High-Tech Businesses – What the Mainland Offers

Over the past few years, “high & new tech” has been one of the major areas encouraged and supported by the Mainland Government. High and new technologies that include, but not limited to, software development, electronic information technology, space technology, biotechnology, new materials, environmental protection technology, have been the core of the Mainland’s economic plan. To attract and channel more investments into high and new technologies, the Mainland Government has applied different but complementary measures, as follows:

i) formulating preferential tax policies and incentives to qualified companies/activities.

ii) setting up development zones for accommodating high and new tech businesses.

Preferential Tax Policies

1. Business Tax Exemption

Business Tax (“BT”) is chargeable on income of services carried out in the Mainland and transfers of technology / technical know-how (including usage right) etc, at 5% of the gross income. Under the encouragement, a company, e.g. foreign company or foreign investment enterprise, can be exempted from BT on income derived from technology / technical know-how. The relief covers income of transfer of ownership or right to use the technology / technical know-how, as well as related consultancy services, systematic research and development, feasibility study, analysis and assessment report. The key criteria is that such technology / technical know-how should be endorsed by the relevant authorities as “high, new, or advanced”.

2. VAT Refund

Sales of goods in the Mainland is within the scope of charge of the VAT, at 17% of the sales value. It is one of the primary concerns of foreign investors who carry out production and sales in the Mainland. Incentives for VAT on sales of software and Integrated Circuit (“IC”) products are offered by the Mainland.

In normal circumstances, when a company purchases raw materials, the vendor will charge VAT in addition to the price. When it sells the products (after utilizing the raw materials), the company should add VAT on the selling price and recover the total from the customers. It should pass the net VAT (i.e. Output VAT minus Input VAT for the period) to the tax bureau in charge.
A General VAT payer which carries out software development and sells the software products will be entitled to a VAT refund until the end of 2010. Under this incentive, the tax bureau shall refund the excess of VAT, over 3% of the sales proceeds of self-developed/produced software, to the company. The threshold for IC companies is 6%. As the VAT has been collected from the customers (in addition to the selling price), the refund means an additional income to the company. As a further incentive, the refunded income can be exempted from Income Tax if it is used for further research or development of software or IC products.

3. **Income Tax Holiday**

A foreign investment company’s profits shall be subject to Foreign Enterprise Income Tax (“FEIT”). It can generally be reduced from 33% to 24% (or further to 15%), when the company operates in coastal cities etc. Under the prevailing regulations, an ordinary production company should qualify for a 5-year tax holiday for FEIT, comprising 2-year exemption followed by 3-year half tax.

As part of the Reform aligning with the WTO, the Income Tax of companies will be consolidated into single track. There will no longer be dual-track taxation policies for foreign and domestic funded companies. Candidates eligible for the tax holiday will be confined to either encouraged businesses or companies operating in encouraged locations. The across-the-board tax holiday for foreign funded production company will no longer be retained after the tax reform.

It is encouraging to note that the latest official circulars of the Mainland Government have indicated that this tax holiday will likely be retained for technology advanced companies, software companies etc. Applications should be submitted to the State Science and Technology Commission for approval.

4. **Withholding Tax**

A non-resident company, when assigning ownership or usage right of a technology or technical know-how to a Mainland company, shall be liable for a withholding tax of 10% of the gross income. Ever since 1991 when the Income Tax Law for FEIT was enacted, it has been allowed that if the technology or technical know-how is qualified as “advanced”, the withholding tax can be waived. We did see some applications have been approved by the Mainland authorities where no withholding tax is payable. With the official policies favoring towards technology transfer, it appears that more applications would be accepted and approved.
5. **Accelerated depreciation**

In normal circumstances, movable fixed assets of a company are eligible for depreciation no less than 5 or 10 years. It would not be easy to convince the Mainland officials to accept any shorter period of depreciation. It may come to the situation that the expenditure for the assets could not yet be fully claimed when they should actually be written off. There would thus be timing difference disfavoring a company.

The Mainland Government allows flexibilities of depreciation for qualified high-tech companies. They can claim for depreciation of the relevant fixed assets faster. For instance, a Software Enterprise can accelerate the depreciation by writing off the capital expenditure within 2 years. An IC Company may depreciate its production equipment in 3 years’ time.

6. **Bonus deduction – Research &Development**

The Mainland Government also encourages companies to apply more efforts and incur more expenditure in research and development (“R&D”). Different from the above incentives, there is no need for the candidates to be a high tech concern. Provided that the company’s R&D expenditure of the current year sustains a 10% growth or more, compared with the preceding year, it will be entitled to an extra 50% bonus deduction of the current year’s relevant expenditure, against the profits. Less FEIT will be payable. The qualifying R&D expenditure is widely defined to cover basically most of R&D activities. In addition, the expenditure incurred in contracting out the R&D activities is also qualified.

**High and New Tech Development Zones**

A number of High and New Tech Zones (“the Zones”) are run by the local governments of the Mainland. We list down below the symbolic Zones in the respective economic regions:

- Bohai-Economic Circle - Beijing Zhongguancun Science Park
- Yangtze River Delta - Shanghai Zhangjiang High Tech Park
- Pearl River Delta - Shenzhen High Tech Industrial Park / Zhuhai High and New Tech Development Zone

1. **General Incentives**

The local governments have invested tremendous resources and monies to enhance the infrastructure and supporting facilities in the Zones. The Zone authorities provide prioritized supports to companies operating there. In order to simplify the formation of a company, procedures which are typically tedious elsewhere, e.g. project approval, can be consolidated into an “one-stop window”. This arrangement significantly shortens the time frame to complete approval procedures and is convenient to the investors, especially the foreigners.
As for supporting the finance of the high-tech businesses, the local governments have set up some specific-purpose funds to breed the research and development activities in the Zones. On the other hand, local regulations also encourage both domestic and foreign investors to establish venture capital institutions in the Zones. This offers an additional means to companies to raise fund for their investment at their initial stage of operations.

Human resources are also taken care of. Local governments also offer various incentives to non-residents, e.g. permanent residence in the city where the Zone is located. This attracts experts of other provinces to work and develop their career in the Zones. In addition, for senior managerial/technical personnel working for companies in the Zones, the procedures of visa approval for overseas business trip, training, etc. are simplified.

2. **Specific Incentives**

There are different policies amongst the Zones in connection with the incentives of financial, administration, etc.

a. **Zhongguancun** (中关村科技園區)

The business scope of a company registered in Beijing Zhongguancun Science Park (“Zhongguancun”) can be amended without any tedious procedures of official approval, provided that the amendments represent fine-tuning of the allowed business scope. This help companies adjust and implement their business plans efficiently.

b. **Zhangjiang** (張江高科技園區)

In Shanghai Zhangjiang Hi-Tech Park (“Zhangjiang”), various financial subsidies from the local government are available to qualified hi-tech companies and activities. For instance, a newly established and endorsed high and new technology enterprise can receive subsidies for three years with reference to the amount of value-added of their products, revenue and total profit at 4%, 5% and 14% respectively. In the next five years (from the fourth to eighth year), 7% subsidy will be granted to a company according to its profits.

In addition, companies established in Zhangjiang and engaged in scientific development activities can use its equity shares to exchange for free rent or rental subsidies.
c. Shenzhen Hi-tech Park (深圳高新技術產業園區)

In Shenzhen High Tech Industrial Park (“Shenzhen Hi-tech Park”), small and medium enterprises can acquire factory building at a lower price. The approval for application of land use right is expedited and simplified in order to facilitate the progress of investment. In addition, newly built or acquired production building that belongs to a high and new tech company is exempted from Urban Real Estate Tax for five years. The Deed Tax is also fully refundable.

To give aid to small and medium high tech enterprises, credit guarantee institutions, established by the Shenzhen Municipal Government, provide guarantee to companies in Shenzhen Hi-tech Park so that they are able to obtain loans and financial supports from bankers.

d. Zhuhai High-tech Zone (珠海高新技術產業開發區)

In Zhuhai High & New Tech Development Zone (“Zhuhai High-tech Zone”), companies are exempted from various local administrative charges. In addition, utility charges to these companies are generally 20% lower than those outside the Zhuhai High-tech Zone. Furthermore, surcharge of land-use right is exempted for 7 years if the land is used for industrial, warehousing, or scientific projects.

Conclusion

The Mainland’s accession to the WTO means “CHANGES”. While the government’s task is to monitor the changes, investors and businessmen should manage how to keep and enhance their competitiveness amid the changes.

To better position the company under the new economic environment of the Mainland, it is time for foreign investors to revisit their business operations in the Mainland and formulate new investment plans towards the encouraged, e.g. high-tech businesses and high-tech zones, in order to benefit from the preferential treatments and incentives.

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