瑞士文斐律师事务所
WENFEI ATTORNEYS-AT-LAW LTD.

CHINA LEGAL REPORT*

OCTOBER 2010

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I. Introduction

Scientific research and technological development are critical factors in the development of China. In the past few years, many foreign-invested research and development centers have been established in China. In order to encourage scientific research and technological development and to promote technological progress, the Chinese government has issued a package of regulations and rules to regulate the exemption of import duties on the import of equipment used for scientific and technological development.

On March 22, 2010, the Ministry of Commerce, the Ministry of Finance, the General Administration of Customs and the State Administration of Taxation jointly issued a circular called “Notice on Issuing the Measures for the Examination and Approval of Foreign-invested Research and Development Centers’ Eligibility for Tax Exemption or Refund in the Purchase of Equipment” (hereinafter referred to as "Circular 93") to further clarify the procedures for the examination and approval of tax exemptions and refunds for the purchase of equipment made by foreign-invested research and development centers in China.

This issue of our China Legal Report will provide you with a comprehensive introduction of the Regulations regarding tax exemptions and refunds for purchase of equipment made by foreign-invested research and development centers in China.

II. Applicable regulations

The Chinese competent departments have issued a package of relevant regulations and rules. It includes the following:

On January 31, 2007, the Ministry of Finance, the General Administration of Customs and the State Administration of Taxation jointly issued a circular “Provisions on the Exemption of Import Duties from the Articles Used for Scientific and Technological Development” (hereinafter referred to as "Circular 44"). Circular 44 provides that when scientific research and technological development institutes import the articles for scientific and technological development which can not be made in China or if made in China, if their performance cannot satisfy the required needs, the customs import duties, import value-added taxes and consumption taxes will be exempted.

On October 10, 2009, the Ministry of Finance, the General Administration of Customs and the State Administration of Taxation jointly issued a circular “Notice Concerning the

Taxation Policy on the Procurement of Equipment by Research and Development Institutions" (hereinafter referred to as "Circular 115"). Circular 115 sets conditions for import duty exemptions for foreign-invested research and development centers purchasing certain equipment.

In order to implement Circular 115, on March 22, 2010, the aforesaid Circular 93 was jointly issued by the Ministry of Commerce, the Ministry of Finance, the General Administration of Customs, and the State Administration of Taxation. Circular 93 provides detailed rules for the examination and approval for a qualification for tax exemption or refund.

III. Key Highlights

With regard to the said regulations, the following points shall be addressed due to their importance to foreign-invested research and development centers, which have purchased or intend to purchase equipment:

1. Conditions to be satisfied by foreign-invested research and development centers

According to Circular 115, a foreign-invested research and development center should satisfy the following conditions based on their time of establishment in order to be exempted from import duties:

(1) A foreign-invested research and development center established on and before September 30, 2009 is qualified for the tax exemption, if:

  a) Criteria on research and development cost: (i) For foreign-invested research and development centers established for less than two years and classified as independent legal persons, the total investment amount should not be less than USD 5 million. For internal departments in a company or branch companies, the total research and development investment should not be less than USD 5 million; (ii) For foreign-invested research and development centers established for two years and above, the annual enterprise research and development expenses should not be less than RMB10 million.
  b) The development personnel dedicated to researches and trials should not be fewer than 90.
  c) The original value of the equipment procured since the establishment of the center should not be less than RMB 10 million.

(2) A foreign-invested research and development center established on and after October 1, 2009 is qualified for the tax exemption, if:

a) Criteria on research and development cost: As an independent legal person, the total investment amount should not be less than USD 8 million. As an internal department of a company or a branch company, the total research and development investment should not be less than USD 8 million.
b) The development personnel dedicated to researches and trials should not be fewer than 150.
a) The original value of the equipment procured since the establishment of the centre should not be less than RMB 20 million.

Circular 93 provides a detailed explanation of the above conditions.

In accordance with Circular 93, for a foreign-invested research and development center that is an independent legal person, the total investment amount conforms to the amount shown in the approval certificate for foreign invested enterprises. For a foreign-invested research and development center that is not a separate legal entity and has been established for less than 2 years, the total investment amount equals to the assets invested within two years, for the establishment and construction of such research and development center by the foreign-invested enterprise to which it is affiliated, including the assets to be invested for the execution of purchase contracts.

According to Circular 93, for a foreign-invested research and development center which has been established for more than two years, the annual research and development expenditure refers to the average yearly expenditure for research and development for the last two years. If a research and development center has been established for less than two full accounting years, the annual research and development expenditure may be computed based on the amount of research and development funds that is actually disbursed during any 12 successive months since it is established. The investment of cash and physical assets should not fall below 60%.

Circular 93 also clarifies that the development personnel dedicated to researches and trials refer to the employees who focus on scientific activities of the following three categories: fundamental research, applied research, and experimental development, including those who directly participate in the aforementioned activities in the three categories and who are engaged in scientific management, as well as those who provide direct services for the projects, such as the supplying of reference books, materials, and equipment. The aforementioned personnel should sign labor contracts of at least one year with the foreign-invested research and development center or its parent company. The number of such personnel on the day before the tax exemption application should be used in examining the qualifications of a research and development center.

When calculating the cumulative value of equipment, the value of imported equipment and that of domestic equipment will both be included, including the value to be incurred in a purchase contract that will be executed by 2010.

2. Examination of eligibility

The commerce department, finance department, tax administration and admission of customs at the local levels are responsible for examining the applications from research and development centers and confirming the list of qualified research and development centers. The examining authorities will provide written opinions of unqualified research and development centers. They should examine the applications and publish the list of qualified research and development centers within 60 business days from the day an application is accepted.

The examining authorities will re-examine the qualification of previously qualified research and development centers every two years. The foreign-invested research and development centers that are no longer eligible will be disqualified from enjoying the preferential treatment of tax return/exemption.

3. Materials to be submitted

The following materials should be submitted when foreign-invested research and development centers apply for tax exemption/return for equipment purchased:

(1) Application for Tax Exemption/Return for Equipment Purchased by research and development Centers and examination form;
(2) The approval certificate for foreign invested enterprises and a photocopy of the business license; If the foreign-invested research and development center is not an independent legal person, the approval certificate for foreign invested enterprises and a photocopy of the business license of its parent company as well as the confirmation documents relating to the foreign-invested research and development center (the approval of or the Confirmation Letter for Foreign-Invested Projects Encouraged by the State issued by relevant business regulatory bodies) should be submitted;

(3) Capital verification report and a photocopy of the audit report for the previous year;
(4) Breakdown of research and development expenditures, breakdown of the expenses for equipment purchase;
(5) List of the personnel specialized in research and experimental development (including name, position, labor contract term, and contact information);
(6) Other materials required by the examining authorities.

4. Other matters

The equipment mentioned in this article means laboratory equipment, devices and apparatus that provide the necessary conditions for scientific researches, teaching and scientific and technological development. It should be directly used for scientific research and technological development of the importing entity itself, and can not be illegally transferred, used for other purposes or disposed of in other forms.

Enterprises that breach the rules by selling or transferring the equipment that was bought with preferential tax treatment or using it for other purposes, or disposing it otherwise without due approval will be disciplined in accordance with the relevant provisions and will not enjoy preferential tax treatment within one year from the day such breach is discovered. Enterprises that have been criminally charged will not enjoy preferential tax treatment within three years from the day such breach is discovered.

IV. Conclusion

The above-mentioned regulations provide a good development environment for foreign-invested research and development centers. Foreign-invested research and development centers should, according to its actual situation take different approaches to enjoy these respective rights. A foreign-invested research and development center which meets the respective conditions can directly file an application with the local customs office directly under the General Administration of Customs for import duties exemption, and file an application with the state tax institution for tax return for domestically-made equipment purchased. For equipment eligible for tax return and purchased from July 1, 2009 to March 22, 2010, a foreign-invested research and development center may file an application for return of the tax paid with the local customs office directly under the General Administration of Customs or the state tax institution.

Should you have questions regarding the information provided in this document, please do not hesitate to contact **Dr. Paul Thaler (paul.thaler@wenfei.com)**.

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