



China – Structuring in a Dynamic Tax Environment An Analysis of the New Income Tax Law from Multinational Companies' Perspective

Without much surprise, the new Enterprise Income Tax Law of the PRC was adopted at the Fifth Session of the 10th National People's Congress on March 16, 2007 and will become effective on January 1, 2008. Though not publicly released before, most interest groups were already well aware of the major contents of the new law through various channels, mainly a draft dated last December. There are no significant changes in the final law compared to this draft.

Although the new law is a very brief document with much details to be clarified in the upcoming Detailed Rules and Regulations (DRR) and subsequent circulars, we can expect that with no doubt the new law would result in fundamental changes to the nation's corporate taxation system and the way we structuring our business in China. It is just a start.

What Are the Major Changes?

The major changes of the law are summarized as follows:

- The new law is applicable to both domestic enterprises and foreign investment enterprises (FIE). Historically there are two separate corporate tax systems in China, with the one applicable to FIEs providing significant incentives but most of these incentives are not applicable to domestic enterprises.
- Taxpayers are defined as Resident Enterprises and Non-Resident Enterprises. The definition of Enterprise is not clearly defined but chances are that the scope of tax payers may be broader than the combination of the two old laws;
- General tax rate is set-at 25%;
- Most of the incentives available for foreign enterprise are abolished, while a 5 year grandfathering period will be provided. Incentives are still available in limited industries and projects such like High Tech, Infrastructure, Environment Protection, etc., while the scope and significance of these incentives would be much less compared to the prior FIE rules;
- A new feature on the incentives is that many of them are not directly related to tax rates. Methods

like special deduction allowances, special credits and special depreciation methods will be available.

- Some prevailing international taxation concepts are introduced such like the cost sharing, thin capital rule, CFC rules and arms length basis.
- A five-year grandfathering period is given to “pre-enterprises”. But the details are still to be clarified in the up-coming DRR.

How Will it Affect My Existing Business?

Being many years of a “Low Tax Country” for manufacturing FIEs in the past, the way we do tax planning in China usually focus on maximizing the incentives and reducing the local tax. There are a lot of successful stories that we can achieve Zero tax rate with a combination of tax holidays and the re-investment credit techniques. For many multinational companies, China is generating lower taxed foreign source income which helped to pull the group effective tax rate down. Today China will become a country with an effective tax rate on the higher end and it changes the big premise.

In the meantime, the business costs in the coastal areas of China increased significantly in recent years. Plus an individual income tax rate capped at 45%, many business leaders tends to consider moving some existing functions outside China for tax and non-tax reasons. E.g. Vietnam is becoming highly competitive in manufacturing sector and Hong Kong and Singapore are still competitive for regional headquarters and regional trading especially from tax point of view. Besides, China’s business, legal and foreign exchange environment are much relaxed than 10 years before and infrastructures like financial, logistics and IT as well as human resources are much more developed. 10 years before you had to be in China to do business with Chinese but now you can find Chinese doing business everywhere around the world. Against such context, the restructuring of the existing China related supply chain in a regional scale becomes possible and it can generate huge operational and tax savings.

Although not covered in the new law, it is however possible that the Chinese government may issue some policies relating to the tax incentives for developing the mid-western part of the country in the manufacturing sector. Chances are also there would be certain preference relating to regional headquarter type of entities in costal areas like the ones Shanghai and Beijing governments worked on. These however are still uncertain at this stage.

Historically, under China’s tax incentive oriented foreign investment model, there are some unique characteristics with respect to a foreign investor’s business structure in China. It is very common that today many multinational groups ends up with tens, if not in hundred, of legal entities in China. The reason is not difficult to understand. One new legal entity meant a new tax holiday. While at the same time, there are many tax and non-tax issues derived such like complexity, controllership, transfer pricing, group consolidation (loss utilization), etc. With most, if not all, of the incentives gone, it is a good time to review the existing business structure and see what can be improved from both business and tax perspectives.

Many people believe that a good news brought by the new law is that the service industries, which are

historically taxed at 33%, will see a significant reduction in tax rate. Having said that, the country's business tax system is still problematic. Being a gross receipt tax, business tax may still effectively elevate the effective tax rate significantly. Although the business tax reform is also on Chinese government's agenda, it takes time.

There are many positive aspects of the new law. Disallowance of overheads allocation was deleted at the last minute and cost sharing is now allowed at the law level. Although the detailed rules are not clear yet and there are other considerations such like Business Tax, these new developments would become important considerations when revisiting your China structure.

There are many other considerations to the existing businesses in China. Shall I change my holding structure in view of the uncertainty about the dividend WHT exemption policy? How can I maximize the grandfather benefits... Many of these questions would remain unanswered before more detailed rules come out. However, today it is apparently not too early to revisit your overall China tax strategy.

What if I'm a New Comer/How Do I Structure a New Business?

In a TEI conference organized recently in Shanghai, many tax executives shared the insights that although China will increase the tax rate (for FIEs), their respective multinational group will still be optimistic about their investment in China. The opportunities in next ten years are just huge and people cannot wait. The concern from a tax person's perspective is how we can structure it in a tax efficient way and in this regard, there are many new considerations after the new EIT law.

The Resident Company concept, Effective Management concept, together with several rulings on PE recently issued by the Chinese government may change the way we structure a new business vehicle in China. Transfer pricing will be another critical consideration.

In the past, it seems to be a "natural selection" process that a foreign investor may select a route of Representative Office, service FIEs, trading FIEs, manufacturing FIEs, Chinese Investment Holdco, etc. during different development stages in China. The key consideration in determining the appropriate business vehicle were often not tax but the capital requirement and business scope limitation. The tax implications, in the past, were also closely related to what type of business vehicles you select to use.

The new law, however, is more substance over form. Under the spirit of the new law, a Rep Office doing activities beyond its allowed scope may derive serious Permanent Establishment (PE) issues. A service company/sourcing company may help to reduce the PE risk, but transfer pricing needs to be carefully planned. Some statistics shows that currently around 60%-80% of the FIEs are in loss situation, and many people believes that it'll be just fine as long as we are making a profit. It is not necessary true in next 10 years. China is now entering into an era of international taxation.

It is advisable that for new comers to do a thorough tax and functionality analysis before you determine the appropriate business structure in China.

Another critical consideration is about the appropriate holding vehicle. Historically since all dividends

repatriations from an FIE are exempted from WHT, it really doesn't matter whether you are using a Cayman island or a BVI company. Today it is still not clear whether this preference will be maintained or grandfathered. Even if yes, the preference is no longer at state law level, hence it would be wise to seek a jurisdiction with favorable tax treaty with China when designing your holding structure.

Looking Forward

The new income tax law is just one of a series of changes regarding China's legal and tax system in the upcoming years. China will experience significant changes in next ten years in relation to its civil law, foreign trade and investment regulations, stock market regulations, the indirect tax schemes, accounting rules, customs and the social security tax systems, etc. This is a much more dynamic environment compared to any well-developed western economy.

These changes, however, will move China into a more transparent market economy environment and a level playing ground for everybody. We suggest that an investor should take a proactive approach to plan your business in the context of such changes in order to generate the best business and tax results.

In Appendix I, we are summarizing the major changes in the New EIT Law and our observations.

In Appendix II, we are attaching a full text translation of the New EIT Law.

Please do not hesitate to contact our tax partners on the contact information below if you have any questions.

Dennis Xu: dennis.xu@henderson.com

Eddie Wang: eddie.wang@henderson.com

Leo Guan: leo.guan@henderson.com

Kevin Wang: kevin.wang@henderson.com

Appendix I Summary of Changes and Our Observations

Items	Current Provision on FIEs and FEs	Current Provision to Domestic Enterprises	Provision under New Law	Grandfather Treatment	Our Observations
Tax Payer	Foreign Investment Enterprise and Foreign Enterprises	Domestic Enterprises and Other Organizations with business registration in China (excluding Individual Owned Enterprises and Chinese Partnership)	Resident Enterprise and Non-Resident Enterprise (excluding Individual Owned Enterprises and Chinese Partnership), scope may be broader than the previous laws	N/A	Although the detailed definition of taxpayer is to be clarified under the upcoming DRR, it could possible lead to a border scope on tax payers. For foreign companies having effective management in China, it should be very careful whether it would attract Chinese taxation on world-wide income. In addition, it is not clear whether the new law would potentially lead to a change of the taxation method on ROs, which currently are mainly taxed on cost-plus basis. A third concern is about PE, which traditionally is only enforced on foreign contractors, while two recent rules indicate that China may enforce the PE concept in a wider scope. It is necessary to review the existing activities and legal structure to avoid such risk.
Tax Rate	30% State EIT + 3% Local EIT	33% General Rate; 27% and 18% for small enterprises	25%, reduced rate of 20% for small and low profit enterprises, 15% available for high-tech Enterprise	N/A	The threshold can be very low for "small enterprises". Definition of High-tech is not clear while the current lose control on granting high-tech enterprise may be tightened.

WHT Rate	20%, but exemption available on dividends of FIE	N/A	20%, not clarified whether exemption available for dividends of FIE	N/A	Critical issue is whether dividends paid to a foreign entity can be exempted from WHT. Article 27 still leaves room for such exemption.
Foreign Tax Credit	FTC by country not by basket of income, carry-over period of 5 years	FTC by country not by basket of income, carry-over period of 5 years	Carry-over period of 5 years, likely to follow by country model	N/A	In practice not common for a FIE due to limitation on outbound investments.
Tax Incentives					
- Tax Holiday (General)	2-year exemption and 3-year 50% reduction for manufacturing Enterprise, starting from the first profit making year	2-year exemption for high-tech enterprises, 1-2 year holiday for certain tertiary industries	Details not clear until DRR by the State Council, likely to be abolished	Grandfather treatment may be available for 5 years but start to count from effective date of law if enterprise not profitable yet	Grandfather treatment is only available to enterprise approved prior to the issuance of the law, i.e. March 16 th , 2007.
- Prolonged Tax Holiday (TAE)	Technology Advanced Enterprise can enjoy additional 3-year 50% reduction	Not available	May not available	Not Clear	There is basis to argue that the prolonged tax holiday for TAE (three years), if not expired prior to this new law, can continue be applicable. However, if the TAE status is not obtained before March 16, 2007 (arguably January 1, 2008), such preference may not be available.
- Prolonged Tax Holiday (EOE)	50% Reduction available for EOE if current year export exceeds 70%	Not available	Likely to be abolished	Not Clear	Tax reduction relating to EOE is granted on yearly basis, since it may be regarded as subsidy by other WTO countries, this benefit is likely to be abolished soon after the new law is effective.

- Reduced tax rate	15% for all Enterprises located in SEZs; 15% for manufacturing in Economic Development Zones; 15% for High-tech Enterprise in High-tech Parks	15% for High-tech Enterprise in High-tech Parks	15% may be available to qualified High-tech Enterprises on a national-wide basis	5-year grandfathering period may be available, but only high-tech enterprises specifically mentioned in the draft law	Second paragraph of article 57 is problematic and we think there are conflicts with first paragraph (which says reduced tax rate based on existing laws and administrative regulations will be grandfathered for 5 years). However, the second paragraph only mentions that location-related reduced rates will be grandfathered for high-tech enterprise, it may indicate that for other types of enterprise grandfathering on location related reduced tax rate may not be available. The DRR needs to clarify this point, which is critical to many FIEs in SEZs, Pudong, Economic Zones and High-tech Zones.
- Reinvestment credit	40-100% refund of EIT paid for reinvestment of after tax dividend	Not available	Not clear, likely to be abolished	Not clear, may not be available if abolished	Many companies achieve zero tax rate for years using the reinvestment credits (reinvestment of after tax dividend of a FIE in China and obtain a 40-100% refund of EIT). The new law may fundamentally change such strategy.
- Investment credit (e.g. 40% EIT credit on purchasing domestic equipments)	Generally available for FIEs for qualified industry and qualified equipment	Available for qualified technology upgrading projects	Not clear	Not clear	Not clear.

- Others	Additional incentives available in agriculture, farming, forestry and fishery industries; additional incentives available in certain infrastructure projects	Incentives in the recycling use of resources, incentives in Autonomous Regions, remote areas and undeveloped areas	The incentives to the left may be preserved, new incentives would also be available for investment in environment protection, energy saving and safe production	N/A	
Expense Deduction					
- R&D credit/super deduction	50% bonus deduction available	Available	Available, details not clarified yet	N/A	Current treatment is 150% super deduction. Possibly to adopt the current treatment in future.
- Accelerated depreciation of fixed Assets	Not available	Not available	May available under qualified circumstance	N/A	Positive impact to high-tech and similar industries.
- Management fee (overheads allocation)	Not deductible	Deductible for group companies with certain requirements	Not in the disallowed scope. Cost sharing is also available	N/A	Positive impact for overheads allocation and cost sharing arrangements.
- Salaries	Deductible on actual basis	Deductible within statutory limit	Deductible on actual basis	N/A	No impact on FIEs.
- Provisions	Not deductible	Not deductible	Qualified provisions deductible	N/A	Positive impact on tax deferral.

Thin-capital Rule	Not available	Not available	Interest expense non-deductible for debt investment exceeding requirement	N/A	The current limitation is under the forex rules. The development from our perspective is in line with the international practice.
Loss Carry Forward	5 year	5 year	5 year	N/A	
Related Party Transactions	Arms Length Principle and basic documentation requirement introduced	Not available at law level	Arms Length Principle and basic documentation requirement introduced	N/A	TP will be strengthened as a general trend.
CFC Rule	Not available	Not available	There would be CFC type of rules	N/A	Implication mainly to domestic companies.
Group Tax Consolidation	Not allowed	Applicable for certain group companies	Not allowed, unless otherwise provided by the State Council	N/A	May be possible to argue for consolidation by a FIE group since currently it is available to major domestic group companies.

Appendix II Full Text of the New EIT Law

Enterprise Income Tax Law of the People's Republic of China (PRC) (Issued on March 16th, 2007, effective on January 1, 2008)

Unofficial Translation by Hendersen Taxand

Chapter 1 General Provisions

Article 1 - Enterprises and other organizations (hereinafter collectively referred to as Enterprises) within the territory of the PRC are the payers of Enterprises Income Tax (EIT), and shall pay EIT based on the stipulations of this Law.

Individually Owned Enterprises and Partnership Enterprises are not subject to this law.

Article 2 – Enterprises are categorized as Resident Enterprise and Non-Resident Enterprise.

Resident Enterprises under this Law refer to Enterprises that are incorporated within the territory of the PRC under PRC law, or enterprise incorporated under the law of a foreign country (district) but the actual management organizations are located in the PRC.

Non-resident Enterprise under this Law refer to Enterprises that are incorporated under the law of a foreign country (or district) while having establishments or places in China, and the actual management organizations are located outside the PRC; or Enterprises that do not have establishments or places in the PRC but having income derived from the PRC.

Article 3 – Resident Enterprises shall be subject to EIT on incomes sourced from the PRC and overseas.

Non Resident Enterprise having establishments or places in the PRC shall be subject to EIT on the incomes derived from their establishments or places in the PRC, and income derived overseas but actually related to the establishments or places in the PRC

Non Resident Enterprise which do not have establishments or places in the PRC, or those having establishments or places in the PRC but the incomes derived are not actually related to the establishments or places in the PRC, shall be subject to EIT on the incomes sourced from the PRC.

Article 4 – The applicable EIT rate is 25%.

The applicable tax rate for Non-Resident Enterprise on income stipulated under paragraph 3 of Article 3 is 20%.

Chapter 2 Taxable Income

Article 5 – Taxable Income refer to the total income of an Enterprise, after deduction of non-taxable income, tax exempted income, deduction items and allowable losses carried forward from prior years.

Article 6 – Total income of an Enterprise refer to incomes from all sources of the Enterprise in cash and non-cash form, including:

- (1) Income from sales of goods;
- (2) Income from provision of services;
- (3) Income from transfer of assets;
- (4) Dividends;
- (5) Interests'
- (6) Rental proceeds;
- (7) Royalties;
- (8) Income from acceptance of donations;
- (9) Others

Article 7 – The following incomes are non-taxable incomes

- (1) State fiscal allocations;
- (2) Administrative charges, government funds collected under law, and which are under the management of State Finance;
- (3) Other Non-taxable items provided by the State Council.

Article 8 – Reasonable expenditures related to the Enterprise's operation activities which are actually incurred, including costs, expenses, taxes, losses and other expenditures, can be deducted when calculating the taxable income.

Article 9 – Public donations made by the Enterprise to the can be deducted within the threshold of 12% of total annual profit.

Article 10 – The following expenditures are not deductible when calculating the taxable income:

- (1) Compensation for equity paid to investors;
- (2) Payments for EIT;
- (3) Late payment interests for tax;
- (4) Penalties, fines and losses from goods confiscated;
- (5) Donations that are non-public nature;
- (6) Sponsorship fees;
- (7) Un-assessed provisions;
- (8) Other expenditures that are not contributing to income generation.

Article 11 – When calculating the taxable income, depreciation of fixed assets calculated in accordance with relevant stipulations can be deducted.

Depreciations shall not be claimed for the following types of fixed assets:

- (1) Fixed assets not put into use except for buildings and erections;

- (2) Assets borrowed under operation lease;
- (3) Assets leased out under financial lease;
- (4) Fixed assets that are fully depreciated but still in use;
- (5) Fixed assets that are not related to operation activities;
- (6) Land that are separately valued as fixed asset;
- (7) Other fixed assets that are not allowed for depreciation.

Article 12 – When calculating the taxable income, amortization of intangible assets calculated in accordance with relevant stipulations can be deducted.

Amortization cannot be claimed for the following assets:

- (1) Self-developed intangible assets for which the development costs has already been deducted;
- (2) Self-developed good will;
- (3) Intangible assets that are not related to operation activities;
- (4) Other intangibles that are not allowed for amortization..

Article 13 – When calculating the taxable income, amortization of long term deferred expenses derived from the following expenditures can be deducted:

- (1) Re-building costs for fixed assets fully depreciated;
- (2) Expenses for leasehold improvements and alternations;
- (3) Significant reparation costs for fixed assets;
- (4) Others expenditures that should be treated as long term deferred expenses.

Article 14 – The cost of invested assets cannot be deducted when calculating the taxable income within the duration of a long term investment.

Article 15 – The cost for inventory consumed or sold can be deducted according to relevant rules.

Article 16 – For assets transferred by an Enterprise, the net value and transfer expenses of the asset can be deducted when calculating the taxable income.

Article 17 – When an Enterprise calculates the EIT on a consolidated basis, losses incurred by its offshore establishments or places shall not be used to offset profits from its establishments or places in the PRC.

Article 18 – The losses incurred by an Enterprise in the current tax year can be carried-over to subsequent years and to be made up by income from subsequent years, however, the maximum duration that the loss can be carried-forward shall not exceed 5 years.

Article 19 – For income derived by non-resident Enterprise under paragraph 3 of Article 3 of this Law, the following method shall be adopted to calculate the taxable income:

- (1) For dividends, interests, rental income and royalty income, the gross amount is taxable income;

(2) For income derived from transfer of assets, the amount after deducting the net asset value from the gross income is taxable income;

(3) For other incomes, the taxable income shall be calculated with reference to the above two methods.

Article 20 - Detailed scope and standard for deductions under this Chapter will be stipulated by the finance and tax departments under State Council.

Article 21 - When calculating the taxable income, in case the stipulations under the finance and accounting rules are different from the stipulations under the tax law and administrative regulations, the stipulations under tax law and administrative regulations shall prevail.

Chapter 3 Tax Payable

Article 22 – The amount of tax payable is equal to the taxable income times the applicable EIT rate, less the amount of allowable reduction, exemptions and credits pursuant to this Law.

Article 23 – The income tax paid overseas on the following incomes derived by an enterprises can be credited against the current EIT liability, the limitation of the credit is the tax payable calculated for such category of income under this Law. The amount exceeding the limitation shall not be creditable in the current period, while it can be carried over in the succeeding 5 years to credit against the balance of the creditable tax after deducting the tax credit in the revenant year.

(1) Taxable income derived outside the PRC by a Resident Enterprise;

(2) Taxable income derived outside the PRC by a Non-resident Enterprise's establishments or places in China, which is actually related to such establishments or places.

Article 24 – Dividends received by a Resident Enterprise from a directly or in-directly owned Foreign Enterprise, for the foreign income taxes actually paid which are relevant to such dividend income, it can be treated as the tax credit of the Resident Enterprise, and be credited within the limitation set-out under Article 23 of this Law.

Chapter 4 Tax Incentives

Article 25 –EIT incentives are provided to key industries and projects supported and encouraged by the State.

Article 26 – The following incomes of an Enterprise are exempted from EIT:

(1) Interests of State Bonds;

(2) Qualified dividends between Resident Enterprises;

(3) Dividends, profit distributions and other compensations for equity derived by Non-Resident Enterprises having

establishments or places in China from Resident Enterprises, and such incomes are actually related to the establishments or places in the PRC;

- (4) Incomes of qualified non-profitable public organizations.

Article 27 – EIT exemption or reductions can be provided to the following incomes:

- (1) Incomes derived from agriculture, forestry, farming and fishery projects;
- (2) Incomes derived from the investment and operation of key infrastructure projects encouraged by the State;
- (3) Incomes derived from environmental protection, efficient use of energy or water conservation projects upon meeting relevant conditions;
- (4) Incomes derived from transfer of technologies upon meeting relevant conditions;
- (5) Income described under paragraph 3 of Article 3 of this Law.

Article 28 – The tax rate applicable to qualified small and low profit enterprise is reduced to 20%.

The reduced tax rate of 15% is applicable to key High-tech Enterprises needs to be supported by the State.

Article 29 – The portion of EIT belongs to a Local Autonomous Region collected from Enterprises in such Local Autonomous Region can be exempted or reduced upon approval of the Local Autonomous Region Government.

Article 30 – Bonus Deduction can be provided to the following expenditures of an Enterprise:

- (1) Research and Development expenditures of an Enterprise for development of new technologies, new products and new production process;
- (2) Salaries paid by an Enterprise to disabled personnel and other special groups that the State encourages Enterprise to hire.

Article 31 – Investment Enterprise for Start-up Business can be entitled to a percentage of the investment amount as EIT credit for investing in new business start-ups that are encouraged by the State.

Article 32 – If the fixed assets of an Enterprise actually has to apply for a reduced useful life or accelerated depreciation method due to strong vibration, erosion or technology upgrading, etc, the reduced useful life or accelerated depreciation method may be adopted.

Article 33 – A reduction in taxable income can be available to the income derived by an Enterprise in resource recycling and production of the relevant products in line with the State's industrial policy.

Article 34 – For investment made by an Enterprise on special equipments for the purposes of environmental production, energy and water saving, safe production, etc., a percentage of the investment can be used as EIT credit.

Article 35 - The detailed measures for the tax incentives under this law shall be stipulated by the State Council.

Article 36 – In accordance with the needs of national economic and social development, or in the case of significant intervention to Enterprises' operation activities due to public incidences, the State Council is entitled to issue special

EIT incentives with copy to the Regular Committee of the National People's Congress for record.

Chapter 5 Tax Withholding

Article 37 - Tax withholding is applicable to the EIT on incomes derived by non-resident Enterprise under Paragraph 3 of Article 3. The payer shall be withholding agent. The tax liabilities shall be withheld from the actual amount paid or payable by the withholding agent when the payment is settled or is due.

Article 38 - Tax withholding is applicable to the EIT on incomes derived by Non-Resident Enterprises performing onshore projects and services in the PRC. The tax authority can designate the payer of the onshore project fee or service fee as the withholding agent.

Article 39 - In case the withholding agent does not or cannot fulfill the withholding responsibility in accordance with Article 37 and Article 38 of this Law, the tax payer shall settle the tax liability at the place where the income is derived. In case the tax payer does not settle the tax liability in accordance with law, the tax authority is entitled to collect the tax payable from the payment due by other payers to the Enterprise on other items of income.

Article 40 - The tax liabilities withheld by the withholding agent shall be settled to the State's Account within 7 days after withholding, and the relevant EIT returns shall be filed with the local in-charge tax authority.

Chapter 6 Special Tax Adjustments

Article 41 For related party transactions between an Enterprise and its related parties, if the transactions are not in line with the Armth Length Principle and the income or taxable income of the Enterprise or its related party is reduced, the in-charge tax authority is entitled to adjust with reasonable methods.

If an Enterprise, together with its related party, engages in joint development, purchasing of intangible assets or joint provision or purchasing of services, the cost incurred shall be allocated in accordance with the Armth Length Principle when calculating the taxable income.

Article 42 Enterprises can provide the principle and methods on the transfer pricing arrangement with its related parties to the in-charge tax authority. Upon negotiation and confirmation between the in-charge tax authority and the Enterprise, an Advanced Pricing Arrangement can be made.

Article 43 When the Enterprise submits the annual EIT returns to the in-charge tax authority, the annual related party transaction report shall be attached.

When the in-charge tax authority is conducting an investigation on related party transactions, the Enterprise and its related parties, as well as other Enterprises that are related to the investigation shall furnish the relevant information and materials.

Article 44 - In case an Enterprise fail to fulfill the related party transaction materials or the Enterprise provides artificial or incomplete materials, and unable to reflect the actual situation about its related party transactions, the in-charge tax authority is entitled to assess the relevant taxable income.

Article 45 - In case a subsidiary of a Resident Enterprise or a subsidiary under Individual Residents and Resident Enterprises is located in a tax jurisdiction with significantly lower tax rates as provided under first paragraph of Article 6 of this law, if there is no profit distribution by the subsidiary or the profit distribution is unreasonable, the portion of the profits which belongs to the Resident Enterprise shall be included in the Enterprise's income of the current period.

Article 46 – In case the ratio of debt investment to equity investment received by an Enterprises from its related parties exceeds the relevant standard provided, the relevant interest expense is not deductible in calculating taxable income.

Article 47 – In case income or taxable income is reduced due to other arrangements by the Enterprise that are lack of reasonable commercial purpose, the in-charge tax authority is entitled to make adjustments using reasonable methods.

Article 48 – In case backlog payment of tax is required because of re-assessment by in-charge tax authority in accordance with the stipulations under this Chapter, late payment interests shall be imposed.

Chapter 7 Tax Collection and Administration

Article 49 – With respect to the collection and administration on EIT, unless otherwise provided by this Law, it shall follow the stipulations under the Tax Collection and Administration Law of the PRC.

Article 50 – Except for provisions by other tax law and regulations, a Resident Enterprises shall decide the place for tax collection based on the place of registration of the Enterprise. However, if the place of registration is overseas, the place for tax collection shall be the place where the actual management organization is located.

In case a Resident Enterprise establishes multiple operation units without legal person status in the PRC, the Enterprise shall consolidate the EIT calculation and payment.

Article 51 – For Non-resident Enterprises having establishment or place in the PRC, the place for tax collection shall be the place where the establishment or place is located. In case the non-resident Enterprise has more than two establishments or places in the PRC, upon approval of the in-charge tax authority, the Enterprise can elect the major establishment or place to consolidate EIT filing and payments.

For incomes derived by Non-resident Enterprises under Paragraph 3 of Article 3, the place for tax collection shall be the place of the withholding agent.

Article 52 – Unless otherwise provided by the State Council, consolidated filing is not allowed among different Enterprises.

Article 53 – The tax year is calendar year from Jan 1 to December 13.

If an Enterprise starts or ends its operation in the middle of a tax year, as such the actual operation period is less than 12 months, the actual operation period is treated as a tax year.

In the case of liquidation of an Enterprise, the duration of the liquidation is treated as a tax year.

Article 54 – The EIT shall be calculated on a yearly basis and pre-paid on monthly or quarterly basis.

An Enterprise shall submit EIT prepayment returns to its in-charge tax authority within 15 days after the end of the current month or quarter.

An Enterprise shall submit the Annual EIT returns to its in-charge tax authority and conduct consolidate filing within 5 months after the end of the tax year.

When the Enterprise submits the annual EIT returns, it shall submit the relevant financial statements and other required materials according to relevant requirements.

Article 55 – In case an Enterprise terminates its operation in the middle of a tax year, the Enterprise shall conduct consolidated filing with its in-charge tax authority within 60 days after the actual termination of operation.

In case of liquidation, the Enterprise shall conduct EIT filing and settle the tax liabilities prior to deregistration.

Article 56 – EIT paid in accordance with this Law shall be calculated in CNY. In case the income is in foreign currency, it shall be converted to CNY according to the standard conversion rate issued by the PBOC to calculate the tax liabilities.

Chapter 8 – Supplementary Provisions

Article 57 – Enterprises which are approved prior to this Law and which enjoy reduced tax rates based on the prior laws and regulations, shall adapt to the tax rates provided under this Law within 5 years after this law is effective. Enterprises which are entitled to tax holidays can continue to enjoy the tax holidays until expiration. However, in case the tax holiday has not started yet due to the Enterprise does not start to make profit, the tax holiday shall be calculated from the effective year of this Law.

For high tech Enterprises encouraged by the State which are located in special areas for foreign economic development and technology exchange as wells in locations approved by the State Council that the same preferences are applicable, grandfatering treatments will be provided. Detailed measures on grandfatering will be stipulated by the State Council. Other encouraged Enterprises by the state can enjoy tax incentives according to the regulations issued by the State Council.

Article 58 – In case of discrepancy between this Law and the International Tax Treaties concluded between PRC and foreign governments, International Tax Treaties shall prevail.

Article 59 – The State Council shall stipulate the Detailed Rules for Implementation in accordance with this Law.

Article 60 – This Law shall be Effective January 1, 2008. The Enterprise Income Tax Law for Foreign Investment Enterprises and Foreign Enterprises of the PRC approved by the No. 4 Session of the 7th National Peoples Congress on April 9, 1991 and the Provisional Regulation on Enterprise Income Tax of the PRC issued by the State Council on December 13, 1993 shall be repealed simultaneously.