRC where such income is effectively connected with such establishment or place; and
- (4) revenue of a not-for-profit organization that meets the [relevant] conditions.

Article 27. The following income of an Enterprise may be eligible for exemption from or reduction of enterprise income tax:

- (1) income derived from an agriculture, forestry, animal husbandry or fishery project;
- (2) income derived from investment in or operation of infrastructure construction projects eligible for key support from the state;
- (3) income derived from environmental protection, energy efficiency or water conservation projects that meet the [relevant] conditions;
- (4) income derived from the transfer of technology that meets the [relevant] conditions; and
- (5) income described in the third paragraph of Article 3 of this Law.

Article 28. The tax rate applicable to small-scale, low-profit Enterprises that meet the prescribed conditions is reduced to 20 percent.

High and new technology Enterprises to which the state needs to provide key support will pay enterprise income tax at the reduced rate of 15 percent.

Article 29. Autonomous agencies of an autonomous minority location may decide to reduce or exempt the enterprise income tax of an Enterprise located in the autonomous minority location to the extent that such enterprise income tax is allocated to the local government. If the autonomous prefecture or autonomous county so decides, it must seek approval for the reduction or exemption from the people's government of the relevant province, autonomous region or municipality directly under the central government.

- Article 30. The following expenditures of an Enterprise are eligible for super-deduction for purposes of calculating taxable income:
- (1) research and development expenses incurred for the development of new technology, new products and new processes; and
 - (2) wages paid to handicapped personnel employed by the Enterprise and to other personnel whose employment is encouraged by the state.
- Article 31. A venture capital Enterprise that makes venture capital investments to which the state needs to provide key support and encouragement may set off a certain percentage of its investment against its taxable income.
- Article 32. If it is necessary to accelerate the depreciation of an Enterprise's fixed assets owing to such reasons as technical advances, the depreciation period may be shortened or an accelerated depreciation method may be adopted.
- Article 33. Revenue derived from the manufacture of products that are in conformity with state industrial policies may be recorded at a reduced amount for purposes of calculating taxable income where the Enterprise made comprehensive use of resources in the manufacture of the products.
- Article 34. A certain percentage of the amount invested by an Enterprise in the purchase of equipment may be used to offset the tax of an Enterprise where the equipment is used for such special purposes as environmental protection, energy efficiency, water conservation and safer production.
- Article 35. The State Council shall formulate specific measures for the tax incentives prescribed by this Law.
- Article 36. In response to national economic and social development needs, or because of reasons such as unexpected incidents that have a substantial impact on the business activities of Enterprises, the State Council may formulate specific enterprise income tax preferential policies and file them with the Standing Committee of the National People's Congress for the record.

CHAPTER 5. WITHHOLDING OF TAX AT SOURCE

- Article 37. The income tax payable on the income described in the third paragraph of Article 3 of this Law that is derived by a non-resident Enterprise shall be withheld at source, and the payer shall be the withholding agent. The withholding agent shall withhold tax from the amount of each payment that is paid or that becomes due, at the time of payment or at the time the payment falls due.
- Article 38. With respect to the income tax payable on income derived from projects and labor services inside the PRC by a non-resident Enterprise, the tax authorities may designate the payer of the project price or service fee as the withholding agent.
- Article 39. With respect to the income tax of a non-resident Enterprise that is subject to withholding pursuant to Articles 37 and 38 of this Law, if a withholding agent fails to withhold according to law or is unable to perform its withholding obligations, the taxpayer shall pay at the place where the income arose. If the taxpayer fails to pay according to law, the tax authorities may recover the tax payable by such taxpayer from payments of other revenue items due to such Enterprise from payers in the PRC.
- Article 40. A withholding agent shall pay each amount of tax it withholds into the state treasury within seven days from the date of withholding and shall submit forms for reporting the withholding and payment of enterprise income tax to the tax authorities at the place where it is located.

CHAPTER 6. SPECIAL TAX ADJUSTMENTS

Article 41. If the business transactions between an Enterprise and its related parties do not conform to the arm's length principle and reduce the taxable revenue or income of the Enterprise or the related party, the tax authorities have the authority to make adjustments based on reasonable methods.

When calculating taxable income, the costs incurred by an Enterprise and its related parties in the joint development or transfer of intangible assets or in the joint provision or receipt of labor services shall be allocated according to the arm's length principle.

Article 42. An Enterprise may submit its pricing principles and calculation methods for related party business transactions to tax authorities. After consultation and confirmation, the tax authorities may conclude an advance pricing arrangement with the Enterprise.

Article 43. When an Enterprise files its annual enterprise income tax return with the tax authority, it shall submit, with respect to its business transactions with related parties, a form for the annual report on related party business transactions.

When the tax authorities investigate related party business transactions, the Enterprise and its related parties, as well as other Enterprises related to the investigation of the related transactions, shall provide relevant information in accordance with regulations.

Article 44. If an Enterprise does not provide information on its related party business transactions, or provides false or incomplete information that does not truthfully reflect its related party transactions, tax authorities shall have the power to deem the taxable income of the Enterprise in accordance with law.

Article 45. If an Enterprise that is established in a country (or region) where the actual tax burden is distinctly lower than the tax rate specified in the first paragraph of Article 4 of this Law and that is controlled by any resident Enterprise, or by any resident Enterprise and any PRC resident, does not distribute any profits or distributes reduced profits where such non-distribution or reduced distribution is not a result of reasonable operational needs, the portion of such profit that should belong to the resident Enterprise shall be included in such resident Enterprise's revenue in the current period.

Article 46. If the ratio between debt investment and equity investment received by an Enterprise from its related parties exceeds the prescribed standard, the interest payments incurred thereon shall not be deducted for the purpose of calculating taxable income.

Article 47. If an Enterprise implements other plans that lack a rational business purpose and as a result reduces its taxable revenue or income, the tax authorities have the authority to make reasonable adjustments.

Article 48. When additional tax is to be levied pursuant to a tax adjustment made by the tax authorities in accordance with this Chapter, the additional tax must be paid, and interest must also be levied in accordance with regulations from the State Council.

CHAPTER 7. ADMINISTRATION OF THE LEVY AND COLLECTION OF TAX

Article 49. The administration of the levy and collection of enterprise income tax shall be carried out in accordance with this Law and the provisions of the *Law of the People's Republic of China for the Administration of the Levy and Collection of Tax*.

Article 50. Except as otherwise specified in tax laws and administrative regulations, a resident Enterprise shall pay tax at the place where it is registered, unless it is registered outside the PRC, in which case it shall pay tax at the place where its place of effective management is located.

The enterprise income tax of business establishments without legal personality established in the PRC by resident Enterprises shall be calculated and paid on a consolidated basis.

Article 51. If a non-resident Enterprise derives income as prescribed in the second paragraph of Article 3 of this Law, tax shall be paid where the establishment or place [of the Enterprise] is located. If a non-resident Enterprise has set up two or more establishments or places in the PRC, upon approval from the tax authorities, it may select its main establishment or place to pay enterprise income tax on a consolidated basis.

If a non-resident Enterprise derives income as prescribed in the third paragraph of Article 3 of this Law, tax shall be paid where the withholding agent is located.

Article 52. Different Enterprises may not consolidate their payment of enterprise income tax, unless otherwise specified by the State Council.

Article 53. The enterprise income tax of an Enterprise shall be calculated on the basis of a tax year. The tax year shall begin on January 1 and end on December 31 of the Gregorian calendar.

If an Enterprise commences business or terminates its business activities after the beginning of a tax year with the result that the actual period of operations during such tax year is less than 12 months, its actual period of operations shall be treated as a tax year.

When an Enterprise is liquidated according to law, the liquidation period shall be treated as a tax year.

Article 54. Enterprise income tax shall be paid in advance on a monthly or quarterly basis.

An Enterprise shall file returns for the advance payment of enterprise income tax and pay such enterprise income tax in advance to the tax authorities within 15 days from the last day of the month or quarter.

Within five months from the last day of the year, an Enterprise shall file its annual enterprise income tax return with the tax authorities and effect full and final settlement, thereby settling the tax to be paid or refunded.

When filing its enterprise income tax returns, an Enterprise shall also include financial and accounting reports and other relevant information in accordance with regulations.

Article 55. If an Enterprise terminates business operations during a tax year, it shall carry out full and final settlement of enterprise income tax for the current period with the competent tax authorities within 60 days from the date on which it actually terminates business.

Before an Enterprise deregisters, it shall file a return with and pay tax to the tax authorities in accordance with law in respect of its income from liquidation.

Article 56. Enterprise income tax paid in accordance with this Law shall be calculated in Renminbi. For the purpose of calculating and paying tax, income that is booked in a currency other than Renminbi shall be translated into a Renminbi amount.

CHAPTER 8. SUPPLEMENTARY PROVISIONS

Article 57. For Enterprises that were approved and established** prior to the promulgation of this Law and that, under then current tax laws and administrative regulations, were eligible for a preferential reduced tax rate, a gradual transition to the tax rates set out in this Law shall be effected, in accordance with regulations from the State Council, during the five years after the implementation of this Law; and those that were eligible for preferential fixed-term tax exemption and reduction will, in accordance with regulations from the State Council, continue to be eligible after this Law is implemented until the expiration of the relevant term, provided that the term of preferential treatment for Enterprises that had not yet enjoyed preferential treatment because they were not yet profitable will be calculated from the year in which this Law is implemented. Lawfully established special regions for the development of foreign economic cooperation and technical exchange, and high and new technology Enterprises to which the state needs to provide key support that are newly established in regions specified by the State Council for implementation of the above regional special policies, will be eligible for transitional tax incentives, specific measures for which will be prescribed by the State Council. Other encouraged Enterprises as determined by the state will be eligible for preferential tax exemption and reduction in accordance with State Council regulations.

Translator's notes:

* The Chinese term translated in Article 13 as "alteration" usually applies to fixed assets such as factories, mines and buildings.

** The Chinese term translated in Article 57 as "approved and established" may also be understood to mean "approved to be established".

Article 58. If a tax treaty concluded by the government of the People's Republic of China and a foreign government contains provisions that differ from those of this Law, matters shall be handled in accordance with the treaty.

Article 59. The State Council shall formulate implementing regulations on the basis of this Law.

Article 60. This Law will be implemented from January 1, 2008. The *Income Tax Law of the People's Republic of China Concerning Foreign Invested Enterprises and Foreign Enterprises*, adopted at the Fourth Session of the Seventh National People's Congress on April 9, 1991, and the *Provisional Regulations of the People's Republic of China Concerning Enterprise Income Tax*, promulgated by the State Council on December 13, 1993, are simultaneously repealed.

This Publication has been prepared for clients and professional associates of Baker & McKenzie. Whilst every effort has been made to ensure accuracy, this Alert is not an exhaustive treatment of the area of law discussed and no responsibility for any loss occasioned to any person acting or refraining from action as a result of material in this Alert is accepted by Baker & McKenzie.

Baker & McKenzie International is a Swiss Verein with member law firms around the world. In accordance with the common terminology used in professional service organizations, reference to a "partner" means a person who is a partner, or equivalent, in such a law firm. Similarly, reference to an "office" means an office of any such law firm.

Data Privacy

Please contact Mary Tong by telephone +852 2846 1635 or e-mail: Baker&McKenzieAsiaTaxGroup@bakernet.com should you wish your details to be added or deleted from our mailing list.

©2007 Baker & McKenzie
All rights reserved.