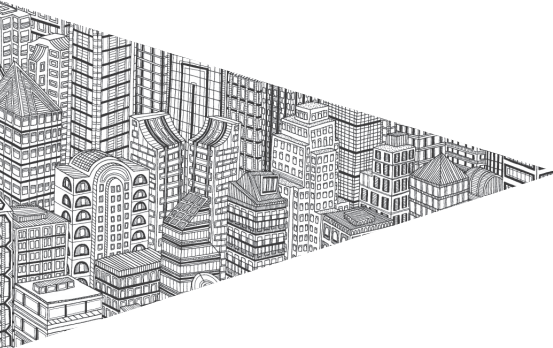


International Tax Alert



Tax incentives for outsourcing companies in mainland China available

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With the development of globalization, more and more multinational companies are considering outsourcing their service functions to developing countries for cost efficiency. In order to seize service opportunities, encourage the export of services and improve the standard and competitiveness of China's offshore service outsourcing, China's central government continues to take various measures to encourage the development of its offshore service outsourcing industry. One of the initiatives is to provide tax incentives to offshore service outsourcing enterprises. Mainland Chinese authorities have recently announced regulations which, subject to meeting the requirements outlined, may provide organizations with an exemption from Business Tax in mainland China. This is of particular interest to groups operating with research centers, shared services centers and other internal support service providers in mainland China.

Technology service company regulations

On 28 July 2010 and 5 November 2010, the Ministry of Finance (MOF), State Administration of Tax (SAT) and other authorities jointly issued Caishui [2010] NO.64 (Circular 64) and Caishui [2010] No.65 (Circular 65). The circulars define the scope of qualifying services and Circular 65 specifies the criteria for being recognized as a Technologically Advanced Service Company (TASC) and provides implementation rules on certification and administration.

Benefits

The tax incentives stated in Circular No. 64 and 65 provided that, from 1 July 2010 to 31 December 2013, enterprises engaged in service outsourcing and registered in 21 pilot cities are entitled to the following favorable tax treatment:

1. Qualified TASCs

- ▶ Preferential corporate income tax (CIT) rate of 15% (compared with the statutory rate of 25%); CIT deduction of actually-incurred staff education charges, up to a limit of 8% of the total payroll.

2. Qualified TASCs or non-TASCs

- ▶ Business tax (BT) exemption for offshore outsourcing service income.¹

The 21 pilot cities are Beijing, Changsha, Chengdu, Chongqing, Dalian, Daqing, Guangzhou, Hangzhou, Harbin, Hefei, Jinan, Nanchang, Nanjing, Shanghai, Shenzhen, Suzhou, Tianjin, Wuhan, Wuxi, Xian and Xiamen.²

How to qualify?

The indicative scopes of services that qualify under the scheme are detailed in the following table:

Table 1 - Indicative scope of qualifying services³

Type	Indicative scope of qualifying services
Information Technology Outsourcing (ITO)	Outsourcing of software development, information technology development, system hosting and system maintenance, etc.
Business Process Outsourcing (BPO)	Design of operational flows, business internal control, business operations management, supply chain management, etc.
Knowledge Process Outsourcing (KPO)	Research on intellectual property, pharmaceutical and biological R&D and testing, product technology R&D, industrial design, data analysis, etc.

³Additionally, in order to qualify for BT exemption or CIT preferential treatment, the company must fulfill *all* of the following requirements:

Table 2 - Additional criteria for BT exemption or CIT preferential treatment⁴

Criteria	BT	CIT
The registered address must be in the 21 designated pilot cities.	√	√
The enterprise provides qualifying offshore technologically advanced services (i.e., ITO or BPO or KPO).	√	√
The outsourcing service income is received from an entity located outside mainland China.	√	-
Must be a legal person without any non-compliance records in the management of import and export, finance, tax, foreign exchanges and customs departments during the past two years.	-	√
At least 50% of total headcount should be graduates with an associate degree or above.	-	√
Revenue from undertaking technologically advanced outsourcing services (including services provided to onshore and offshore clients) is more than 50% of total revenue of the year.	-	√
Revenue from the qualifying offshore technologically advanced outsourcing services should account for no less than 50% of total revenue of the year.	-	√

Conclusion

As China becomes a key market for most global financial institutions, the demand for shared services and research centers increases. As financial institutions set up or expand operations engaged in activities relating to ITO, BPO and KPO, an analysis should be performed to determine if these activities would qualify for tax incentives outlined in the circulars.

Ernst & Young can assist in examining whether a company will meet the criteria outlined to qualify as a TASC; assist in the application; and help navigate the various administrative measures and application schedules. For more information, please contact one of the individuals listed below or your usual Ernst & Young contact.

Endnotes

1. Circular Caishui [2010] No. 64 issued on 28 July 2010.
2. Circular Caishui [2010] No. 64 issued on 28 July 2010 and Caishui [2010] No.65 issued on 5 November 2010.
3. Circular Caishui [2010] No. 65 appendix issued on 5 November 2010.
4. Circulars Caishui [2010] No. 64 and 65.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Tax Services Limited, Hong Kong

▶ Tracy Ho	+852 2846 9065	tracy.ho@hk.ey.com
▶ Agnes Chan	+852 2846 9921	agnes.chan@hk.ey.com
▶ Florence Chan	+852 2846 9228	florence.chan@hk.ey.com
▶ Joe Chan	+852 2629 3092	joe.chan@hk.ey.com
▶ Owen Chan	+852 2629 3388	owen.chan@hk.ey.com
▶ Chee Weng Lee	+852 2629 3803	chee-weng.lee@hk.ey.com
▶ May Leung	+852 2629 3089	may.leung@hk.ey.com
▶ Loretta Shuen	+852 2629 3778	loretta.shuen@hk.ey.com
▶ Grace Tang	+852 2846 9889	grace.tang@hk.ey.com
▶ Jo An Yee	+852 2846 9710	jo-an.yee@hk.ey.com
▶ Patrick Cheung	+852 2846 9905	patrick.cheung@hk.ey.com
▶ Chris Finnerty	+852 2629 3868	chris.finnerty@hk.ey.com
▶ Becky Lai	+852 2629 3188	becky.lai@hk.ey.com
▶ Christian Pellone	+852 2629 3308	christian.pellone@hk.ey.com

International Tax Services

- ▶ **Global ITS**, Jim Tobin, *New York*
- ▶ **Americas**, Jeffrey Michalak, *Detroit*
- ▶ **Asia Pacific**, Alice Chan, *Shanghai*
- ▶ **Europe, Middle East, India and Africa**, Alex Postma, *London*
- ▶ **Japan**, Kai Hielscher, *Tokyo*
- ▶ **Latin America**, Alberto Lopez, *New York*

▶ Argentina	Carlos Casanovas	<i>Buenos Aires</i>
▶ Australia	Daryn Moore	<i>Sydney</i>
▶ Austria	Roland Rief	<i>Vienna</i>
▶ Belgium	Herwig Joosten	<i>Brussels</i>
▶ Brazil	Gil Mendes	<i>Sao Paulo</i>
▶ Canada	George Guedikian	<i>Toronto</i>
▶ Central America	Rafael Sayagues	<i>San José</i>
▶ Chile	Osiel Gonzalez	<i>Santiago</i>
▶ China	Becky Lai	<i>Beijing</i>
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▶ Denmark	Niels Josephsen	<i>Soborg</i>
▶ Finland	Katri Nygård	<i>Helsinki</i>
▶ France	Claire Acard	<i>Paris</i>
	Régis Houriez	<i>Paris</i>
▶ Germany	Stefan Koehler	<i>Frankfurt</i>
▶ Hong Kong	Chris Finnerty	<i>Hong Kong</i>
▶ Hungary	Botond Rencz	<i>Budapest</i>
	Balazs Szolgyemy	<i>Budapest</i>
▶ India	Vijay Iyer	<i>Bangalore</i>
▶ Ireland	Kevin McLoughlin	<i>Dublin</i>
▶ Israel	Sharon Shulman	<i>Tel Aviv</i>
▶ Italy	Mario Ferrol	<i>Milan</i>
	Gaetano Pizzitola	<i>Rome</i>
▶ Japan	Kai Hielscher	<i>Tokyo</i>
▶ Korea	Kyung-Tae Ko	<i>Seoul</i>
▶ Luxembourg	Frank Muntendam	<i>Luxembourg</i>
▶ Malaysia	Hock Khoon Lee	<i>Kuala Lumpur</i>
▶ Mexico	Koen van 't Hek	<i>Mexico City</i>
▶ Middle East	Tobias Lintvelt	<i>Abu Dhabi</i>
▶ Middle East	Michelle Kotze	<i>Dubai</i>
▶ Netherlands	Johan van den Bos	<i>Amsterdam</i>
▶ Norway	Oyvind Hovland	<i>Oslo</i>
▶ Peru	Roberto Cores	<i>Lima</i>
▶ Philippines	Ma Fides Balili	<i>Makati City</i>
▶ Poland	Andrzej Broda	<i>Warsaw</i>
▶ Portugal	Antonio Neves	<i>Lisbon</i>
▶ Russia	Vladimir Zheltonogov	<i>Moscow</i>
▶ Singapore	Andy Baik	<i>Singapore</i>
▶ South Africa	Corlie Hazell	<i>Johannesburg</i>
▶ Spain	Federico Linares	<i>Madrid</i>
▶ Sweden	Erik Hultman	<i>Stockholm</i>
▶ Switzerland	Markus F. Huber	<i>Zurich</i>
▶ Taiwan	Jennifer Williams	<i>Taipei</i>
▶ Thailand	Anthony Loh	<i>Bangkok</i>
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▶ United Kingdom	Matthew Mealey	<i>London</i>
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▶ United States	Jeffrey Michalak	<i>Detroit</i>
▶ Venezuela	Jose Velazquez	<i>Caracas</i>
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