



CHINA'S SUPPORT PROGRAMS FOR SELECTED INDUSTRIES: WOOD AND WOOD PRODUCTS

Trade Lawyers Advisory Group

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EXECUTIVE SUMMARY

Abundant labor supply and large capital investment has turned China into a major processing center in the global supply chain for wood products. Chinese factories supply IKEA with one-fourth of its global stock. Home Depot similarly sources a significant percentage of its wood products from Chinese suppliers. Today, China is the world's largest exporter of furniture and a number of wood panel products. The dramatic growth of China's wood and wood products industry, both at home and internationally through exports, has created tensions with China's trading partners concerned with the extent of government support provided to Chinese producers. In recent years, two countervailing duty cases have found that segments of the Chinese industry have benefited from government assistance that was countervailable under both Canadian and U.S. law. This report reviews the types of government support that China has provided to its wood and wood products industry, covering assistance to timber companies, pulp and paper producers, and solid wood products companies.

China's forest land is limited, and thus so its timber resources. China's per capita forest acreage ranks 119th among nations. In reaction to a major flood, the Chinese government enacted measures to preserve its forest ecological system and to restrict logging in natural forests. With its rapid economic expansion and limited home-grown timber resources, China has been the world's largest importer of logs in

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recent years. To reduce its dependence on imports, the Chinese government has encouraged plantation development in order to meet future timber demand and is now operating the world's largest plantation development program. Between 1978 and 2005, 55 million hectares of forest plantations have been developed. Much of these newly-developed forests are for environmental protection purposes, where commercial logging is strictly limited. Only about 20 percent of the plantings are available for commercial timber production.

Plantation development requires long-term capital commitments, which could be risky and hard to obtain for private companies. The Chinese government therefore has provided loan interest subsidies to support private developers. One program designed by the government to increase the nation's commercial timber supply is the "fast-growth-high-yield" plantation development program. A report prepared by the American Forestry and Paper Association in 2004 estimated that the Ministry of Finance has committed USD \$1.73 billion to 99 projects of fast-growth-high-yield plantation development.

While China is ramping up its domestic timber supplies, it has relied on imports to meet its demand for timber. It has been widely reported that illegal logging is rampant in China's primary timber suppliers, Russia and Indonesia. The Western media has criticized Chinese border authorities for not making a sufficient effort to authenticate the logging documents for imported logs to ensure compliance with national logging limitations. Unfortunately, it is likely that China's demand

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for timber in recent years has worsened the extent of illegal logging in these exporting countries.

China's pulp and paper industry has seen fast growth in demand in recent years. China is now the world's second largest paper and paper board producer. The industry, however, remains fragmented with many small and outdated facilities. The government has been encouraging the consolidation of the industry and supporting adoption of modern and environmentally-friendly production technology. Four thousand small paper mills have been closed; and wood pulp-based new paper making facilities employing the most advanced production technology have been installed at a very fast rate. Production grew from 35.75 million metric tons in 2000 to 54.39 million metric tons in 2004. Government support is an important element contributing to this capacity expansion and industry restructuring.

In a recent countervailing duty case filed in the United States against Chinese producers of coated free sheet paper, the U.S. Department of Commerce, in its preliminary determination, found that the Chinese paper industry has benefited from a number of government support programs that are countervailable under U.S. law. Among these measures is the State Key Technology Renovation Project Fund, under which the government had been providing grants to paper producers in an amount equal to two years of interest payments on loans extended for technology innovation projects. Other programs found to be available to coated free sheet

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paper producers included: (1) tax preferences (including the so-called “two free, three half” program, and various other types of preferential tax treatment extended to companies with foreign investment), (2) tax benefits extended on condition of purchasing domestic equipment, and (3) awards to companies that adopted clean production technology.

Production capacity in China's solid wood products industry has grown very quickly as well. China is now the world's largest furniture exporter, accounting for 30 percent of global furniture trade. Chinese exports of wood panels also have increased rapidly, reaching 10 million cubic meters in 2005.

Chinese exports of certain wood products have caused trade frictions with some of its major trading partners. In the United States, for example, domestic producers filed an antidumping case against imports of wooden bedroom furniture from China. In Canada, as well, the laminate flooring industry brought, in 2004, antidumping and countervailing duty actions against imports of laminate flooring from China. The Canadian authority found that some of the Chinese government subsidies provided to the laminate flooring industry were countervailable under Canadian law. In addition to those measures available to the coated free sheet paper industry noted above, measures which Canada found to be countervailable included discounted loans provided to wood processing companies and awards to companies that adopted environmentally-friendly production methods.

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In addition to the support provided by the Chinese central government, local governments at the provincial and city levels also have provided financial assistance to wood products companies. Indeed, the annual reports of various Chinese paper companies reveal that the majority of the reported financial benefits to these companies has been provided by local governments.

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INTRODUCTION

This report reviews China's wood and wood products, or forestry, industry and relevant government industry policies and support programs that the government has been providing or has made available to enterprises in the industry. This report uses the terms "forestry industry" and "wood and wood products industry" interchangeably. They both refer broadly to the industry encompassing both *raw timber* and *wood products*.¹

Part I

The report begins with a brief introduction to the three segments of China's forestry industry: timber production, the pulp and paper industry, and the solid wood products industry. To stop the fast degradation of China's ecosystem, the government has restricted timber production, which has partially contributed to the current shortage in the supply of domestic timber. For the paper and solid wood products industries, low manufacturing costs and large capital investment has turned China into a major processing center for some of its wood products; for other wood products, especially raw material and high-end wood products, China is now one of the largest importers. The report reviews trade flows for China's forestry industry.

Following the introduction, the report reviews relevant Chinese government industry policies and development strategies. In 2003, China released a refined forestry policy, including the development strategy for the wood products industry as well as an environmental protection

¹ In this report, *pulp and paper production* is carved out and discussed independently from the rest of the wood products industry, with the latter being referred to in this report as the *solid wood products industry*, including enterprises producing sawn wood, wood chips, panel products, wood furniture, *et cetera*.

plan. In 2004, the State Development and Reform Commission (SDRC) issued a guideline for paper and commercial use plantation development. These two documents will guide China's forestry industry for the next 5-10 years. The report reviews the first document, which was issued jointly by the Chinese Communist Party Central Committee (CCPCC) and the State Council. The second document, issued by SDRC, is discussed in the pulp and paper section.

Part II

In Part II, the report discusses government support programs that are available to forestry industry enterprises. First, we review China's April 2006 notification to the World Trade Organization's (WTO) Committee on Subsidies and Countervailing Measures (SCM). Eight programs listed in the notification are expressly applicable to the forestry industry; many other programs listed are potentially usable by the forestry sector. China today operates the largest afforestation program in the world. Environmental protection is the state's primary purpose for this program, in particular, forestry ecosystem restoration and prevention of soil erosion. On the other hand, the program also increases China's timber production capacity. The report then gives a brief introduction to China's Six Grand Afforestation Projects.

The various programs reviewed in this report have resulted in a rapid expansion of China's wood and wood products industries and have attracted attention from trading partners and trade associations. For example, the American Forest and Paper Association (AF&PA) conducted a comprehensive study on government support to China's forestry industry, and published a research paper in July 2004.² The report reviews the AF&PA study.

² AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004). See Exhibit F-9.

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Information on the use of subsidies by China's wood and wood products industries can also be found in the records of two countervailing duty cases that have been filed against China, one in Canada and one in the United States.³ In both cases, the administering authorities in the United States (to date, only a preliminary determination has been issued) and Canada have reached affirmative determinations. In addition, in February 2007, the U.S. government filed a request for consultations with China at the World Trade Organization with respect to some of China's subsidy programs. The report provides a summary of the subsidy programs identified in the three subsidy disputes. The report also looks briefly at some selected information on the types of programs that may be available from the provincial and local governments in China. Finally, the report reviews the issues involved regarding reports of illegal logging in China's neighboring countries and China's handling of imports of such products.

To assist the reader's understanding of the government programs reviewed in the report, we have assigned an identification number to each program discussed; and have prepared a master table listing all of the programs with their underlying legal authorities. This master table is set out on the following pages.

³ See Department of Commerce, *Coated Free Sheet Paper from the People's Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination*, 72 Fed. Reg. 17484 (April 9, 2007). See also Canadian Border Services Agency (CBSA), *Statement of Reasons Concerning the Making of a Final Determination with Respect to the Dumping of Certain Laminate Flooring Originating in or Exported From the People's Republic of China and France* (June 1, 2005) ("Laminate Flooring Statement of Reasons"); available at <http://www.cbsa-asfc.gc.ca/sima/anti-dumping/ad1332f-e.html>.

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ID	Name of the program	Legal authority in English	Legal Authority in Chinese	Exhibit No	Sources of identification						Referenced in Report at Page	
					1	2	3	4	5	6		
G1	Preferential tax policies for FIEs	Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (The Tax Law)	中华人民共和国外商投资企业和外国企业所得税法	F-4	I							69
G1	Same as above	Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprise	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5	I							69
G2	Preferential tax policies for Export FIEs	Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (The Tax Law)	中华人民共和国外商投资企业和外国企业所得税法	F-4	II						✓	82
G2	Same as above	Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprise	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-4	II						✓	82

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					1	2	3	4	5	6		
G3	Preferential tax policies for FIEs which are technology-intensive and knowledge-intensive	SAT Circular on the Preferential Tax Treatment to Foreign-Invested Companies That Are Technology- and Knowledge-Intensive, Guo Shui Fa [1995] No. 139	关于外商投资企业享受“两个密集型企业”税收优惠有关问题的通知	F-79	VI						✓	82
G3	Same as above	SAT Circular on the Preferential Tax Treatment to Foreign-Invested Companies That Are Technology- and Knowledge-Intensive, Guo Shui Fa [2003] No. 135	C5-国家税务总局关于外商投资企业享受“两个密集型”税收优惠政策有关问题的通知 2003	F-48	VI						✓	82
G4	Preferential tax policies for FIEs in the border cities	SAT Circular on Granting Preferential Tax Treatment to Foreign-Invested Companies in 12 Border Cities, Guo Shui Han Fa [1994] No. 1412	国家税务总局关于明确黑河等十二个边境城市执行外商投资企业税收政策问题的通知	F-49	VII							51

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					1	2	3	4	5	6	
G5	Preferential tax policies for FIEs recognized as high or new technology enterprises established in the State high or new technology industrial development zones, and for advanced technology enterprises invested in and operated by foreign businesses	Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5	VIII		✓				51
G6	Preferential tax policies for enterprises recognized as high or new technology enterprises established in the State high or new technology industrial development zones	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No. 001	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》财税字[1994] 001号	F-50	IX						51

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					1	2	3	4	5	6	
G7	Preferential tax policies for FIEs established in special economic zones (excluding Shanghai Pudong area)	Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法	F-4	X						72
G7	Same as above	Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5	X						72
G8	Preferential tax policies for FIEs established in the costal economic open areas and in the economic and technological development zones	Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法	F-4	XI						52
G8	Same as above	Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5	XI						52

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					1	2	3	4	5	6	
G9	Preferential tax policies for FIEs established in Pudong area of Shanghai	Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法	F-4	XII						52
G9	Same as above	Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5	XII						52
G10	Preferential tax policies for FIEs established in the Three Gorges of Yangzi River Economic Zone	MOF Circular on the Tax Policy for Relocation of Residents in the Three Gorges Area and Regional Development, MOF Cai Shui Zi [1995] No. 34	关于长江三峡库区移民开发税收政策的通知, 财税字 [1995]34 号	F-51	XIII						53
G11	Preferential tax policies in the western regions	Circular of the State Council on Several Policies on the Development of Western Regions, Guo Fa [2000] No. 33	国务院关于实施西部大开发若干政策措施的通知, 国发 [2000]33 号	F-24	XIV		✓	✓			67, 73

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					1	2	3	4	5	6	
G11	Same as above	The General Office of the State Council to Circulate the Circular of the State Council on the Implementation of New Policies for the Development of Western Regions, Guo Ban Fa [2001] No. 73	国务院办公厅转发国务院西部开发办关于西部大开发若干政策措施实施意见的通知, 国办发[2001]73号	F-53	XIV		✓	✓			67, 73
G11	Same as above	MOF Circular on Preferential Tax Treatment for Western Regions Development Program, Cai Shui [2001] No. 202	财政部、国家税务总局、海关总署关于西部大开发税收优惠政策问题的通知, 财税[2001]202号	F-54	XIV		✓	✓			67, 73
G11	Same as above	SAT Circular on Extending 15% Preferential Income Tax Rate for Three Years to Foreign-Invested Companies in Central and Western Regions, Guo Shui Fa [1999] No. 172	国家税务总局关于实施对设在中西部地区的外商投资企业给予三年减按 15 % 税率征收企业所得税的优惠的通知, 国税发[1999]172号	F-55	XIV		✓	✓			67, 73

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G12	Preferential tax policies for enterprises established in the poverty stricken areas	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No. 001	财政部、国家税务总局《关于企业所得税若干优惠政策的通知, 财税字[1994] 001号	F-50	XV						54
G13	Fiscal funds to alleviate poverty	MOF Circular on the Distribution of "Interim Administrative Rules of the Fiscal Funds for Poverty Alleviation" and "Interim Administrative Rules of the Administration Fee for the Poverty Alleviation Projects," Cai Nong [2000] No. 18	关于印发《财政扶贫资金管理办法》(试行)和《财政扶贫项目管理费管理办法》(试行)的通知	F-57	XVI						54
G14	Specific subsidy on agricultural production and construction in the poverty stricken areas of Hexi and Dingxi of Gansu Province and Xihaiyu of Ningxia Hui Autonomous Region	Circular of MOF and the Leading Group on Poverty Alleviation and Development of the State Council on the Distribution of "Administrative Rules of the Special Subsidies to the 'Three West' Agricultural Construction," Cai Nong [2001] No. 67	财政部、国务院扶贫开发领导小组关于印发《“三西”农业建设专项补助资金使用管理办法》的通知(2001), 财农[2001] 67号	F-58	XVII						54

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G15	Interests discount of poverty alleviation loans	People's Bank of China Circular re Administrative Rules of Subsidized Loans for Poverty Alleviation, Yin Fa [2001] No. 185	中国人民银行、财政部、国务院扶贫开发领导小组办公室、中国农业银行关于印发《扶贫贴息贷款管理实施办法》的通知, 银发[2001]185号	F-59	XVIII						54
G16	Preferential tax policies for enterprises which utilize the waste materials	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No. 001	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》, 财税字[1994]001号	F-50	XIX						54
G17	Preferential tax policies for enterprises suffering from natural disasters	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No. 001	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》, 财税字[1994]001号	F-50	XX						55
G18	Preferential tax policies for welfare enterprises	SAT Circular on Preferential Turnover Tax Treatment for Social Welfare Enterprises, Guo Shui Fa [1994] No. 155	国家税务总局关于民政福利企业征收流转税问题的通知 国税发[1994]155号	F-60	XXI						55

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G19	Preferential tax policies for enterprises making little profits	MOF & SAT Circular on Certain Decisions Related to Corporate Income Tax Policies, Cai Shui Zi [1994] No. 009	财政部、国家税务总局关于印发《企业所得税若干政策问题的规定》的通知, 财税字[1994]009号	F-61	XXII						55
G20	Preferential tax policies for township enterprises	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No. 001	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》, 财税字[1994] 001号	F-50	XXIII						55
G21	Preferential tax policies for enterprises which provide employment for unemployed people	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No. 001	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》, 财税字[1994] 001号	F-50	XXIV						55
G22	Preferential tax policies for scientific research institutions under transformation	MOF & SAT Circular on the Tax Policy Regarding Research Institutions Undergoing Restructuring, Cai Shui [2003] No. 137	财政部、国家税务总局关于转制科研机构有关税收政策问题的通知, 财税[2003]137号	F-62	XXV						55

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G23	Preferential tax policies for the research and development of foreign-invested enterprises	SAT Circular on Granting Income Tax Deduction to FIEs for Technology Development Expenditure, Guo Shui Fa [1999] No. 173	国家税务总局关于外商投资企业技术开发费抵扣应纳税所得额有关问题的通知, 国税发[1999]173号	F-63	XXVII						55
G24	Preferential tax policies for enterprises transferring technology	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No. 001	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》, 财税字[1994] 001号	F-50	XXVIII						56
G25	Funds for supporting technological innovation for the technological small and medium-sized enterprises (SMEs)	General Office of State Council Circular on the Interim Administrative Rules of the Technological Innovation Fund for the Technological Small- and Medium-sized Enterprises, Guo Ban Fa [1999] No. 47	国务院办公厅转发科学技术部财政部关于科技型中小企业技术创新基金的暂行规定的通知 (国办发〔1999〕47号)	F-64	XXXI						56
G26	Development funds for SMEs	Law of the People's Republic of China on Promotion of Small and Medium-sized Enterprises	中华人民共和国中小企业促进法	F-65	XXXII						56

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G27	Fund for international market exploration by SMEs	MOF Circular on Administrative Measures on Funds Earmarked for International Market Exploitation of Small- and Medium-sized Enterprises, Cai Qi [2000] No. 467	财政部、对外贸易经济合作部关于印发《中小企业国际市场开拓资金管理(试行)办法》的通知,财企〔2000〕467号	F-66	XXXIII						56
G27	Same as above	MOFTEC (MOFCOM) Circular on Implementing Rules of the Administrative Measures on Funds Earmarked for International Market Exploitation of Small- and Medium-sized Enterprises, Ji Cai Fa [2001] No. 270	中小企业国际市场开拓资金管理实施办法实施细则(暂行)外经贸计财发[2001]270号	F-67	XXXIII						56
G28	Special fund for establishment of service system for SMEs	Law of the People's Republic of China on Promotion of Small- and Medium-sized Enterprises	中华人民共和国中小企业促进法	F-65	XXXIV						56
G28	Same as above	MOF Circular on Interim Administrative Measures of the Special Fund for Establishment of the Service System for Small- and Medium-sized Enterprises, Cai Jian [2004] No. 124	中小企业服务体系专项补助资金使用管理办法(暂行)财建[2004]124号	F-68	XXXIV						57

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G29	Fund for subsidizing the training of the rural migrant labor force	MOF and MOA Circular on Administrative Measures of the Fund for Subsidizing the Training of the Rural Migrant Labor Force, Cai Nong [2004] No. 38	财政部、农业部关于印发《农村劳动力转移培训财政补助资金管理办法(试行)》的通知(财农[2004]38号)	F-69	XXXV						57
G30	Outlay for training of youngster farmers on science and technology	MOA Circular on Comments on Development of Trial-Point for the Training of Cross-Century Youngster Farmers on Science and Technology, Nong Ke Jiao Fa [1999] No. 8	关于开展跨世纪青年农民科技培训工程试点工作的意见	N/A	XXXVI						57
G31	Fund for specialized cooperatives of farmers	MOF Circular on the Interim Administrative Measures of the Fund for Specialized Cooperatives of Farmers, Cai Nong [2004] No. 87	财政部关于印发《中央财政农民专业合作组织发展资金管理暂行办法》的通知, 财农[2004]87号	F-70	XXXVII						57
G32	Subsidy for major flood control and drought resistance	MOF and MWR Circular on the Interim Rules of the Distribution of Subsidy for Major Flood Control and Drought Resistance, Cai Nong [2001] No. 30	财政部、水利部关于印发《特大防汛抗旱补助费分配暂行规定》的通知, 财农[2001]30号	F-71	XLV						57

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G33	Fund for construction of small irrigation facilities in rural areas	Circular from the General Office of MOF on the Pilot Administrative Rules of the Subsidy for Construction of Small Irrigation Facilities in Rural Areas, Cai Ban Nong [2001] No. 74	财政部办公厅关于印发《农村小型公益设施建设补助资金管理试点办法》的通知, 财办农[2001]74号	F-16	XLVI						46
G34	Fund for construction of small ecological facilities in rural areas	Circular from the General Office of MOF on the Pilot Administrative Rules of the Subsidy for Construction of Small Irrigation Facilities in Rural Areas, Cai Ban Nong [2001] No. 74	财政部办公厅关于印发《农村小型公益设施建设补助资金管理试点办法》的通知, 财办农[2001]74号	F-16	XLVII						58
G35	Fund for projects on collection, reservation and utilization of rainfall	MOF & MWR Circular on the Interim Administrative Rules of the Fund for Collection, Reservation and Utilization of Rainfall, Cai Nong [2004] No. 138	财政部、水利部关于印发《中央财政雨水集蓄利用专项资金管理暂行办法》的通知, 财农[2004] 138号	F-73	XLVIII						58
G36	Subsidies for national key construction projects on water and soil conservation	MOF Circular on Administrative Rules of the Subsidies for Small Scale Irrigation and Soil Conservation, Cai Nong [1987] No. 402	小型农田水利和水土保持补助费管理的规定, 财农[1987]402号	F-74	L						58

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G37	Income tax credits on purchases of domestically-produced equipment by FIEs	Circular of the Ministry of Finance and the State Administration of Taxation on Enterprise Income Tax Credits for Purchase of Domestic Equipment by Foreign-Invested Enterprises and Foreign Enterprises, Cai Shui [2000] No. 49	财政部、国家税务总局关于外商投资企业 and 外国企业购买国产设备投资抵免企业所得税有关问题的通知	F-79	LVIII					✓		78
G37	Same as above	Administrative Measures on Enterprise Income Tax Credits for Purchase of Domestic Equipment by FIEs and Foreign Enterprises, Cai Shui [2000] No. 90	国家税务总局关于印发《外商投资企业 and 外国企业购买国产设备投资抵免企业所得税管理办法》的通知	F-34	LVIII					✓		78
G38	Preferential tax policies for domestic enterprises purchasing domestically-produced equipments for technology upgrading purpose	MOF & SAT Circular on the Interim Measures of Income Tax Deduction for Domestically-Produced Equipment Purchased for Technology Upgrading Purpose, Cai Shui [1999] No. 290	财政部、国家税务总局关于印发《技术改造国产设备投资抵免企业所得税暂行办法》的通知，财税 [1999] 290	F-38	LIX						✓	81

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G39	VAT and tariff exemptions on imported equipment	Circular of the State Council on Adjusting Tax Policies on Imported Equipment, Guo Fa [1997] No. 37	国务院关于调整进口设备税收政策的通知, 国发 [1997] 37	F-30						✓		79
G40	VAT exemption for grain distributed for compensating returning farmland to forests	SAT Circular on VAT Exemption for Grain Distributed to Compensate for Returning Cultivated Land to Forests and to Grassland, Guo Shui Fa [2001] No. 131	国家税务总局关于退耕还林还草补助粮免征增值税问题的通知, 国税发 [2001] 131	F-20	LXIII							48
G41	Preferential tax treatment for building material products produced with integrated utilization of resources	MOF & SAT Circular on VAT Exemption for Products Produced with Integrated Utilization of Resources, Cai Shui Zi [1995] No. 44	财政部、国家税务总局关于对部分资源综合利用产品免征增值税的通知, 财税字[1995]44号	F-80	LXIX							59
G41	Same as above	MOF & SAT Circular on Continuing with the Preferential VAT Treatment for Products Produced with Integrated Utilization of Resources, Cai Shui Zi [1996] No. 20	财政部、国家税务总局关于继续对部分资源综合利用产品等实行增值税优惠政策的通知, 财税字[1996]20号	F-81	LXIX							60

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G42	Preferential tax treatment for other products produced with integrated utilization of resources	MOF & SAT Circular on VAT Treatment for Products Produced with Integrated Utilization of Resources, Cai Shui [2001] No. 198	财政部、国家税务总局关于部分资源综合利用及其他产品增值税政策问题的通知, 财税[2001]198号	F-82	LXX						60
G42	Same as above	MOF & SAT Supplementary Circular on VAT Treatment for Products Produced with Integrated Utilization of Resources, Cai Shui [2004] No. 25	财政部 国家税务总局关于部分资源综合利用 产品增值税政策的补充通知, 财税[2004]25号	F-83	LXX						60
G43	Preferential tax treatment for products for the disabled people	MOF & SAT Circular on Certain Policy Issues on VAT, Cai Shui Zi [1994] No. 60	财政部、国家税务总局关于增值税几个税收政策问题的通知, 财税字[1994]060号	F-84	LXXIII						60
G44	Preferential tax treatment for casting and forging products	MOF & SAT Circular on VAT Refund for Casting and Forging Products, Cai Shui [2003] No. 96	财政部、国家税务总局关于铸锻件产品增值税先征后返问题的通知	F-85	LXXVI						60

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G45	Preferential tax treatment to dies products	MOF & SAT Circular on Continuing VAT Refund for Dies Products, Cai Shui [1998] No. 139	财政部、国家税务总局关于继续对模具产品实行增值税先征后返的通知国税发（1998）139号	F-86	LXXVII						60
G46	The two free, three half tax benefit for productive FIEs	Article 8, in conjunction with Article 72, of the Implementation Rule for the FIEs Income Tax Law	中华人民共和国外商投资企业和外国企业所得税法	F-4				✓	✓		71
G46	Same as above	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprise	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5				✓	✓		71
G47	Income tax rebate for FIEs investing in encouraged line of business	Article 8 of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法	F-4				✓			71
G47	Same as above	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprise	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5				✓			71

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G48	Tax rebate on certain qualified investment of FIEs profits	Article 10 of the FIE Income Tax Law	中华人民共和国外商投资企业和外国企业所得税法	F-4				✓		✓	72, 83
G48	Same as above	Article 80 of the Implementation Rule for FIE Income Tax Law	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5				✓		✓	72, 83
G49	Exemption for export-oriented FIEs from certain welfare payment	Provisions of the State Council on the Encouragement of Foreign Investment, Guo Fa [1986] No. 95	国务院关于鼓励外商投资的规定, 国发[1986]95号	F-39						✓	83
G50	Reduced income tax rates for FIEs based on location	Article 7 of the FIE Income Tax Law	中华人民共和国外商投资企业和外国企业所得税法	F-4				✓	✓		72
G50	Same as above	Article 71 of the FIE Income Tax Law Implementation Rule (Decree 85)	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5				✓	✓		72
G51	Exemption of tariff and import VAT for the imported technologies and equipments	Circular of the State Council on Adjusting Tax Policy on Imported Equipment, Guo Fa [1997] No. 37	国务院关于调整进口设备税收政策的通知, 国发[1997]37	F-30	LX		✓				74

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G51	Same as above	The Current Catalogue of Key Industries, Products and Technologies the Development of Which is Encouraged by the State (Provisional), Decree 7 [1997]	当前国家重点鼓励发展的产业、产品和技术目录(试行)[失效] 国家计划委员会令[第6号]	F-88							74
G52	Local grants for flooring enterprises	Suggestions on Financial Support of Economic Development in the Pudong New District during the Tenth Five-Year Plan (Dec. 2000)	浦东新区"十五"期间财政扶持经济发展的若干意见	F-33			✓				76
G53	The State key technology renovation project fund	State Key Technology Renovation Project Fund, Guo Jing Mao Tou Zi [1999] No. 886	国家重点技术改造项目管理办法, 国经贸投字 [999]886	F-89					✓		77
G53	Same as above	State Key Technology Renovation Project Fund Management Rule, Guo Jing Mao Tou Zi [2000] No. 822	国家重点技术改造项目[2000]822	F-90					✓		77
G53	Same as above	State Key Technology Renovation Project Audit and Management Rule, Guo Jing Mao Tou Zi [1999] No. 1038	国家重点技术改造项目监督管理办法(试行)	F-91					✓		77
G54	Local income tax exemption and reduction for productive FIEs	Article 9 of the FIE Income Tax Law	中华人民共和国外商投资企业和外国企业所得税法	F-4					✓		78

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G55	VAT rebate on FIE purchase of Domestically product Exemptions for domestic equipments	Trial Administrative Measures on Purchase of Domestic Equipment by Projects with Foreign Investment, Guosuiifa, [1999] No. 171	国家税务总局关于印发《外商投资企业采购国产设备退税管理试行办法》的通知	F-35						✓		79
G56	Domestic VAT refunds for companies located in the Hainan Economic Development Zone	Unknown	Unknown							✓		79
G57	Clean production technology fund	Management Rule for Special Funds Distributed to Subsidize Local Clean Production	中央补助地方清洁生产专项资金使用管理办法, 财建[2004]343号	F-52						✓		80
G58	Income tax rebate for FIEs investing in encouraged line of business	Article 73(6), Rules for Implementation of the Income Tax Law of the PRC on Enterprises with Foreign Investment and Foreign Enterprises, Decree 85 (June 30, 1991)	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5							✓	82
G58	Same as above	MOFCOM Catalogue for the Guidance of Foreign Investment (Nov. 30, 2004)	外商投资产业指导目录 (2004年修订)	F-26							✓	82

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F1	Income tax credit for royalty from supplying forestry production technology	Notice on Income Tax Deduction for Interest Income and Others for Foreign Companies Who Do Not Have Business Presence in China, Guo Fa [2000] No. 37	国务院关于外国企业来源于我国境内的利息等所得减征所得税问题的通知, 国发[2000]37, (11-18-2000)	F-13	I						45
F1	Same as above	Article 19, Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法	F-4	I						45
F1	Same as above	Article 66, Implementing Rules of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则	F-5	I						45
F2	Preferential tax policies for the enterprises engaged in forestry	Circular on Certain Issues Regarding Forestry Tax Policy	财政部, 国家税务总局关于林业税收政策的通知, 财税[2001] 171 (11-01-2001)	F-12	XXX						46
F3	Funds for construction of small forests in rural areas	The Pilot Rule for Administering the Subsidy for the Construction of Small Irrigation Facilities in the Rural Areas, Cai Ban Nong [2001] No. 74	财政部办公厅关于印发《农村小型公益设施建设补助金管理试点办法》的通知, 财办农[2001] 74号, (05-22-2001)	F-16	XLVI						46

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F4	Special fund for projects on protection of natural forestry	Regulation on the Management of the Special Fund for Projects on Protection of Natural Forests, Cai Nong [2000] No. 151	财政部关于印发《天然林保护工程财政资金管理规定的通知, 财农[2000] 151, (01-01-2001)	F-77	LI						47
F5	Cash subsidy for returning cultivated land to forests	Opinions of the State Council on Further Improving the Policies and Measures on Returning Cultivated Land to Forests, Guo Fa [2002] No. 10	国务院关于进一步完善退耕还林政策措施的若干意见, 国发[2002]10号, (04-11-2002)	F-17	LII						47
F6	Compensation fund for forestry ecological benefits	MOF & NFB Circular on Distribution of Administrative Measures for the Central Compensation Fund for Forestry Ecological Benefits, Cai Nong [2004] No. 169	财政部 国家林业局关于印发《中央森林生态效益补偿基金管理办法》的通知, 财农[2004]169号, (10-24-2004)	F-18	LIII						47
F7	Interest discount for loans for the purpose of desertification prevention in forestry	MOF Circular on Administrative Measures of the Fund for Loan Interest Subsidy for Desertification Prevention in Forestry, Cai Nong [2002] No. 137	财政部关于印发《林业治沙贷款财政贴息资金管理规定的通知, 财农[2002] 137, 01-01-2003	F-19	LIV						48

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ID	Name of the program	Legal authority in English	Legal Authority in Chinese	Exhibit No	Sources of identification						Referenced in Report at Page
					1	2	3	4	5	6	
F8	Subsidy to prevent and control forest pest and disease	MOF Circular on Administrative Measures of the Subsidy for Prevention from and Control of Pest and Disease in Forestry, Cai Nong [2002] No. 69	财政部关于印发《林业病虫害防治补助费管理规定》的通知 财农[2002]69号, 08-01-2002, (expired)	F-54	LV						48
F9	Natural forests protection projects	Funds Management Rule for Major Natural Forests Protection Projects	重点地区天然林资源保护工程建设资金管理管理工作	F-72		✓					62
F10	The Beijing-Tianjin sandstorm prevention afforestation projects	SFA Opinion on Reinforcing the Afforestation Efforts to Control the Sources of Sandstorms Affecting the Beijing-Tianjin Area	国家林业局关于进一步加强京津风沙源治理工程区荒山荒地造林的若干意见	F-56		✓					62
F11	The natural reserve development project	MOA Notice on Reinforcing the Efforts on Management and Expanding of the Natural Reserves	农业部关于进一步加强自然保护区建设和管理工作的通知	F-87		✓					63
F12	Protective afforestation program	MOF Response to Certain Questions on Funds Management Rule for the Four Major Protective Afforestation Programs	财政部关于四大防护林建设专项资金有关问题的复函	F-36		✓					63

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ID	Name of the program	Legal authority in English	Legal Authority in Chinese	Exhibit No	Sources of identification						Referenced in Report at Page
					1	2	3	4	5	6	
F12	Same as above	SFA Opinion on Reinforcing the Efforts in Constructing and Managing the Protective Afforestation Projects in the Yangzi River Drainage Basin	国家林业局关于加强长江流域等重点地区防护林体系工程建设和管理工作的若干意见	F-21		✓					63
F12	Same as above	Interim Fund Management Rule for the Projective Afforestation Program in Three Northern Areas	三北防护林体系建设专项资金管理暂行办法	F-76		✓					63
F13	Return farmland to forests	Opinions of the State Council on Further Improving the Policies and Measures on Returning Cultivated Land to Forests, Guo Fa [2002] No. 10	国务院关于进一步完善退耕还林政策措施的若干意见, 国发[2002]10号, (04-11-2002)	F-17		✓					64
F14	Fast-growth-high-yield forest construction project	SFA Opinions on Fast-growth-high-yield Forest Projects Development, Lin Dai Fa [2005] No. 129	国家林业局关于加快速生丰产林基地工程建设的若干意见, 林贷发 [2005] 129号	F-78		✓	✓				64
F14	Same as above	SFA Interim Rule on the Development of Fast-growth-high-yield Forest Projects (1986)	林业部关于速生丰产用材林基地建设若干问题的暂行规定 (1986)	F-37		✓	✓				64

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ID	Name of the program	Legal authority in English	Legal Authority in Chinese	Exhibit No	Sources of identification						Referenced in Report at Page
					1	2	3	4	5	6	
F15	Loan interest subsidy for plantation development	Resolution by the CCPCC and State Council on Accelerating the Development of the Forestry Industry, Zhongfa [2003] No. 9	中共中央，国务院关于加快林业发展的决定，中发 [2003] 9 号; (06-25-2003)	F-1		✓	✓	✓			65
F15	Same as above	Circular of Ministry of Finance Regarding the Issuance of Fund Management Method of Financial Interest Subsidy of Central Government of the Loan of Capital Construction, Caidian [2003] No. 421	财政部关于印发《基本建设贷款中央财政贴息资金管理暂行办法》的通知，财建[2003]421 号	F-32		✓	✓	✓			65
F16	Reduction of tax and fees and import tariff for wood products	Resolution by the CCPCC and State Council on Accelerating the Development of the Forestry Industry, Zhongfa [2003] No. 9	中共中央，国务院关于加快林业发展的决定，中发 [2003] 9 号; (06-25-2003)	F-1			✓				66
F16	Same as above	MOF Notice on VAT Rebate Rate Adjustment Cai Shui [2003] No. 222	财政部，国家税务总局关于调整出口货物退税率的通知，财税[2003]222 号	F-23			✓				66
F17	The pulp/paper development projects	The 10 th 5-year Plan	第十个五年规划	F-25			✓				67

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ID	Name of the program	Legal authority in English	Legal Authority in Chinese	Exhibit No	Sources of identification						Referenced in Report at Page
					1	2	3	4	5	6	
F18	Loan interest subsidies for technology renovations	Unknown	Unknown	F-9			✓				68
F19	Discounted loans for wood processing projects	Unknown	Unknown	F-9			✓				68
F20	Expedited foreign investment approval process	N/A	N/A	F-9			✓				68
F21	Refund of VAT for products produced with fuel wood and other low-valued wood or wood residuals	Circular of Ministry of Finance and State Administration of Taxation Regarding the VAT Favorable Policy of the Comprehensively-used Product Produced and Processed with the Three Residues and Small Firewood Materials as Raw Materials, Cai Shui [2001] No. 72	财政部、国家税务总局关于以三剩物和次小薪材为原料生产加工的综合利用产品增值税优惠政策的通知, 财税[2001]72号	F-29			✓	✓	✓		74

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ID	Name of the program	Legal authority in English	Legal Authority in Chinese	Exhibit No	Sources of identification						Referenced in Report at Page
					1	2	3	4	5	6	
F22	Loan interest assistance	Circular of Ministry of Finance Regarding the Issuance of Fund Management Method of Financial Interest Subsidy of Central Government of the Loan of Capital Construction, Cai Jian [2003] No. 421.	基本建设贷款中央财政贴息资金管理 办法 2003 421	F-32			✓	✓			75

ID numbers:

G-series: General programs which are not limited to agricultural entities.

F-series: Programs that specifically apply to the forestry industry.

Sources of Identification:

- 1:** This column identifies the number of the subsidy program listed in China's SCM Notification. *See* People's Republic of China: *New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement*, G/SCM/N/123/CHN (13 April 2006).
- 2:** China's State Forestry Administration (SFA) website.
- 3:** AF&PA, China's Subsidization of its Forest Products Industry (July 2004).
- 4:** CBSA, *Laminate Flooring from China* (June 1, 2005).
- 5:** DOC, *Coated Free Sheet Paper from China*, 72 Fed. Reg. 17484 (April 9, 2007) (Amended Preliminary CVD Determination).
- 6:** U.S. Request for Consultation re Chinese Subsidies, WT/DS358/1/Add.1 (2 May 2007).

I. OVERVIEW OF CHINA'S WOOD AND WOOD PRODUCTS INDUSTRY AND THE NEW INDUSTRY POLICY

A. CHINA'S WOOD AND WOOD PRODUCTS INDUSTRY

The wood and wood products (or forestry) industry is deemed to be a basic industry in China. The government has not only assigned it the function of supplying wood products but also of managing the national forests and preserving the forestry ecosystem. In this report, the industry is roughly divided into three segments: timber production, the pulp and paper industry, and the solid wood products industry. Each of these segments is separately discussed herein.

1. Timber Production

Until recently, forests in China had been converted to farm land to produce food for the growing population. As a result, the nation was left with very limited forest resources. China's per capita forest acreage ranks 119th among nations.^{4 5} In the summer of 1998, a huge flood causing extensive loss of life gave the Chinese leadership a loud and unpleasant wake-up call to the nation's deforestation problem, which was believed to be the main contributing factor to the flood. As a result, the government swiftly banned logging in the state-owned forests to save the ecosystem from further degradation.⁶ Massive afforestation programs were launched shortly thereafter, as discussed in detail below. The logging ban caused the nation's already diminishing timber production capacity to drop dramatically overnight. Demand, on the other hand, has been increasing quickly with the expansion in economic activities occurring in the country, creating a

⁴ Nan Li, *Integrating Plantation and Paper Production – The Only Viable Development Strategy for China's Paper Industry*, ECONOMIC DAILY (August 12, 2005). See Exhibit F-7.

⁵ China's total forested area is estimated at 175 million ha, with the forest stocking volume at 12,456 million cubic meters. See USDA, Foreign Agricultural Service, *PRC Solid Wood Products Annual, 2006*, GAIN Report CH6052 (July 13, 2006) at 3. See Exhibit F-6.

⁶ See *Several Opinions of the CCPC and State Council on Disaster Recovery, Major Bodies of Water Management and Irrigation Works Development*, Zhong Fa [1998] No. 15. See Exhibit F-8.

huge gap between domestic timber supply and demand. This gap will only grow larger in the years ahead.

Construction timber provides an example of the gap in supply and demand. In 2005, domestic production was 170 million cubic meters. Demand, however, estimated at 230 million cubic meters, far exceeded the domestic capacity.⁷ It is anticipated that, by 2015, the gap will increase to 140 million cubic meters.⁸ The increased domestic consumption of timber has been satisfied by imports. The volume of imports tripled between 1997 and 2005. Total imports measured by Round-Wood Equivalent (RWE) rose from 40 million cubic meters in 1997 to 134 million cubic meters in 2005, with Russia being the largest supplier, providing 70 percent of the softwood logs.⁹

In recent years, in addition to imports, China has been relying on plantation development to meet its future demand for timber. China has the largest plantation development program in the world (discussed *infra*). In 2005 alone, new plantations covering an area of 3,647,900 hectares (“ha”) have been developed,¹⁰ with 17 percent of these newly-developed plantations being designated for future timber production.¹¹ The majority of the new plantations, 73 percent

⁷ See SDRC, *The Tenth Five-Year and 2010 Special Plan for the Construction of National Forestry and Papermaking Integration Project* (2004) at 3. An English translation of this Plan is provided in NewPage Corporation’s *Petition for the Imposition of Countervailing Duties in the Matter of Coated Free Sheet Paper from China, Indonesia, And South Korea* (October 30, 2006) at Exhibit III-6, which is reproduced in Exhibit F-2.

⁸ *Id.* See Exhibit F-2.

⁹ Chinese imports of Russian logs have increased from 0.95 million cubic meters in 1997 to 20 million cubic meters in 2005. The value of imported wood raw materials and products rose from USD \$6.4 billion in 1997 to USD \$16.4 billion in 2005. See Andy White, *et al.*, *China and the Global Market for Forest Products: Transforming Trade to Benefit Forests and Livelihoods* (March 2006) at 11. See Exhibit F-10.

¹⁰ USDA, Foreign Agricultural Service, *PRC Solid Wood Products Annual, 2006*, GAIN Report CH6052 (July 13, 2006) at 3. See Exhibit F-6.

¹¹ *Id.* See Exhibit F-6.

of them, were for desertification and soil erosion prevention purposes. The total area of plantations developed in recent years was estimated to have reached 55 million ha by the end of 2005. Considering the government support plans already laid out, further rapid expansion of plantations is to be expected in the years ahead.¹²

In addition to the lack of adequate supply of domestic wood resources, China's wood products industry is suffering from technology obsolescence which not only causes low productivity but also gives rise to huge pollution problems. This is especially true with regard to the pulp and paper industry.

2. The Pulp and Paper Industry

The pulp and paper industry is, by far, the most important among the wood products industries in China. Domestic paper consumption has increased rapidly in recent years, from 35.75 million metric tons in 2000 to 54.39 million metric tons in 2004.¹³ Production grew from 30.5 million metric tons to 49.5 million metric tons for the same period.¹⁴ China is now the second largest paper and paper board producer in the world, with most of its production for domestic consumption.¹⁵

Notwithstanding its recent growth, China's pulp and paper industry remains fragmented. It is comprised of thousands of predominantly small-scale mills with production technology dating back to the 1960s and the 1970s. In China, the average paper production capacity per mill

¹² *Resolution by the Chinese Communist Party Central Committee and the State Council on Accelerating the Development of Forestry*, Zhong Fa [2003] No. 9. See Exhibit F-1.

¹³ China Paper Association, *Directory of China Paper Industry 2005-2006* (March 2006).

¹⁴ *Id.*

¹⁵ UNECE, *FAO Forest Products Annual Market Review 2005-2006* (October 2006) at 19.

is only 12,000 metric tons, while mills in the rest of the world enjoy an average production capacity of 80,000 metric tons.¹⁶ The production technology employed by the majority of the industry is outdated. It is based on non-wood pulp, processed from rice straw and other agricultural residues. Compared with modern paper production technology, which is based on wood pulp, China's non-wood-based technology causes much more pollution and is not capable of producing high grade paper.

The government has been seeking ways to modernize and expand the pulp and paper industry in order to meet domestic demand and to reduce pollution. Approximately four thousands small-scale non-wood pulp mills have been closed.¹⁷ Wood pulp and production equipment were imported in large quantity to jump start the domestic production of wood fiber-based high-end paper. In 2001, the industry spent USD \$11.7 billion on wood pulp imports, making wood pulp China's third largest import category, behind only crude oil and steel.¹⁸

After some initial trial and adjustment, the State Development and Reform Commission (SDRC) issued a refined policy statement on January 6, 2004 in a publication entitled *The Tenth Five-Year and 2010 Special Plan for the Construction of National Forestry and Papermaking Integration Project*.¹⁹ The guideline identified the following major problems facing the paper industry at the time.

¹⁶ See SDRC, *The Tenth Five-Year and 2010 Special Plan for the Construction of National Forestry and Papermaking Integration Project* (2004) at 2. See Exhibit F-2.

¹⁷ Dequan He and Christopher Barr, *China's Pulp and Paper Sector: An Analysis of Supply and Demand and Medium Term Projections*, INTERNATIONAL FORESTRY REVIEW, Vol.6 (3-4) (2004) at 254, 262.

¹⁸ Nan Li, *Integrating Plantation and Paper Production – The Only Viable Development Strategy for China's Paper Industry*, ECONOMIC DAILY (August 12, 2005). See Exhibit F-7.

¹⁹ See SDRC, *The Tenth Five-Year and 2010 Special Plan for the Construction of National Forestry and Papermaking Integration Project* (2004). See Exhibit F-2.

- (1) The industry remained so fragmented that it had 3500 paper mills across the nation.
- (2) Most of the paper mills were still using obsolete production technology from the 1960s and the 1970s, and were primarily based on outdated and highly-polluting non-wood fiber production methodology. The modern and more environmentally-friendly wood fiber technology had yet to be widely introduced in the industry; and the nation had yet to develop a domestic wood pulp production capacity. Wood pulp currently accounted for a mere 6 percent of the total domestic pulp production.
- (3) The prevalent production method -- non-wood fiber-based paper production -- is both wasteful and heavily polluting. Non-wood fiber-based paper production poses a major environmental threat, accounting for one-third of the total industry Chemical Oxygen Demand (COD) discharge.
- (4) The industry is dependant on imports for technology and equipment; domestic investment in R&D has been low; and the enterprises lack technological innovation capacity.²⁰

The guideline calls for accelerating the transformation of the industry from the traditional non-wood pulp to the modern wood pulp-based paper production method, so as to reduce water pollution and improve product quality. To achieve this, the guideline saw the need to build up sufficient domestic wood pulp production capacity. It anticipates that by 2010, China will need new paper production capacity of 5.6 million metric tons.²¹ To support this new addition of paper production capacity, China in turn will need to add 4.35 million metric tons of wood pulp production capacity and 1.2 million metric tons of bamboo-based pulp capacity.²² A total investment of RMB 157.3 billion would be needed for this capacity building.²³

²⁰ See *id.* at 2. The Guideline for the Paper Industry revealed that, as compared to modern paper production technology based on wood pulp, non-wood pulp paper production in China consumes six times the water, and discharges twenty-three times the COD pollutant. See Exhibit F-2.

²¹ *Id.* at 10. See Exhibit F-2.

²² *Id.* See Exhibit F-2.

²³ *Id.* at 17. See Exhibit F-2.

Considering the limited forest resources in China, the guideline calls for development of fast-growing varieties in plantations to meet the demand for commercial timber. The guideline envisions government support for this plantation development. It contemplates that, at the initial stage, in addition to laying down a development strategy for the industry, it would be necessary for the government to provide direct investment or subsidized loans to support plantation development. This is necessary because, as the AF&PA report pointed out:

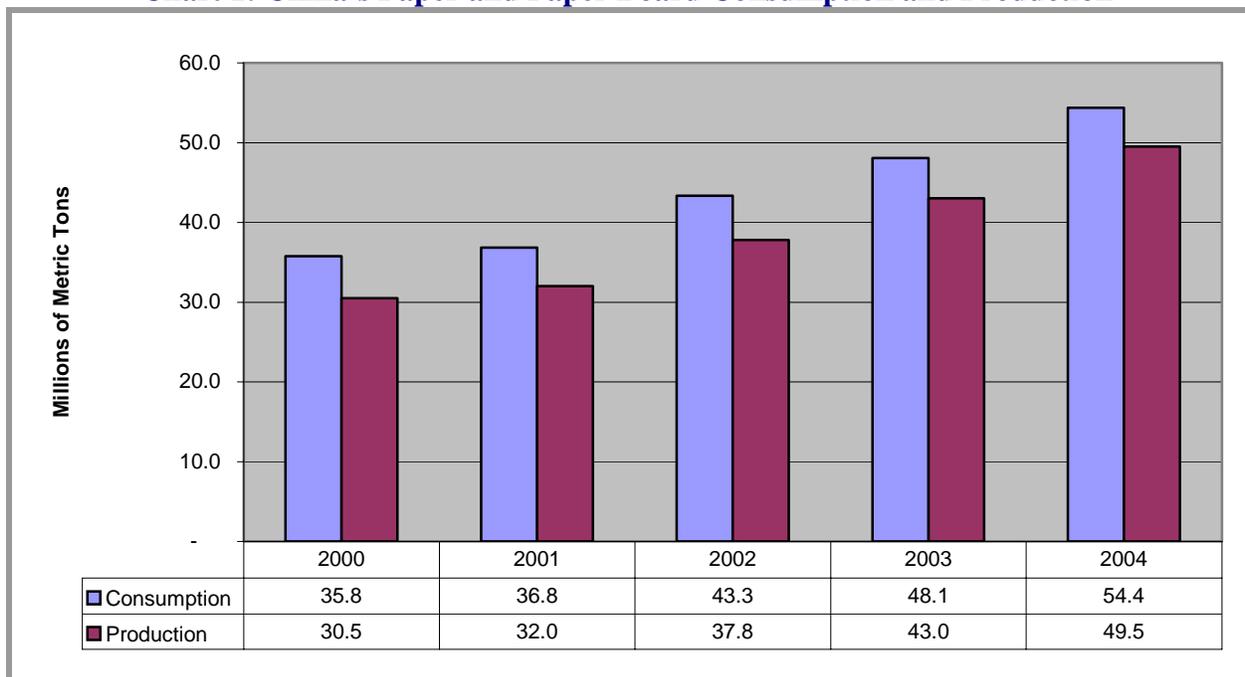
Domestic companies are, for the most part, simply unwilling to invest in plantations because they cannot absorb the cost associated with waiting for plantation crops to mature before harvesting begins.... At the same time, domestic banks are unable ... and/or unwilling ... to provide loans to a majority of domestic companies that propose to invest in plantation projects.²⁴

In addition, the guideline contemplates a timber-use tax at the rate of RMB 10-20 per cubic meter. The funds collected from the tax are to be used exclusively to support plantation development. Finally, the guideline calls for favoring domestically-produced paper and pulp production equipment.²⁵

²⁴ AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 19. See Exhibit F-9.

²⁵ See SDRC, *The Tenth Five-Year and 2010 Special Plan for the Construction of National Forestry and Papermaking Integration Project* (2004) at 19. See Exhibit F-2.

Chart 1: China's Paper and Paper Board Consumption and Production



Source: The Directory of China Paper Industry (2005-2006)

3. The Solid Wood Products Industry

The solid wood products industry was reported to have 3,868 sizeable enterprises²⁶ -- SOEs, and big and medium private- or foreign-invested enterprises with annual sales over RMB 2 million -- providing 690,000 jobs, with an annual turnover reaching USD \$46.78 billion.²⁷ The problems facing the industry include: (1) an insufficient domestic supply of timber, which drives up the production cost; (2) a lack of well-defined legal rights with regard to land ownership and wood usage rights which hinders private and foreign investment; (3) an industry that is too

²⁶ The term “sizeable enterprises” refers to state-owned enterprises or private productive enterprises with annual revenue over RMB 2 million. When including private enterprises with annual revenue below RMB 2 million, the overall number of enterprises reaches as many as 30,000. See AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 34. See Exhibit F-9.

²⁷ *Id.* See Exhibit F-9.

fragmented to be efficient; and (4) a low level of technology.²⁸ Notwithstanding these problems, the industry in recent years has seen a very rapid expansion of production capacity.

Wood panel production capacity has been increasing 12.2 percent annually since 1997. There were approximately 6,000 plywood enterprises in China in 2004.²⁹ Domestic plywood production increased from 2.6 million cubic meters in 1994 to 21 million cubic meters in 2004. China is now the world's largest plywood producer.³⁰ As plywood production has grown much faster than domestic demand in China, exports have also grown. By 2001, China became a net exporter of plywood. By 2005, China's plywood exports increased to over 10.7 million cubic meters Round Wood Equivalent, making China the largest exporter of plywood in the world.³¹

Chinese exports of fiberboard and particle board are insignificant. China has over 400 production lines for medium-density fiberboard and country registered 7.67 million cubic meters of fiberboard production in 2002, predominantly for medium-density fiberboard. China's particle board production capacity reached 3.69 million cubic meters in 2002, while domestic consumption was 4.29 million cubic meters for the year.³²

B. TRADE FLOWS

The overall trade flows for the past ten years presents a picture in which there has been a huge increase of imports into China of raw forest products accompanied by the even more rapid increase of exports of processed wood products from China to Europe and the United States.

²⁸ *Id.* See Exhibit F-9.

²⁹ *Id.* at 36. See Exhibit F-9.

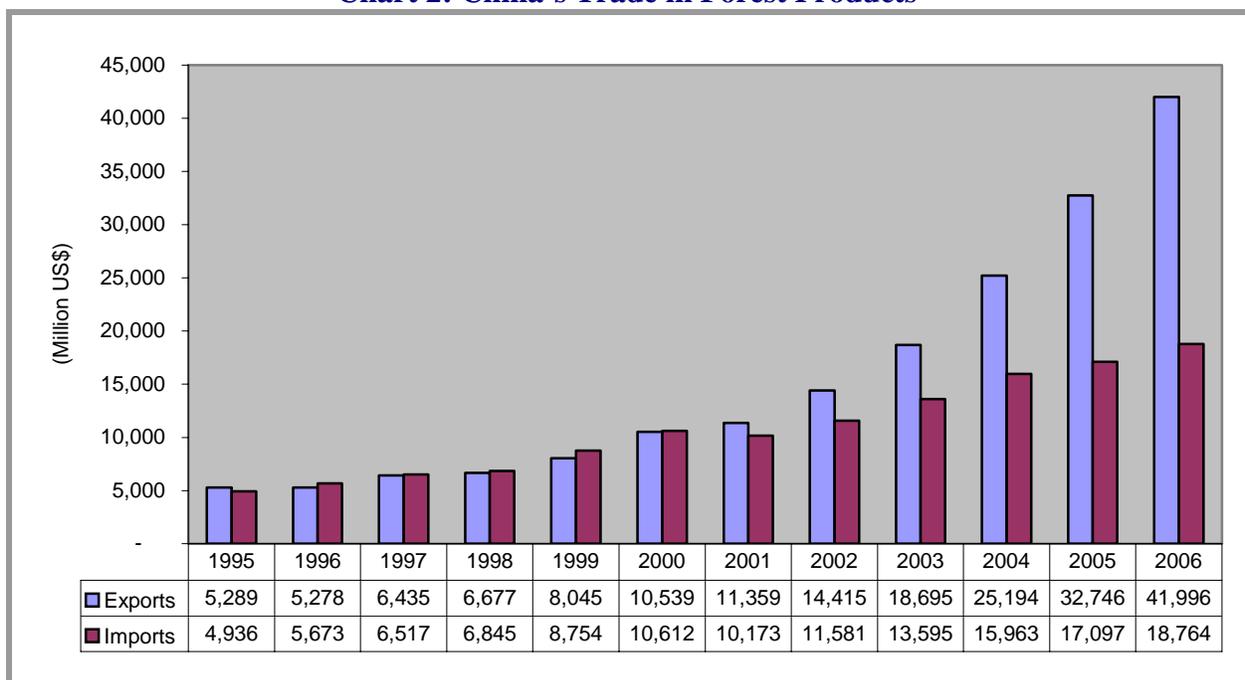
³⁰ See Andy White, *et al.*, *China and the Global Market for Forest Products: Transforming Trade to Benefit Forests and Livelihoods* (March 2006) at 11 (2006). See Exhibit F-10.

³¹ *Id.* See Exhibit F-10.

³² AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 36. See Exhibit F-9.

With fast growth of production capacity, China has become a processing center in the global supply chain of wood products. For instance, Chinese factories supply IKEA with one-fourth of its global stock.³³ This is also demonstrated by the fact that the export volume of processed forest products is equivalent to 70 percent of the total volume of timber imports.³⁴

Chart 2: China's Trade in Forest Products



Source: World Trade Atlas, China Customs

The major processed forest products exported by China are furniture, panels and, to a lesser extent, wood chips. The three products accounted for 80 percent of China's total non-paper wood products exports.³⁵ China is now the largest furniture exporter, accounting for 30

³³ Peter S. Goodman and Peter Finn, *Corruption Strains Timber Trade*, THE WASHINGTON POST (April 1, 2007) at A01. See Exhibit F-14.

³⁴ Andy White, *et al.*, *China and the Global Market for Forest Products: Transforming Trade to Benefit Forests and Livelihoods* (March 2006) at 4. See Exhibit F-10.

³⁵ *Id.* at 10. See Exhibit F-10.

percent of the world's furniture trade. Export volume increased from 3.2 million cubic meters RWE in 1997 to 12.7 million cubic meters RWE in 2005, recording an average annual increase of 19 percent. China is also the world's largest exporter of wood panels. The export volume reached 10 million cubic meters in 2005.³⁶ For the wood products industry as a whole, the total value of exports rose from USD \$3.6 billion to USD \$17.2 billion between 1997 and 2005.

Exports of paper have been increasing in recent years as well. Paper exports now account for 25 percent of the total wood products exports from China.³⁷

Imports of wood products have grown almost as fast as exports. During the 1997-2005 period, China's imports of raw wood material and wood products rose at a 16 percent annual growth rate, from USD \$6.4 billion to USD \$16.4 billion in value, and from 40 million cubic meters RWE to 134 million cubic meters in volume.³⁸ Russia supplies 75 percent of China's softwood logs, which totaled 20 million cubic meters in 2005.³⁹ It is anticipated that China's imports of wood products are likely to double by 2015, based on the estimate that China's domestic production of industrial round wood is unlikely to exceed 200 million cubic meters by 2015.⁴⁰

³⁶ *Id.* See Exhibit F-10.

³⁷ *Id.* See Exhibit F-10.

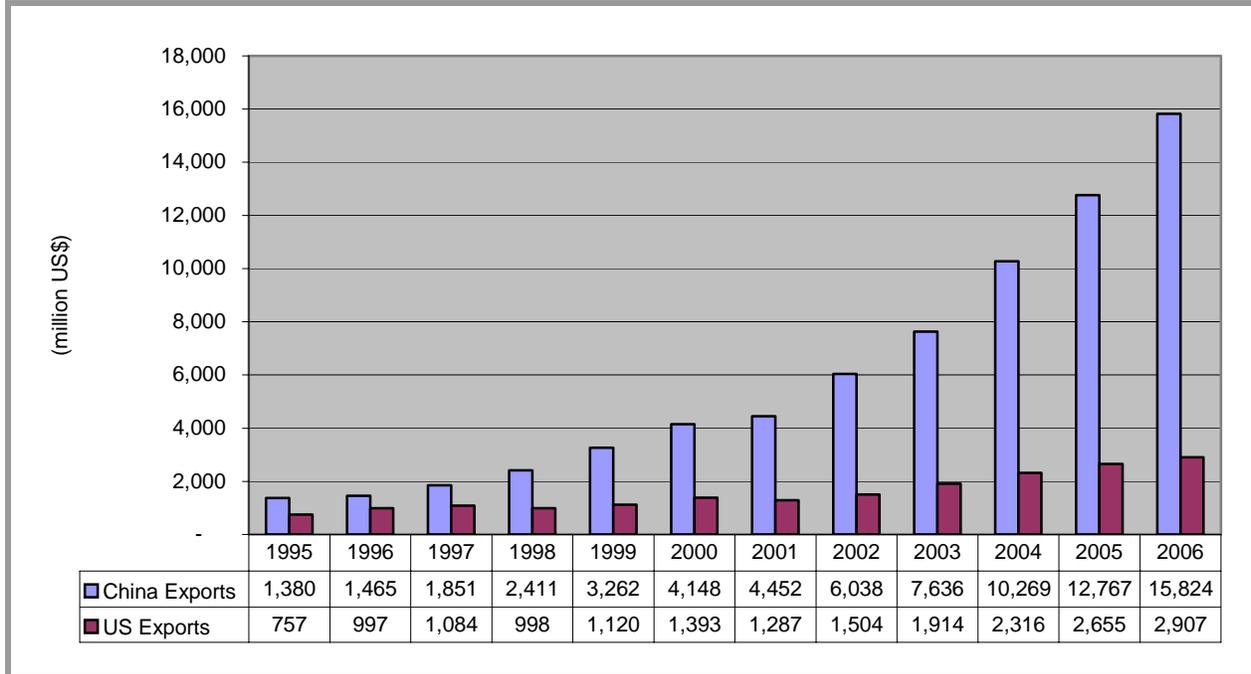
³⁸ UNECE/FAO, *Forest Products Annual Market Review, 2005-2006* (2006) at 19.

³⁹ *Id.*

⁴⁰ See Andy White, *et al.*, *China and the Global Market for Forest Products: Transforming Trade to Benefit Forests and Livelihoods* (March 2006) at 6. See Exhibit F-10.

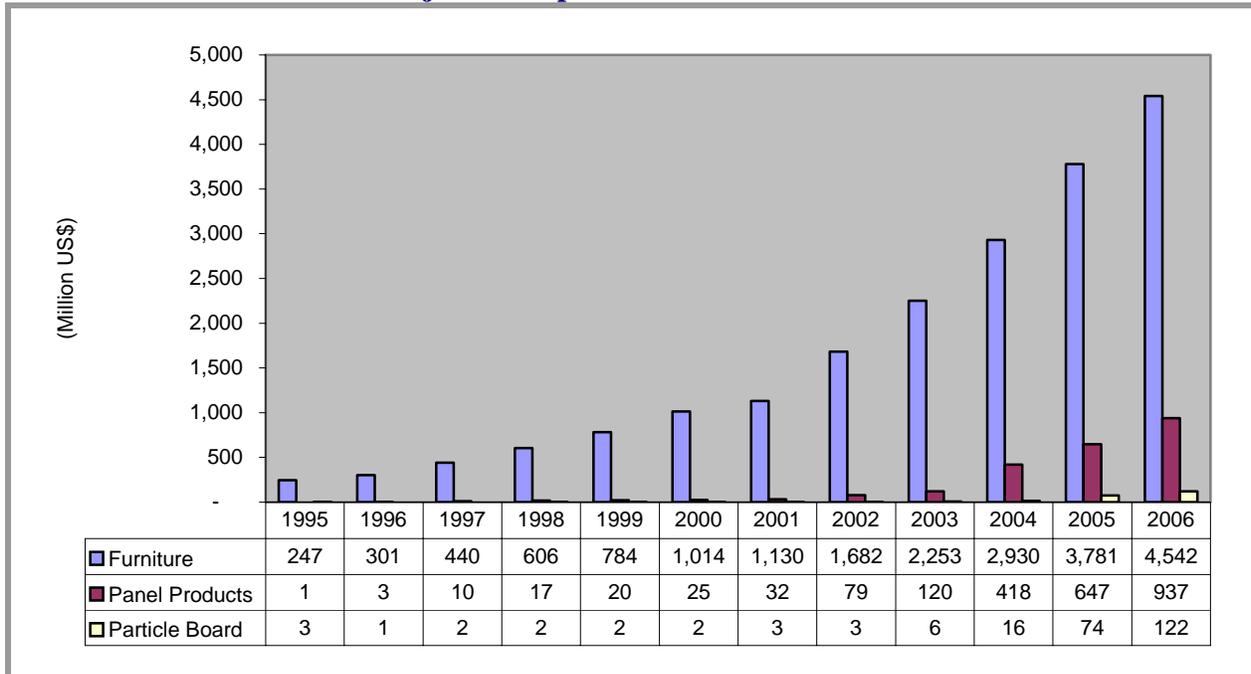
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Chart 3: US-China Trade in Wood Products



Note: Aggregate value for products under HS chapter 44, 47, 48 and 94.
Source: World Trade Atlas, China Customs

Chart 4: Major US imports of Chinese Wood Products



Source: U.S. Bureau of Census Statistics.

C. THE GOVERNMENT INDUSTRY POLICY

China's forestry industry policy embraces two basic goals: ecosystem preservation and wood products supply. Alarming, the 1998 flood revealed to the leadership the severity of the degradation of China's ecosystem. Their first reaction was to ban logging in the state-owned natural forests. Other programs were rolled out in the following years in an effort to restore the nation's forestry resources. In 2003, the government consolidated the then existing policies in *Resolution by the Chinese Communist Party Central Committee and the State Council on Accelerating the Development of Forestry* ("Joint Resolution").⁴¹

The preamble to the Joint Resolution states that safeguarding the ecosystem is the common theme for the human race in the 21st Century; that China's forestry industry shall perform the dual duties of ecosystem restoration and timber production; that China's sustainable development strategy requires the forestry industry to undergo an unprecedented transformation which will have a lasting impact; and that safeguarding the forestry ecosystem must take priority over production of timber products.⁴²

The Joint Resolution lists the following as the main tasks for the nation's forestry industry:

- To excel in forestry management;
- To develop new plantations;
- To return more farmland to forests;
- To optimize the structure of the forestry industry;
- To restore the forestry ecosystem;

⁴¹ *Resolution by the Chinese Communist Party Central Committee and the State Council on Accelerating the Development of Forestry*, Zhong Fa [2003] No. 9. See Exhibit F-1.

⁴² *Id.* at 1. See Exhibit F-1.

- To increase the supply of wood products; and
- To raise the income level of the industry employees.

The Joint Resolution also sets the goal for China's afforestation effort: the forest density of the nation will be restored, from 19 percent of the land area to 26 percent by 2050.⁴³

With regard to government support to the forestry industry, the Joint Resolution calls for: (1) an increase in direct government investment in the industry; (2) the provision of financial support; and (3) the reduction or elimination of taxes/fees on the industry. In addition, the Joint Resolution requires that government, at each level, (1) make priority budgetary allocations for development costs and management expenses for public utility forests (*Gongyi Lin*), (2) invest in important forestry infrastructure projects, and (3) provide compensation funds for forests being designated as public utility forests.⁴⁴ Moreover, the government, at each level, shall support projects to develop fast-growth-high-yield plantations. Specifically, the government will continue to provide long-term low-interest loans and may subsidize the interest payments. Financial institutions shall provide favorable loans to individuals undertaking afforestation projects. Furthermore, efforts will be made to reduce the burden of tax and administrative fees on the industry. Specialty crop taxes applicable to log and bamboo shall be phased out.⁴⁵ Public funds will be made available to grass root forest management units.⁴⁶

⁴³ *Id.* at 3. See Exhibit F-1.

⁴⁴ Under the Forestry Law, forests in China are classified into two categories: forests for commercial use (*Shangyong Lin*), and forests for public utility (*Gongyi Lin*). Logging in public utility forests is restricted. In return, the government distributes compensation funds to the enterprises that manage these forests and are otherwise entitled to the timbers from the forests.

⁴⁵ China abolished its specialty crops tax in 2005.

⁴⁶ *Resolution by the Chinese Communist Party Central Committee and the State Council on Accelerating the Development of Forestry*, *Zhong Fa* [2003] No. 9 at para. 20. See Exhibit F-1.

II. GOVERNMENT SUPPORT PROGRAMS AVAILABLE TO THE WOOD AND WOOD PRODUCTS INDUSTRY

At each level, the Chinese government actively engages in economic development. Government agencies have developed many industrial support programs and quite a few of them are available to companies in the forestry industry. The support programs normally take the form of preferential tax treatment, loan interest subsidies or direct grants. They are initiated and administered by a myriad of government agencies, national as well as provincial and local.

The forestry industry is administered independently from agriculture. The State Forestry Administration (SFA) has principal responsibility for administration of the forestry industry. This structure is similar to the differentiation maintained within the WTO system where wood products are not covered by the Agriculture Agreement. On the other hand, many enterprises in the two segments are within the realm of the “three-rural issue” in the sense that measures designed to address the “three-rural issue” are applicable to these enterprises. Indeed, as reviewed below, many programs identified in the agriculture report are equally applicable to the forestry industry when specific criteria are met.

In April 2006, China submitted its first notification to the World Trade Organization’s (WTO) Committee on Subsidies and Countervailing Measures (“SCM Notification”) which listed seventy-eight (78) subsidy programs.⁴⁷ Eight of the programs are expressly applicable to the forestry industry. Many other listed programs are potentially usable by forest product enterprises. In addition, China is currently undertaking the world’s largest afforestation program with public funds, commonly known in China as the Six Grand Afforestation Projects. Although

⁴⁷ See People's Republic of China: *New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement*, G/SCM/N/123/CHN (13 April 2006). See Exhibit F-3.

its primary purpose is for environmental protection, the program promotes China's timber production capacity and may result in cheaper timber for downstream industries. In other instances, specific promotion programs are rolled out to upgrade the domestic industries.

A. PROGRAMS IDENTIFIED BY CHINA'S SCM NOTIFICATION

Among the seventy-eight (78) programs listed in China's first SCM Notification, eight (8) programs are expressly applicable to the forestry industry. However, many more of the programs listed in the SCM Notification are potentially applicable to enterprises in the forestry industry.

1. Programs Specifically Applicable to Forestry Enterprises

a. FIEs Income Tax Reduction for Royalty Received for Supplying Forestry Production Technology (F1)

Program No. 1 (I) in China's SCM Notification provides an income tax reduction for royalties received by foreign companies or foreign-invested enterprises (FIEs) "for supplying technology in scientific research, exploitation of energy resources, development of the communications and transportation industries, agricultural, forestry and animal husbandry production, and the development of important technologies."⁴⁸ Qualified royalties are levied at the reduced income tax rate of 10 percent.⁴⁹ If the underlying technology is certified by MOFCOM as advanced technology, income tax is exempted entirely.⁵⁰ This tax benefit is available to FIEs only when the transaction that generates the royalty income is not related to the

⁴⁸ See People's Republic of China: *New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement*, G/SCM/N/123/CHN (13 April 2006) at 3. See Exhibit F-3.

⁴⁹ See G/SCM/N/123/CHN at 2 (item I), citing "Preferential tax policies for foreign-invested enterprises" and "State Council Circular Guo Fa No. 37 of 2000." See Exhibits F-3 and F-13.

⁵⁰ See G/SCM/N/123/CHN at 3. See Exhibit F-3.

FIE's productive operation in China. An enterprise is qualified as an FIE if the foreign investors contribute at least an aggregate of 25 percent of the registered capital. The policy objective of this program is to increase the importation of advanced technology in forestry production. It should be noted that the FIEs Income Tax Law is scheduled to be superseded by January 1, 2008, with the existing benefit to be phased out in 5 years.⁵¹

b. Preferential Tax Policies for Certain Forestry Enterprises (F2)

Program No. 30 (XXX) in the SCM Notification allows an income tax exemption for enterprises that are engaged in plantation development, seeds or seedling cultivation, or preliminary processing of forestry products. This program is available to both FIEs and domestic-invested enterprises (DIEs), and is aimed at reducing the tax burden on the forestry industry, and thus encouraging investment in the industry.⁵²

c. Fund for Construction of Small Forests in Rural Areas (G33 & F3)

Program No 46 (XLVI) in the SCM Notification provides direct grants to individuals and enterprises that engage in the construction of projects deemed closely related to the welfare of the rural population. The qualified projects include, *inter alia*, rural water supply, soil conservation, small forest, *et cetera*. The total annual budgetary allocation was RMB 100 million for the years 2001 through 2004.⁵³

⁵¹ *Corporate Income Tax Law of the People's Republic of China* (March 13, 2007). See Exhibit F-15.

⁵² See G/SCM/N/123/CHN at 34-35 (item XXX), citing "Preferential tax policies for the enterprises engaged in forestry" and "MOF Circular Cai Shui No.171 of 2001." See Exhibits F-3 and F-12.

⁵³ See G/SCM/N/123/CHN at 52 (item XLVI), citing "Fund for construction of small irrigation facilities in rural areas" and "MOF Circular Cai Ban Nong No. 74 of 2001." See Exhibits F-3 and F-16.

d. Special Fund for Projects on the Protection of Natural Forestry (F4)

Program No. 51 (LI) in the SCM Notification is a program under which funds are provided to state-owned forestry enterprises to offset the negative impact on these enterprises and their employees from the logging ban or timber production restrictions, as the case may be. A large portion of the fund is used to assist laid-off workers. For the years 2001 through 2004, a total of RMB 24.45 billion was allocated.⁵⁴

e. Cash Subsidy for Returning Farmland to Forests (F5)

The government launched this program in 2001 to give a cash subsidy to farmers whose farmland was converted to forests. During the four years between 2001 and 2004, a total of RMB 6.049 billion was distributed to the farmers.⁵⁵

f. Compensation Fund for Forestry Ecological Benefits (F6)

This Fund is an important component of the compensation provided as a result of the government's policy of restricting logging. The government provides funds at the rate of RMB 5 per mu⁵⁶ (equal to USD \$10 per ha) to entities that manage the key national forests. These entities formerly profited from logging in the forests that they are designated to manage. This Fund distributed a total of RMB 5 billion between 2001 and 2004.⁵⁷

⁵⁴ See G/SCM/N/123/CHN at 57-58 (item LI), *citing* "Special fund for projects on protection of natural forestry" and "MOF Circular Cai Nong No. 151 of 2000." See Exhibits F-3 and F-77; *see also* Exhibit F-12.

⁵⁵ See G/SCM/N/123/CHN at 58-59 (item LII), *citing* "Cash subsidy for returning cultivated land to forests" and "State Council Circular Guo Fa No. 10 of 2002." See Exhibits F-3 and F-17.

⁵⁶ The "mu" is a Chinese measure of land area. One mu is equal to 0.067 hectares, and 15 mu equals 1 hectare.

⁵⁷ See G/SCM/N/123/CHN at 59-60 (item LIII), *citing* "Compensation fund for forestry ecological benefits" and "MOF Circular Cai Nong No. 169 of 2004." See Exhibits F-3 and F-18.

g. Loan Interest Subsidy for Afforestation Program Closely Related to Desertification Prevention Purpose (F7)

Program No. 54 (LIV) of the SCM Notification provides direct grants to enterprises in an amount equal to certain qualified interest payments for loans obtained to conduct afforestation projects. Only those afforestation projects that effectively prevent desertification qualify for this program. During the four-year period between 2001 and 2005, a total of RMB 576 million was distributed.⁵⁸

h. Subsidy to Prevent and Control Forest Pest and Disease (F8)

Program No. 55 (LV) of China's SCM Notification allows funds to be distributed to individuals and enterprises in the forestry industry for the purpose of controlling and preventing forest disease and controlling hazardous creatures. A total of RMB 338 million was distributed between 2001 and 2004.⁵⁹ The program has now been discontinued.⁶⁰

i. VAT Exemption for Grain Distributed for Compensating Returning Farmland to Forests (G40)

Program No. 63 (LXIII) in China's SCM Notification provides for compensation to farmers for giving up their farmland under the return-farmland-to-forests program.⁶¹ Under this program, the government has distributed cash and grain to the affected farmers. Grain

⁵⁸ See G/SCM/N/123/CHN at 61 (item LIV), *citing* "Interest discount for loans for the purpose of desertification prevention in forestry" and "MOF Circular Cai Nong No. 137 of 2002." See Exhibits F-3 and F-19.

⁵⁹ See G/SCM/N/123/CHN at 62 (item LV), *citing* "Subsidy for prevention from and control of pest and disease in forestry" and "MOF Circular Cai Nong No. 69 of 2002." See Exhibits F-3 and F-54.

⁶⁰ See G/SCM/N/123/CHN at 63. See Exhibit F-3.

⁶¹ See G/SCM/N/123/CHN at 71-72 (item LXIII), *citing* "Preferential tax policies for the relief grain and disaster relief grain, compensation grain for returning cultivated land to forests and to grass land, and the grain rations for the migrants from the reservoir areas" and "MOF Circular Cai Shui Zi No. 198 of 1999" and "SAT Circular Guo Shui Fa No. 131 of 2001." See Exhibits F-3 and F-20.

distributed to the farmers is exempted from the value-added tax (VAT) in order to lower the cost for this compensation program. It should be noted that this is just one of the tax measures that support the return of farmland to forests project and other afforestation programs.

2. Programs Potentially Useable by Forestry Enterprises

In addition to the eight programs listed above that are specifically applicable to the forestry industry, many other programs listed in China's SCM Notification are potentially usable by companies in the wood products industry. While this report does not discuss each of these programs in detail, a table summarizing these programs is provided on the following pages.

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Programs Listed In China's SCM Notification That Are Potentially Usable By Companies In The Wood and Wood Products Industry					
ID	SCM No.	Subsidies	Legislation for the Listed Subsidies		
			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G1	1	Preferential tax policies for foreign-invested enterprises	N/A	Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises (The Tax Law)	中华人民共和国外商投资企业和外国企业所得税法
G1	1	Same as above	N/A	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprise	中华人民共和国外商投资企业和外国企业所得税法实施细则
G2	2	Preferential tax policies for foreign-invested export enterprises	N/A	Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises (The Tax Law)	中华人民共和国外商投资企业和外国企业所得税法
G2	2	Same as above	N/A	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprise	中华人民共和国外商投资企业和外国企业所得税法实施细则
G3	6	Preferential tax policies for enterprises with foreign investment which are technology-intensive and knowledge-intensive	SAT Circular, Guo Shui Fa [1995] No. 139	Circular on the Preferential Tax Treatment to Foreign-Invested Companies That Are Technology- and Knowledge-Intensive	关于外商投资企业享受“两个密集型企业”税收优惠有关问题的通知
G3	6	Same as above	SAT Circular, Guo Shui Fa [2003] No. 135	SAT Circular on the Preferential Tax Treatment to Foreign-Invested Companies That Are Technology- and Knowledge-Intensive	国家税务总局关于外商投资企业享受“两个密集型”税收优惠政策有关问题的通知 2003

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ID	SCM No.	Subsidies	Legislation for the Listed Subsidies		
			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G4	7	Preferential tax policies for enterprises with foreign investment in the border cities	SAT Circular, Guo Shui Han Fa [1992] No. 1412	SAT Circular on Granting Preferential Tax Treatment to Foreign-Invested Companies in 12 Border Cities	国家税务总局关于明确黑河等十二个边境城市执行外商投资企业税收政策问题的通知
G5	8	Preferential tax policies for enterprises with foreign investment recognized as high or new technology enterprises established in the State high or new technology industrial development zones, and for advanced technology enterprises invested in and operated by foreign businesses	N/A	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则
G6	9	Preferential tax policies for enterprises recognized as high or new technology enterprises established in the State high or new technology industrial development zones	MOF Circular, Cai Shui Zi [1994] No. 001	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》

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			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G7	10	Preferential tax policies for enterprises with foreign investment established in special economic zones (excluding Shanghai Pudong area)	N/A	Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法
G7	10	Same as above	N/A	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则
G8	11	Preferential tax policies for enterprises with foreign investment established in the costal economic open areas and in the economic and technological development zones	N/A	Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法
G8	11	Same as above	N/A	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则
G9	12	Preferential tax policies for enterprises with foreign investment established in Pudong area of Shanghai	N/A	Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法

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ID	SCM No.	Subsidies	Legislation for the Listed Subsidies		
			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G9	12	Same as above	N/A	Rules for the Implementation of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises	中华人民共和国外商投资企业和外国企业所得税法实施细则
G10	13	Preferential tax policies for enterprises with foreign investment established in the Three Gorges of Yangzi River Economic Zone	MOF Circular, Cai Shui Zi [1995] No. 034	Circular on the Tax Policy for Relocation of Residents in the Three Gorges Area and Regional Development	关于长江三峡库区移民开发税收政策的通知
G11	14	Preferential tax policies in the western regions	State Council Circular, Guo Fa [2000] No. 33	Circular of the State Council on Several Policies on the Development of Western Regions	国务院关于实施西部大开发若干政策措施的通知
G11	14	Same as above	General Office of State Council Circular, Guo Ban Fa [2001] No. 73	The General Office of the State Council to Circulate the Circular of the State Council on the Implementation of New Policies for the Development of Western Regions	国务院办公厅转发国务院西部开发办关于西部大开发若干政策措施实施意见的通知
G11	14	Same as above	MOF Circular, Cai Shui [2001] No. 202	Circular on Preferential Tax Treatment for Western Regions Development Program	财政部、国家税务总局、海关总署关于西部大开发税收优惠政策问题的通知
G11	14	Same as above	SAT Circular, Guo Shui Fa [1999] No. 172	SAT Circular on Extending 15% Preferential Income Tax Rate for Three Years to Foreign-Invested Companies in Central and Western Regions.	国家税务总局关于实施对设在中西部地区的外商投资企业给予三年减按 15% 税率征收企业所得税的优惠的通知

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			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G12	15	Preferential tax policies for enterprises established in the poverty stricken areas	MOF Circular, Cai Shui Zi [1994] No. 001	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》
G13	16	Fiscal funds to alleviate poverty	MOF Circular, Cai Nong [2000] No. 18	Circular on the Distribution of "Interim Administrative Rules of the Fiscal Funds for Poverty Alleviation" and "Interim Administrative Rules of the Administration Fee for the Poverty Alleviation Projects"	关于印发《财政扶贫资金管理办法》(试行)和《财政扶贫项目管理费管理办法》(试行)的通知
G14	17	Specific subsidy on agricultural production and construction in the poverty stricken areas of Hexi and Dingxi of Gansu Province and Xihaiigu of Ningxia Hui Autonomous Region	MOF Circular, Cai Nong [2001] No. 67	Circular of MOF and the Leading Group on Poverty Alleviation and Development of the State Council on the Distribution of "Administrative Rules of the Special Subsidies to the 'Three West' Agricultural Construction"	财政部、国务院扶贫开发领导小组关于印发《“三西”农业建设专项补助资金使用管理办法》的通知(2001)
G15	18	Interest discount of poverty alleviation loans	People's Bank of China Circular, Yin Fa [2001] No. 185	Administrative Rules of Subsidized Loans for Poverty Alleviation	中国人民银行、财政部、国务院扶贫开发领导小组办公室、中国农业银行关于印发《扶贫贴息贷款管理实施办法》的通知
G16	19	Preferential tax policies for enterprises which utilize waste materials	MOF Circular, Cai Shui Zi [1994] No. 001	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》

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			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G17	20	Preferential tax policies for enterprises suffering from natural disasters	MOF Circular, Cai Shui Zi [1994] No. 001	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》
G18	21	Preferential tax policies for welfare enterprises	SAT Circular, Guo Shui Fa [1994] No. 155	SAT Circular on Preferential Turnover Tax Treatment for Social Welfare Enterprises	国家税务总局关于民政福利企业征收流转税问题的通知
G19	22	Preferential tax policies for enterprises making little profits	MOF Circular, Cai Shui Zi [1994] No. 009	MOF & SAT Circular on Certain Decisions Related to Corporate Income Tax Policies	财政部、国家税务总局关于印发《企业所得税若干政策问题的规定》的通知
G20	23	Preferential tax policies for township enterprises	MOF Circular, Cai Shui Zi [1994] No.001	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》
G21	24	Preferential tax policies for enterprises which provide employment for unemployed people	MOF Circular, Cai Shui Zi [1994] No. 001	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》
G22	25	Preferential tax policies for scientific research institutions under transformation	MOF Circular, Cai Shui [2003] No. 137	MOF & SAT Circular on the Tax Policy Regarding Research Institutions Undergoing Restructuring	财政部、国家税务总局关于转制科研机构有关税收政策问题的通知
G23	27	Preferential tax policies for the research and development of foreign-invested enterprises	SAT Circular, Guo Shui Fa [1999] No. 173	SAT Circular on Granting Income Tax Deduction to FIEs for Technology Development Expenditure	国家税务总局关于外商投资企业技术开发费抵扣应纳税所得额有关问题的通知

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			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G24	28	Preferential tax policies for enterprises transferring technology	MOF Circular, Cai Shui Zi [1994] No. 001	MOF & SAT Circular on Several Preferential Corporate Income Tax Policies	财政部、国家税务总局《关于企业所得税若干优惠政策的通知》
G25	31	Funds for supporting technological innovation for small- and medium-sized technological enterprises (SMEs)	General Office of State Council Circular, Guo Ban Fa [1999] No. 47	Circular on the Interim Administrative Rules of the Technological Innovation Fund for Small- and Medium-sized Technological Enterprises	国务院办公厅转发科学技术部财政部关于科技型中小企业技术创新基金的暂行规定的通知（国办发〔1999〕47号 1999年5月21日）
G26	32	Development funds for SMEs	N/A	Law of the PRC on Promotion of Small- and Medium-sized Enterprises	中华人民共和国中小企业促进法
G27	33	Fund for international market exploration by SMEs	MOF Circular, Cai Qi [2000] No. 467	Administrative Measures on Funds Earmarked for International Market Exploitation of Small- and Medium-sized Enterprises	财政部、对外贸易经济合作部关于印发《中小企业国际市场开拓资金管理(试行)办法》的通知
G27	33	Same as above	MOFTEC (MOFCOM) Circular, Ji Cai Fa [2001] No. 270	Implementing Rules of the Administrative Measures on Funds Earmarked for International Market Exploitation of Small- and Medium-sized Enterprises	中小企业国际市场开拓资金管理实施办法实施细则（暂行）
G28	34	Special fund for establishment of service system for SMEs	N/A	Law of the PRC on Promotion of Small- and Medium-sized Enterprises	中华人民共和国中小企业促进法

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			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G28	34	Same as above	MOF Circular, Cai Jian [2004] No. 124	Interim Administrative Measures of the Special Fund for Establishment of the Service System for Small- and Medium-sized Enterprises	中小企业服务体系专项补助资金使用管理办法(暂行)
G29	35	Fund for subsidizing the training of the rural migrant labor force	MOF Circular, Cai Nong [2004] No. 38	MOF and MOA Circular on Administrative Measures of the Fund for Subsidizing the Training of the Rural Migrant Labor Force	财政部、农业部关于印发《农村劳动力转移培训财政补助资金管理暂行办法(试行)》的通知(财农[2004]38号)
G30	36	Outlay for training of youngster farmers on science and technology	MOA Circular, Nong Ke Jiao Fa [1999] No. 8	Comments on Development of Trial-Point for the Training of Cross-Century Youngster Farmers on Science and Technology	关于开展跨世纪青年农民科技培训工程试点工作的意见
G31	37	Fund for specialized cooperatives of farmers	MOF Circular, Cai Nong [2004] No. 87	MOF Circular on the Interim Administrative Measures of the Fund for Specialized Cooperatives of Farmers	财政部关于印发《中央财政农民专业合作社发展资金管理暂行办法》的通知
G32	45	Subsidy for major flood control and drought resistance	MOF Circular, Cai Nong [2001] No. 30	MOF and MWR Circular on the Interim Rules of the Distribution of Subsidy for Major Flood Control and Drought Resistance	财政部、水利部关于印发《特大防汛抗旱补助费分配暂行规定》的通知
G33	46	Fund for construction of small irrigation facilities in rural areas	MOF Circular, Cai Ban Nong [2001] No. 74	Circular from the General Office of MOF on the Pilot Administrative Rules of the Subsidy for Construction of Small Irrigation Facilities in Rural Areas	财政部办公厅关于印发《农村小型公益设施建设补助资金管理试点办法》的通知

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Programs Listed In China's SCM Notification That Are Potentially Usable By Companies In The Wood and Wood Products Industry					
ID	SCM No.	Subsidies	Legislation for the Listed Subsidies		
			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G34	47	Fund for construction of small ecological facilities in rural areas	MOF Circular, Cai Ban Nong [2001] No. 74	Circular from the General Office of MOF on the Pilot Administrative Rules of the Subsidy for Construction of Small Irrigation Facilities in Rural Areas	财政部办公厅关于印发《农村小型公益设施建设补助资金管理试点办法》的通知
G35	48	Fund for projects on collection, reservation and utilization of rainfall	MOF Circular, Cai Nong [2004] No. 138	MOF & MWR Circular on the Interim Administrative Rules of the Fund for Collection, Reservation and Utilization of Rainfall	财政部、水利部关于印发《中央财政雨水集蓄利用专项资金管理暂行办法》的通知
G36	50	Subsidies for national key construction projects on water and soil conservation	MOF Circular, Cai Nong [1987] No. 402	Administrative Rules of the Subsidies for Small Scale Irrigation and Soil Conservation	小型农田水利和水土保持补助费管理的规定
G37	58	Preferential tax policies for foreign-invested enterprises and foreign enterprises which have establishments or places in China and are engaged in production or business operations purchasing domestically-produced equipments	MOF Circular, Cai Shui [2001] No. 49	MOF & SAT Circular on Granting Income Tax Deduction for Domestically Produced Equipment Purchased by Foreign Invested Enterprises and Foreign Enterprises	财政部、国家税务总局关于外商投资企业和外国企业购买国产设备投资抵免企业所得税有关问题的通知

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Programs Listed In China's SCM Notification That Are Potentially Usable By Companies In The Wood and Wood Products Industry					
ID	SCM No.	Subsidies	Legislation for the Listed Subsidies		
			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G37	58	Same as above	SAT Circular, Guo Shui Fa [2000] No. 90	SAT Circular on Administrative Measures of Income Tax Deduction for Domestically-Produced Equipment Purchased by Foreign-Invested Enterprises and Foreign Enterprises	国家税务总局关于印发《外商投资企业和外国企业购买国产设备投资抵免企业所得税管理办法》的通知
G38	59	Preferential tax policies for domestic enterprises purchasing domestically-produced equipment for technology upgrading purpose	MOF Circular, Cai Shui [1999] No. 290	MOF & SAT Circular on the Interim Measures of Income Tax Deduction for Domestically-Produced Equipment Purchased for Technology-Upgrading Purpose	财政部、国家税务总局关于印发《技术改造国产设备投资抵免企业所得税暂行办法》的通知
G39	60	Exemption of tariff and import VAT for imported technologies and equipment	State Council Circular, [1997] Guo Fa No. 37	Circular of the State Council on Adjusting Tax Policy on Imported Equipment	国务院关于调整进口设备税收政策的通知
G40	63	Preferential tax policies for relief grain and disaster relief grain, compensation grain for returning cultivated land to forests and to grassland, and grain rations for migrants from the reservoir areas	MOF Circular, Cai Shui Zi [1999] No. 198	MOF & SAT Circular on VAT Exemption for Staple Crops Enterprises	财政部、国家税务总局关于粮食企业增值税征免问题的通知
			SAT Circular, Guo Shui Fa [2001] No. 131	SAT Circular on VAT Exemption for the Relief Grain and Disaster Relief Grain, Compensation Grain for Returning Cultivated Land to Forests and to Grassland	国家税务总局关于退耕还林还草补助粮免征增值税问题的通知
G41	69	Preferential tax treatment for building material products produced with integrated utilization of resources	MOF Circular, Cai Shui Zi [1995] No. 44	MOF & SAT Circular on VAT Exemption for Products Produced with Integrated Utilization of Resources	财政部、国家税务总局关于对部分资源综合利用产品免征增值税的通知

CHINA'S SUPPORT PROGRAMS FOR SELECTED INDUSTRIES: WOOD AND WOOD PRODUCTS
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Programs Listed In China's SCM Notification That Are Potentially Usable By Companies In The Wood and Wood Products Industry					
ID	SCM No.	Subsidies	Legislation for the Listed Subsidies		
			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G41	69	Same as above	MOF Circular, Cai Shui Zi [1996] No. 20	MOF & SAT Circular on Continuing with the Preferential VAT Treatment for Products Produced with Integrated Utilization of Resources	财政部、国家税务总局关于继续对部分资源综合利用产品等实行增值税优惠政策的通知
G42	70	Preferential tax treatment for other products produced with integrated utilization of resources	MOF Circular, Cai Shui [2001] No. 198	MOF & SAT Circular on VAT Treatment for Products Produced with Integrated Utilization of Resources	财政部、国家税务总局关于部分资源综合利用及其他产品增值税政策问题的通知
G42	70	Same as above	MOF Circular, Cai Shui [2004] No. 25	MOF & SAT Supplementary Circular on VAT Treatment for Products Produced with Integrated Utilization of Resources	财政部 国家税务总局关于部分资源综合利用 产品增值税政策的补充通知
G43	72	Preferential tax treatment for imported products exclusively used by disabled people	State Council Circular, Guo Han [1997] No. 3	Provisional Regulations on Tax Exemption for Imported Products for Scientific and Educational Purposes	科学研究和教学用品免征进口税收暂行规定
G44	76	Preferential tax treatment for casting and forging products	MOF Circular, Cai Shui [2003] No. 96	MOF & SAT Circular on VAT Refund for Casting and Forging Products	财政部、国家税务总局关于铸锻件产品增值税先征后返问题的通知
G45	77	Preferential tax treatment to dies products	MOF Circular, Cai Shui [1998] No. 139	MOF & SAT Circular on Continuing VAT Refund for Dies Products	财政部、国家税务总局关于继续对模具产品实行增值税先征后返的通知

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**Programs Listed In China's SCM Notification That Are Potentially Usable
By Companies In The Wood and Wood Products Industry**

ID	SCM No.	Subsidies	Legislation for the Listed Subsidies		
			Doc No.	Laws/Circulars in English	Laws/Circulars in Chinese
G45	77	Same as above	MOF Circular, Cai Shui [2003] No. 95	MOF & SAT Circular on VAT Refund for Dies Products	财政部、国家税务总局关于模具产品增值税先征后返问题的通知
<p>ID numbers:</p> <p>G-series: General programs which are not limited to agricultural entities.</p> <p>SCM No.: This column identifies the number of the subsidy program listed in China's SCM Notification. <i>See People's Republic of China: New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement, G/SCM/N/123/CHN (13 April 2006).</i></p>					

B. THE SIX GRAND AFFORESTATION PROJECTS

Afforestation is an important component of China's forestry policy. The Six Grand Afforestation Projects refers to the six largest afforestation projects currently managed by the State Forestry Administration. The program is primarily for environmental purposes, aimed at restoring the nation's forestry ecosystem for future generations. The program also increases the potential for timber production. A brief introduction to these six projects is provided below.

1. The Natural Forests Protection Project (F9)

This project evolved from the 1998 logging ban. It now includes three components: (a) a ban on logging in the natural forests in the drainage basins of the upper reach of the Yangzi River and the middle and lower reach of the Yellow River, accompanied by some afforestation projects in the same areas; (b) strict enforcement of a significantly reduced logging quota in the north-east region and Inner Mongolia; and (c) measures aimed at improving the management of the 1.415 billion mu (94.33 million ha) natural forests with priority being given to the recovery of the degraded forests. This project also includes reemployment programs for the 740,000 workers whose livelihoods formerly depended on the logging industry. By 2005, seven years after the kickoff of this program, the aggregated area of afforestation under this project had reached 13.177 million ha, with government investment totaling RMB 44.89 billion.⁶²

2. The Beijing-Tianjin Sandstorm Prevention Project (F10)

This project is designed to prevent sandstorms by reversing deforestation trends and restoring the natural ecological system around the Beijing-Tianjin areas. Launched in 2000, the

⁶² *The Six Grand Projects Accelerates the Development of the Forestry Industry*, CHINA GREEN DAILY (October 28, 2005); available at <http://www.linye.sh.cn/news/national/11299.shtml>. See Exhibit F-22.

project aims to increase the forest density of the area to 21.4 percent by 2010. By 2005, the total afforestation area under this project had reached 2.19 million ha with RMB 8.33 billion government investment.⁶³

3. The Natural Reserve Development Project (F11)

The Natural Reserve Development project was launched in 2001. A total of 763 new natural reserves have been designated since that time to protect China's forestry ecosystem. Currently, a total of 1672 national natural reserves have been established and are being managed under this project, covering an area of 1190 million ha, equivalent to 12.4 percent of China's total land area. To date, the project has received government investment of RMB 1.57 billion.⁶⁴

4. The Protective Afforestation Project (F12)

The Protective Afforestation Project is a program comprised of six afforestation sub-projects. The largest is the Three Northern Regions Protective Afforestation Project, commonly known as the Green Great Wall Project. Officially initiated in 1978, the Green Great Wall Project is designed to build a forest shelterbelt -- a Green Great Wall -- in the northern part of China, an area that has the lowest forest density and that is facing the most serious threat from deforestation. The project involves an area equivalent to 42.4 percent of China's land territory. When finished in 2050, this project is expected to create new forests covering an area of 35 million ha. It will raise the forest density for the three northern regions from the current level of 5.05 percent to 14.95 percent. While information about China's total investment in this project is

⁶³ *Id.* See Exhibit F-22.

⁶⁴ *Id.* See Exhibit F-22.

not available, the government spent RMB 4.138 billion on this project between 2001 and 2005. China invested another RMB 7.907 billion for the other Protective Afforestation Projects.⁶⁵

5. Return Farmland to Forests (F13)

The Return Farmland to Forest project was initiated in 2000 and was designed to ameliorate soil erosion problems by converting slope farmland to forests. By 2005, 17.34 million ha of slope farmland had been converted under this project, with governmental investment reaching RMB 60 billion. Eighty percent of the forests thus built are designated as ecological forests, for which commercial logging is strictly restricted. The rest are available for timber production.⁶⁶

6. Fast-Growth-High-Yield Forest Construction Project (F14)

The Fast-Growth-High-Yield Forest Construction project was designed to increase commercial timber production capacity, so as to reduce the pressure on natural forests for timber. The project was launched in 2002. By 2005, a total of 334,500 ha of fast-growth-high-yield (FGHY) plantations had been planted. The details of this program are discussed below (see program F15).⁶⁷

In addition to the Six Grand Afforestation Projects, there are other government support programs that benefit China's timber industry. In general, the government has adopted a very supportive position toward reforestation/afforestation efforts. For instance, Article 8 of the PRC

⁶⁵ *Id.* See Exhibit F-22.

⁶⁶ *Id.* See Exhibit F-22.

⁶⁷ See SDRC, *The Tenth Five-Year and 2010 Special Plan for the Construction of National Forestry and Papermaking Integration Project* (2004). See Exhibit F-2. See also *SFA Opinions on Fast-Growth-High-Yield Forests Production Base Construction*, Lin Dai Fa [2005] No. 129. See Exhibit F-78.

Forest Law explicitly calls for the national and local authorities to provide economic support or long-term loans for afforestation projects.⁶⁸

C. PROGRAMS IDENTIFIED IN THE AF&PA REPORT

The American Forest and Paper Association (AF&PA) published a report in 2004 titled *China's Subsidization of its Forest Products Industry* (AF&PA report). The report presented an extensive review of Chinese government support programs for the forestry industry, ranging from timber production to the paper and other processed wood products industries. The following sections review those support programs identified by the AF&PA report that have not already been discussed previously in this paper.

1. Loan Interest Subsidy for Plantation Development (F15)

The AF&PA report notes that China's wood products industry has suffered from high prices for raw materials. This problem arose from limited supply due to China's lack of natural forest resources and the government restriction on logging. In addition, heavy taxation and administrative fees on timber production discouraged private investment in plantation development. To increase timber supply, in 2001, the Chinese government launched a program to promote the construction of fast-growth-high-yield plantations. It was designed to increase the domestic production of commercial-use timber, especially for wood-pulp production. According to a government plan, a total of 99 plantations, covering an area of 13.33 million ha, are to be developed between 2001 and 2015.⁶⁹ The project was estimated to require a total

⁶⁸ *Forestry Law of the People's Republic of China* (2004) at Article 8. See Exhibit F-11.

⁶⁹ AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 9. See Exhibit F-9.

investment of USD \$8.65 billion.⁷⁰ It is expected that the Ministry of Finance (MOF) would provide USD \$1.73 billion or 20 percent of the total estimated investment,⁷¹ primarily through loan interest subsidies. The subsidies are available to state-owned, private, and foreign-invested enterprises. Specifically, the MOF will provide funds to commercial banks to cover interest payments for loans extended for the purpose of developing fast-growth-high-yield plantations.⁷²

2. Reduction of Production Cost (F16)

The AF&PA report notes that the Chinese government has taken measures to help enterprises in the wood products sector to reduce production costs. Heavy tax and administrative fees have discouraged private investment in plantations. To address this issue, the State Council issued a circular entitled *Resolution on Accelerating Development of the Forestry Industry*, calling for the reduction of taxes and fees on plantations and on logging.⁷³ The Resolution also delegated to local government authorities the task of lowering local taxes and fees. In addition, to discourage exports, the government in 1999 abolished the VAT export rebate on logs, lumber and wood pulp, and waste paper.⁷⁴ On the other hand, the VAT rates on imported timber, processed forest products, and wood pulp were reduced by half.⁷⁵ Both of these measures reduced the domestic price for these relevant products, and, in turn, reduced the manufacturing cost for downstream enterprises.

⁷⁰ *Id.* at 10. See Exhibit F-9.

⁷¹ *Id.* See Exhibit F-9.

⁷² *Id.* See Exhibit F-9.

⁷³ *Id.* at 11, citing *Resolution by the Chinese Communist Party Central Committee and the State Council on Accelerating the Development of Forestry*, Zhong Fa [2003] No. 9. See Exhibits F-9 and F-1.

⁷⁴ *MOF & SAT Circular on Adjustment of VAT Rebate Rate on Certain Products*, Cai Shui [2003] No. 222. See Exhibit F-23.

⁷⁵ AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 11. See Exhibit F-9.

3. The Grand Development Program for the West Region (G11)

In 2000, in order to promote the economic development in the inland area, the Chinese government launched the program entitled *The Grand Development of the West Region*.⁷⁶ Under this program, preferential treatment was granted to enterprises operating in the West Region. Many of these preferences are usable by companies in the forestry industry in the region. The AF&PA report identifies the following preferences: (a) a 3-year tax holiday followed by a 50 percent tax reduction; and (b) zero tariffs on imports of certain equipment, machines and technology.⁷⁷ In addition, the China Development Bank offers discounted loans to enterprises in the West Region. The AF&PA report also states that *free land use rights* are granted to enterprises for plantation development.⁷⁸ Citing to a report that the Ministry of Transportation and Communication is planning to invest a total of USD \$26.59 billion in the highway and rail system in the West Region, the AF&PA report points out that government investment in infrastructure helps the industry to lower manufacturing costs.⁷⁹

4. The Pulp/Paper Development Projects (F17)

The 10th 5-Year Plan calls for China to develop more pulp and paper production capacity to meet domestic demand and to reduce reliance on imports for high-grade paper.⁸⁰ The AF&PA report found that, in 2001, the State Development and Planning Commission (SDPC) planned to

⁷⁶ See *State Council Circular on Several Policies on the Development of Western Regions*, Guo Fa [2000] No. 33. See Exhibit F-24.

⁷⁷ AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 15. See Exhibit F-9.

⁷⁸ *Id.* See Exhibit F-9.

⁷⁹ *Id.* See Exhibit F-9.

⁸⁰ See *The PRC Economic and Social Development 10th Five-Year Plan Outline* (March 15, 2001). An English translation of this Plan is provided in NewPage Corporation's *Petition for the Imposition of Countervailing Duties in the Matter of Coated Free Sheet Paper from China, Indonesia, And South Korea* (October 30, 2006) at Exhibit III-2, which is reproduced in Exhibit F-25.

establish 42 pulp/paper projects in 6 regions for the development of pulp material bases, pulp production, and high-grade paper production capacity. For the initial stage of these projects, the SDPC provided USD \$2.13 billion in loan interest subsidies to 13 of the projects.⁸¹

5. Loan Interest Subsidies for Technology Renovations (F18)

The AF&PA report found that, between 1998 and 2002, the Chinese government provided USD \$1.67 billion, mostly in the form of loan interest subsidies, to enterprises for the purpose of technology renovation.⁸² The beneficiaries of this program are mostly newsprint and light-weight coated paper producers. The AF&PA report estimates that this subsidy helped to develop new production capacity of over 1.7 million metric tons.⁸³

6. Discounted Loan for Wood Processing Projects (F19)

The People's Bank of China normally sets a minimum lending rate for commercial banks. The AF&PA report indicates that the State Council has allowed commercial banks to extend loans to wood processing enterprises at 90 percent of the standard rate with a preferential payback period of between 3 to 5 years, as opposed to the normal loan term of 1 to 2 years.⁸⁴

7. Expedited Foreign Investment Approval Process (F20)

The SDRC maintains a catalogue that lists industries for which foreign investment is encouraged or restricted. The current catalogue encourages foreign investment in wood-based paper production, medium-to-large chemical and mechanical pulp processing, and high-grade

⁸¹ AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 22. See Exhibit F-9. The AF&PA report does not identify the legal authority for this program.

⁸² *Id.* See Exhibit F-9.

⁸³ *Id.* See Exhibit F-9.

⁸⁴ *Id.* See Exhibit F-9.

paper and paper board production (not including newsprint). For industries where foreign investment is encouraged, the State Council delegates foreign investment approval authority down to the local level, and the local authority is authorized to extend preferential treatment to these foreign investment projects. This policy allows foreign investors to bypass an otherwise time-consuming approval procedure at the central government level. Prior to the issuance of this new policy, the AF&PA report notes that it could take years to obtain an approval from the central government. The AF&PA report concludes that this policy, together with other preferential policies, has resulted in large foreign investments in the forestry industry. By 2002, companies with more than 25 percent foreign ownership accounted for 29 percent of total paper production and 44.8 percent of industry profits.⁸⁵

8. Favorable Tax Treatment to High-Tech and Foreign-Invested Producers (G1)

The AF&PA report notes that the Chinese government provides preferential tax treatment to enterprises with foreign investment and to enterprises classified as high-tech enterprises. This preferential tax treatment is potentially applicable to paper and paper board producers.⁸⁶ The details of these measures are discussed below. It should be noted that the legislation providing a tax break to enterprises with foreign investment will be superseded, effective January 1, 2008, with existing benefits to be phased out by January 1, 2013.⁸⁷

⁸⁵ *Id.* at 23. See Exhibit F-9.

⁸⁶ *Id.* See Exhibit F-9.

⁸⁷ In addition to the above measures, the AF&PA report also notes that, in the past, China had initiated antidumping investigations against imports of newsprint and coated wood-free paper. For example, in February 2002, an investigation was launched, and, subsequently, an antidumping duty order was imposed on coated wood-free paper imports from Korea and Japan. In March 2004, China initiated an antidumping investigation against imports of Kraft linerboard and Kraft top linerboard from the U.S., South Korea, Taiwan and Thailand. See AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 23. See

D. PROGRAMS IDENTIFIED IN THE THREE SUBSIDY DISPUTES INVOLVING CHINA

As reviewed above, China has become a large exporter of a variety of wood products, and many of China's paper and wood products are potentially eligible for support from an array of government programs. To date, two countervailing duty cases have been brought against wood products exported from China. In addition, pursuant to WTO dispute settlement procedures, the United States has requested consultations with China on certain industry support programs, some of which are applicable to wood and wood products. This section of the paper reviews these three cases. It should be noted that, subsequent to the U.S. request for consultations regarding Chinese subsidies, Mexico submitted an independent subsidy complaint against China at the WTO. As the measures challenged in the Mexican complaint are exactly the same as those listed in the U.S. request for consultations, the Mexican complaint will not be specifically discussed in this paper.

1. Canadian Countervailing Duty Investigation of Laminate Flooring from China

On October 4, 2004, Uniboard Surfaces, the only known Canadian manufacturer of laminate flooring, filed a petition for the imposition of countervailing duties on imports of laminate flooring from China and France. Following investigation, the Canadian Border Services Agency (CBSA) found that certain Chinese subsidy programs were in existence during the period of investigation, that they had been used by the Chinese companies under

Exhibit F-9. A positive finding was reached in September 2005. The antidumping duty order on imports of Kraft linerboard and Kraft top linerboard from the United States was later terminated when the U.S. government threatened to challenge the decision at the WTO. See USTR, *China Terminates Antidumping Duty Order on Kraft Linerboard* (01/10/2006); available at http://www.ustr.gov/Document_Library/Press_Releases/2006/January/China_Terminates_Antidumping_Duty_Order_on_Kraft_Linerboard.html.

investigation, and that they were countervailable under Canadian law.⁸⁸ These subsidy programs are reviewed below.

a. Tax Break for Productive Foreign-Invested Enterprises Scheduled to Operate for a Period of Not Less Than 10 Years (G46)

The CBSA found that Article 8 of the FIE Income Tax Law allows a tax break to FIEs that are engaged in production and are scheduled to operate for more than 10 years. A tax exemption is provided to these FIEs for the first 2 years after they start to register profits. In the following 3 years, these FIEs are eligible to a 50 percent tax deduction.⁸⁹ The implementation rule of the FIE Income Tax Law specifically states that this tax benefit is applicable to eligible enterprises in the forest products industry.⁹⁰

b. Local Tax Break for FIEs in Industries Where Foreign Investment is Encouraged (G47)

The Ministry of Commerce maintains a catalogue that lists all of the industries for which foreign investment is encouraged.⁹¹ FIEs that are engaged in the encouraged industries listed in

⁸⁸ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005).

⁸⁹ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 1), *citing* Article 8 of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (1991).

⁹⁰ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 1), *citing* Article 72 of the Detailed Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (1991). It should be noted that this legislation will be superseded, effective on January 1, 2008; with a 5-year grace period for existing benefits available to FIEs.

⁹¹ MOFCOM, *Catalogue for the Guidance of Foreign Investment Industries (Amended in 2004)* (November 30, 2004). See Exhibit F-26.

the catalogue are eligible for local tax breaks under Article 9 of the FIE Income Tax Law.⁹² The forestry industry is listed as an industry in which foreign investment is encouraged.

c. Tax Rebate on Reinvested Profits by FIEs (G48)

Under Article 10 of the FIE Income Tax Law, FIEs are entitled to a 40 percent rebate of income taxes paid on profit that is later reinvested directly in China. If such reinvestment is for the establishment of a new project, this rebate is available when the new project is scheduled to remain in operation for at least 5 years. If the reinvestment is for the establishment or expansion of export-oriented enterprises or for enterprises with advanced technology, 100 percent of the income taxes paid on the reinvested profit will be rebated.⁹³

d. Tax Benefit for Enterprises Located in SEZs, CEOZs, or in the Old Urban Districts of Cities Where the SEZs or the ETDZs are Located, or in Areas Designated by the State Council (G7 & G50)

Article 7 of the FIE Income Tax Law provides that productive FIEs, in certain specifically-designated locations, are eligible for a reduced income tax rate of 15 percent. The most important designated locations are Special Economic Zones (SEZ), Coastal Economic Open Zones (CEOZ), and Economic & Technology Development Zones (ETDZ).⁹⁴ Some local

⁹² See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 2), citing Article 9 of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (1991) (to be phased out by 2013).

⁹³ *Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises* (1991) at Article 10 (to be phased out by 2013). See Exhibit F-4.

⁹⁴ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 4), citing Article 7 of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (1991) (to be phased out by 2013).

tax regulations have extended this benefit to domestic enterprises.⁹⁵ For instance, in the *Circular of the Shenzhen Taxation Bureau on Interpretations of the Provisions Pertaining to Tax Policies for Enterprises in Shenzhen Special Economic Zone by the Municipal People's Government of Shenzhen*, Article 1 expressly states that the reduced tax rate benefit is applicable to domestic enterprises as well as to FIEs.⁹⁶

e. Tax Break for Enterprises in the Western Region and Other Specified Regions (G11)

The CBSA found that the Chinese government provided tax breaks to enterprises from certain key industries that located in the Western Region and other specified regions. Article 1 of the *Circular of the Ministry of Finance, State Administration of Taxation and General Administration of Customs on the Preferential Tax Policy of Development of the Western Region* stipulates that, between 2001 and 2010, both DIEs and FIEs from industries encouraged by the State will be taxed at a reduced rate of 15 percent.⁹⁷ To qualify for this reduced rate, the enterprises must derive 70 percent of their total revenue from operations that are listed in the *Current Catalogue of Key Industries, Products and Technologies the Development of Which is Encouraged by the State*. Paper production is listed in this catalogue.⁹⁸

⁹⁵ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 4), citing Articles 1 and 6 of *Regulations on Special Economic Zones in Guangdong Province*. The original regulation is not identified.

⁹⁶ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 4).

⁹⁷ *Circular of the Ministry of Finance, State Administration of Taxation and General Administration of Customs on the Preferential Tax Policy of Development of the Western Region*, Cai Shui [2001] No. 202. See Exhibit F-27.

⁹⁸ SDRC, *Current Catalogue of Key Industries, Products and Technologies the Development of Which is Encouraged by the State*, Decree No.7 [2000]. See Exhibit F-28.

f. Enterprises Operating in the Forestry Industry (F2)

This program is discussed above in Part II, section A.1.b. of this paper.

g. Refund of VAT for Products Produced with Fuel Wood and Other Low-valued Wood or Wood Residuals (F21)

Certain environmentally-friendly wood products produced by using fuel woods or other low-value woods or wood residuals are entitled to an immediate VAT refund after levy.⁹⁹ This measure is aimed at encouraging full utilization of raw wood, thus reducing the aggregate demand for timber. Raw wood products are subject to a 13 percent VAT in China; processed woods products are subject to a VAT of 17 percent.

h. Tariffs and VAT Exemption on Imported Equipment (G51)

The CBSA found that, from January 1, 1998, China has exempted tariffs and VAT for certain equipment imported by both DIEs and FIEs under the *Circular of the State Council Concerning the Adjustment in the Taxation Policy of Import Equipment*.¹⁰⁰ Equipment that is imported for use in a domestic project qualifies for the benefit only if such equipment or the project is listed in the *Current Catalogue of Key Industries, Products and Technologies the Development of Which is Encouraged by the State*¹⁰¹ and is not listed in the *Directory of*

⁹⁹ *Joint Circular of Ministry of Finance and State Administration of Taxation (SAT) Regarding the VAT Favorable Policy of the Comprehensively Used Product Produced and Processed with the Three Residues and Small Firewood Materials as Raw Materials*, Cai Shui [2001] No. 72. See Exhibit F-29.

¹⁰⁰ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 10); see also *Circular of the State Council Concerning the Adjustment in the Taxation Policy of Import Equipment*, Guo Fa [1997] No. 37. See Exhibit F-30.

¹⁰¹ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 10); see also SDRC, *Current Catalogue of Key Industries, Products and Technologies the Development of Which is Encouraged by the State*, Decree No. 7 [2000]. See Exhibit F-28.

*Imported Commodities of Non-Tax Exemption to be Used in Domestic Invested Projects.*¹⁰² For FIEs, the type of project in which the equipment will be used must be listed in the *Guideline Catalogue for Foreign Investment Industries* under the *Encouraged Catalogue* or the *Restricted B Catalogue.*¹⁰³

i. Loan Interest Assistance (F22)

The CBSA found that, in September 24, 2003, the MOF issued the *Circular of Ministry of Finance Regarding the Issuance of Fund Management Method of Financial Interest Subsidy of Central Government of the Loan of Capital Construction.*¹⁰⁴ According to the circular, the loan interest assistance is available to large and medium “Capital Construction Projects,” which are defined as projects with total investment of least RMB 50 million for commercial projects or RMB 30 million for non-commercial projects. Under Article 5 of the Circular, fast-growth-high-yield plantations are expressly listed as eligible projects for this support program. Companies invested in fast-growth-high-yield plantations may apply for loan interest assistance. The amount of the loan interest assistance may not be more than 3 percent of the amount of the eligible loan and may be provided throughout the construction period but not exceeding 5 years. Certain large projects, however, are not subject to the duration limit under this project.¹⁰⁵

¹⁰² See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 10).

¹⁰³ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 10); see also MOFCOM, *Catalogue for the Guidance of Foreign Investment Industries (Amended in 2004)* (November 30, 2004). See Exhibit F-26.

¹⁰⁴ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 11); see also *Circular of Ministry of Finance Regarding the Issuance of Fund Management Method of Financial Interest Subsidy of Central Government of the Loan of Capital Construction*, Cai Jian [2003] No. 421. See Exhibit F-32.

¹⁰⁵ *Circular of Ministry of Finance Regarding the Issuance of Fund Management Method of Financial Interest Subsidy of Central Government of the Loan of Capital Construction*, Cai Jian [2003] No. 421. See Exhibit F-32.

j. Local Grants for Flooring Enterprises (G52)

Enterprises located in Shanghai Pudong New District, as well as some other development zones, have received grants in their first three operative years as development aid from the local authorities.¹⁰⁶

2. U.S. Countervailing Duty Investigation of Coated Free Sheet Paper from China

In the fall of 2006, NewPage Corporation filed a petition in the United States alleging that subsidies provided by the Chinese government to Chinese producers of coated free sheet paper were causing material injury to the U.S. industry producing coated free sheet paper. In November 2006, the International Trade Administration of the U.S. Department of Commerce (Commerce) initiated an investigation. Commerce also indicated that it would determine during the course of the investigation whether to change or adhere to a mid-1980s construction of U.S. law that countervailing duty law was not applicable to non-market economies.¹⁰⁷ In its preliminary countervailing duty determination, issued at the end of March and amended in early April 2007, Commerce found that certain government subsidies were specific and thus potentially countervailable.¹⁰⁸

¹⁰⁶ See CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 13), citing *Suggestions on Financial Support of Economic Development in the Pudong New District During the Tenth Five-year Plan* (December 2000). See Exhibit F-33.

¹⁰⁷ U.S. Department of Commerce, International Trade Administration, *Notice of Initiation of Countervailing Duty Investigations: Coated Free Sheet Paper from the People's Republic of China, Indonesia, and the Republic of Korea*, 71 Fed. Reg. 68546 (November 27, 2006).

¹⁰⁸ U.S. Department of Commerce, International Trade Administration, *Coated Free Sheet Paper from the People's Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination*, 72 Fed. Reg. 17484 (April 9, 2007) ("CFS Paper Preliminary Determination").

a. Programs Preliminarily Determined by Commerce to be Countervailable

i. The State Key Technology Renovation Project Fund (G53)

Commerce found that subsidies had been granted to paper enterprises under the *State Key Technology Renovation Project Fund* program. Specifically, under Article 9 of the *Measures for the Administration of National Debt Special Fund for National Key Technological Renovation Project*,¹⁰⁹ the Chinese government provided grants to paper producers equal to 2 years' interest payments on loans extended for technology innovation projects, or up to 3 years' interest payments for enterprises located in certain specified areas.¹¹⁰ Commerce determined that the program was not generally available to all enterprises; the recipients were selected mainly from the 512 key enterprises, the 120 pilot enterprises groups, and the leading enterprises in various industries. This program, however, was not operational after 2003, even though the legal authority for the program is currently still in effect.¹¹¹

ii. The Two-Free, Three-Half Program (G46)

Commerce preliminarily determined that the "Two Free, Three Half" program (which has been discussed previously in this report) is limited to certain enterprises as a matter of law and, thus, is countervailable under U.S. law.¹¹² The Chinese legal authority for this program, however, will be superseded on January 1, 2008, with a five-year grace period for existing tax benefits granted to FIEs.

¹⁰⁹ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17491, citing State Circular, Guo Jing Mao Tou Zi [1999] No. 886. See Exhibit F-89.

¹¹⁰ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17491.

¹¹¹ See *id.*

¹¹² See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17494.

iii. Reduced Income Tax Rates for FIEs Based on Location (G7 & G50)

This program is discussed in the Canadian laminate flooring case above at Part II, section D.1.d.

iv. Local Income Tax Exemption and Reduction Program for “Productive” FIEs (G54)

The FIE Income Tax Law authorizes Chinese local government authorities to exempt or reduce the tax burden on certain productive FIEs. Commerce concluded that tax exemption or reduction is a financial contribution from the local government and confers a benefit. In addition, Commerce found that as each program is applicable locally, each is specific as a matter of law.¹¹³

v. Income Tax Credits on Purchases of Domestically-Produced Equipment by FIEs (G37)

Commerce found that provisions in two circulars issued in 2000 by the MOF allow a tax credit of up to 40 percent of the purchase value for domestically-produced equipment when certain criteria are met.¹¹⁴ Since the program is only available to FIEs, Commerce determined that the program is countervailable.¹¹⁵

¹¹³ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17495; see also *Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises* (1991) at Article 9. See Exhibit F-4.

¹¹⁴ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17495, citing *Circular of the Ministry of Finance and the State Administration of Taxation on Enterprise Income Tax Credits for Purchase of Domestic Equipment by Foreign Invested Enterprises and Foreign Enterprise*, Cai Shui [2000] No. 49 and *Administrative Measures on Enterprise Income Tax Credits for Purchase of Domestic Equipment by FIEs and Foreign Enterprises*, Guo Shui Fa [2000] No. 90. See Exhibits F-75 and F-34.

¹¹⁵ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17495.

vi. VAT Rebates on FIE Purchases of Domestically-Produced Equipment (G55)

Pursuant to *Trial Administrative Measures on Purchase of Domestic Equipment by Projects with Foreign Investment*, the Chinese government provides VAT refunds to FIEs on purchases of certain domestically-produced equipment. As this program is limited to FIEs, Commerce found the program to be countervailable.¹¹⁶

vii. FIE VAT and Tariff Exemptions on Imported Equipment and Technology (G39)

Commerce found that, in order to encourage the use of advanced production technology, the Chinese government grants, to both FIEs and certain qualified DIEs, an exemption from VAT and tariffs on imports of certain technologically-advanced equipment that is used in production.¹¹⁷

viii. Domestic VAT Refunds for Companies Located in the Hainan Economic Development Zone (G56)

Commerce found that the local government provides a VAT rebate to enterprises located in the Economic Development Zone of Hainan. An enterprise that qualifies as high-tech and employs more than 1000 local workers is entitled to a 25 percent refund of VAT paid on domestic sales for up to 5 years.¹¹⁸

¹¹⁶ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17495, citing *Trial Administrative Measures on Purchase of Domestic Equipment by Projects with Foreign Investment*, Guo Shui Fa [1999] No. 171. See Exhibit F-35.

¹¹⁷ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17496, citing the *Circular of the State Council on Adjusting Tax Policies on Imported Equipment*, Guo Fa [1997] No. 37. See Exhibit F-30.

¹¹⁸ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17496.

b. Programs Preliminarily Determined by Commerce to be Not Used

i. Clean Production Technology Fund (G57)

The Chinese government launched the Clean Production Technology Fund program in October 2004 to encourage enterprises to conduct environmentally-clean production inspection.¹¹⁹ Local authorities give awards under this program to enterprises when certain criteria are met.¹²⁰ Commerce found that although one company reported receiving a grant under this program, the benefit received was less than 0.005 percent, and that programs with subsidy rates under 0.005 percent are not included in the total countervailable duty rate.¹²¹

ii. Other programs

During the investigation, Commerce found that nine programs were in existence but did not determine that they were countervailable because none of the respondents in the case had applied for or received any benefits from such programs. These programs are the following:

- Direction Adjustment Tax on Fixed Assets
- Income Tax Exemption Program for Export-Oriented FIEs
- Corporate Income Tax Refund Program for Reinvestment of FIE Profits in Export-oriented Enterprises
- Discounted Loans for Export-Oriented Enterprises
- Exemption from Payment of Staff and Worker Benefits for Export-Oriented Enterprises
- Preferential Tax Policies for FIEs Engaged in Forestry and Established in Remote Underdeveloped Areas

¹¹⁹ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17497, citing the decree of the NDRC and the National Administration of Environmental Protection titled *Provisional Measures on Clean Production Inspection*, Decree [2004] No. 16. See Exhibit F-31.

¹²⁰ See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17497.

¹²¹ See *id.*

- Preferential Tax Policies for Enterprises Engaged in Forestry
- Special Fund for Projects for the Protection of Natural Forestry
- Compensation Fund for Forestry Ecological Benefits¹²²

3. U.S. Request for Consultations with Regard to Certain Chinese Subsidy Programs

On February 7, 2007, the United States submitted a request for consultations to the Chinese Delegation regarding certain subsidy and other programs. The U.S. request listed a total of 9 measures which it believed were inconsistent with China's obligations under two WTO agreements – the Agreement on Subsidies and Countervailing Measures (SCM) and the Agreement on Trade-Related Investment Measures (TRIMS). Several of the nine measures have already been discussed in this paper. Among these are two measures that grant tax refunds to FIEs for purchasing domestic equipment (discussed in Part II, D.2.a.vi.) and the measure exempting VAT and import tariffs for certain equipment and technology (discussed in Part II, D.2.a.viii.). The following reviews those measures listed in the U.S. request that have not been discussed previously in detail.

a. Income Tax Rebate for Domestic Enterprises Purchasing Domestically-Made Equipment (G38)

This measure was listed in China's first SCM Notification as item 59 (LIX).¹²³ It was designed to encourage domestic enterprises to invest in technology renovation. Under the measure, domestic companies are entitled to a tax rebate equal to 40 percent of the purchase price for any domestically-produced equipment that is used in technology renovation projects

¹²² See *CFS Paper Preliminary Determination*, 72 Fed. Reg. at 17497.

¹²³ See People's Republic of China: *New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement*, G/SCM/N/123/CHN (13 April 2006) at 67. See Exhibit F-3.

consistent with national industrial policies. The actual tax rebate however, is not to exceed the difference between the amount of the taxes paid for the current year compared to the taxes paid in the previous year. This measure does not apply to foreign-invested companies.¹²⁴

b. Income Tax Rebate for Export-Oriented or High-Tech FIEs (G2, G3)

The FIEs Income Tax Law provides an additional tax rebate for export-oriented FIEs and High Tech FIEs beyond those normally available to FIEs. Export-oriented FIEs are those FIEs that export 70 percent or more of their total production (measured by value). Export-oriented FIEs are entitled to a 50 percent reduction of their income taxes if they do not enjoy other tax benefits.¹²⁵ For those export-oriented FIEs that are already qualified for the reduced income tax rate of 15 percent, they will be taxed at a further reduced rate of 10 percent.¹²⁶ FIEs employing advanced technology that is certified by MOFCOM enjoy three additional years of the 50 percent tax reduction beyond the “two-free, three-half” benefit (discussed above).¹²⁷

c. Income Tax Rebate for FIEs Investing in Encouraged Line of Business (G58)

As noted previously, MOFCOM maintains an investment catalogue listing industries in which foreign investment is encouraged. Upon approval by the State Tax Administration, FIEs operating in these encouraged industries are eligible to receive a reduced income tax rate of 15

¹²⁴ See *China – Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments – Request for Further Consultations by the United States*, WT/DS358/1/Add.1 (2 May 2007) at 2, citing MOF & SAT, *Circular on the Interim Measures of Income Tax Deduction for Domestically Produced Equipment Purchased for Technology Upgrading Purpose*, Cai Shui [1999] No. 290. See Exhibit F-38.

¹²⁵ See *id.*, WT/DS358/1/Add.1 at 2, citing *Provisions of the State Council on the Encouragement of Foreign Investment*, Guo Fa [1986] No. 95. See Exhibit F-39.

¹²⁶ *Id.*

¹²⁷ See *SAT Circular on the Preferential Tax Treatment to Foreign Invested Companies That Are Technology- and Knowledge-Intensive*, Guo Shui Fa [1995] No.139. See Exhibit F-79

percent.¹²⁸ The forestry industry and the paper making industry are listed as encouraged industries.¹²⁹

d. Tax Refund for Qualified Reinvestment by FIEs (G48)

This program was previously discussed in Part II, D.1.c. Export-oriented or high-tech FIEs that reinvest their profits in similar projects are entitled to a 100 percent refund of income taxes paid on their reinvested profits.

e. Exemption for Export-Oriented and High-Tech FIEs from Certain Welfare Payments (G49)

In addition to the tax benefits discussed above, export-oriented and high-tech FIEs are exempted from making certain employee welfare payments.¹³⁰

E. GOVERNMENT INACTION AGAINST ILLEGAL LOGGING

Illegal logging, in addition to its undesirable social and environmental consequences, may distort trade by providing some wood products producers with artificially-low-cost timber

¹²⁸ See WT/DS358/1/Add.1 at 2, citing Article 73(6), *State Council Rules for Implementation of the Income Tax Law of the PRC on Enterprises with Foreign Investment and Foreign Enterprises*, Decree [1991] No. 85. See Exhibit F-5.

¹²⁹ See WT/DS358/1/Add.1 at 2, citing MOFCOM, *Catalogue for the Guidance of Foreign Investment (Amended in 2004)* (November 30, 2004). See Exhibit F-26.

¹³⁰ See WT/DS358/1/Add.1 at 2, citing Article 3, *Provisions of the State Council on the Encouragement of Foreign Investment*, Guo Fa [1986] No. 95. See Exhibit F-39.

that has been harvested contrary to national laws.¹³¹ A recent report estimated that, in 2002, 30 percent of China's wood exports might have used timber from suspicious sources.¹³²

Illegal logging used to be a significant problem in China. In 1995, 34 million cubic meters of raw timber were reported to be logged over quota.¹³³ The Ministry of Forestry estimated in 1997 that 31 percent of the timber harvested in Heilongjiang, the most important timber-producing province in China, was over quota. Currently, the situation of over-quota logging is less clear after China strengthened its enforcement of the logging quota and the new forest law subsequent to the 1998 flood. In 2004, "SFA reported that the problem of 'excessive logging' had been 'straightened out.'"¹³⁴ Other reports, however, indicate that illegal logging remains a problem in some areas.¹³⁵

In addition, illegal logging has been a serious problem in some countries that export logs to China. In Russia, from which China imports 70 percent of its softwood logs, 20-30 percent of the harvest is believed to be illegal.¹³⁶ Indonesia, the other primary source of China's log imports, frequently is cited as having the highest illegal logging rate among the world's major

¹³¹ In response to such concerns, the U.S. International Trade Commission recently included illegal logging as a factor to be examined in a Section 332 investigation requested by the Senate Committee on Finance regarding the competitive conditions affecting the U.S. wood flooring and hardwood plywood industry. See International Trade Commission, *Wood Flooring and Hardwood Plywood: Competitive Conditions Affecting the U.S. Industries*, 72 Fed. Reg. 19960 (April 20, 2007).

¹³² Seneca Creek Associates & Wood Resources International, *"Illegal" Logging and Global Wood Markets: The Competitive Impacts on the U.S. Wood Products Industry* (November 2004) at 17. If this estimation is accurate, USD \$1.811 billion worth of China's exports of wood products to the United States that year would be from suspicious sources.

¹³³ *Id.* at 129, citing Chen & Lu, *Natural Forest Resource Conservation and Sustainable Management in Key Forest Areas*, FORESTRY ECONOMICS, No 2 (April 1999).

¹³⁴ Seneca Creek Associates & Wood Resources International, *"Illegal" Logging and Global Wood Markets: The Competitive Impacts on the U.S. Wood Products Industry* (November 2004) at 130.

¹³⁵ *Id.*

¹³⁶ *Id.* at 99.

log producers.¹³⁷ Sixty to eighty percent of the log harvest in Indonesia is believed to be unlicensed.¹³⁸ News reports have voiced concern that China's strong demand for wood products has had the unintended consequence of worsening the illegal logging problem as countries expand log exports to China to meet the growing demand for logs by wood products companies in China. Concerns have also been raised that China has not done enough to stop the importation of illegal logs.

A recent article in the *Washington Post* claimed that half of the logging in Russia was illegal, and that much of the illegally-harvested timber ended up in China. The article criticized the Chinese border authority for not making a sufficient effort in authenticating harvest permits for the imported logs.¹³⁹ Another article reported that some Chinese companies have been importing Merbau, an endangered species, notwithstanding that they have reason to know that the logs were harvested illegally.¹⁴⁰ Foreign multinational companies, including IKEA and Home Depot, that purchase wood products from the Chinese manufacturers were blamed for turning a blind eye to the sources of the raw timber their Chinese suppliers had been using.¹⁴¹ A

¹³⁷ *Id.* In the U.S. CVD investigation of *CFS Paper from Indonesia*, the United Steelworkers Union and the Sierra Club alleged that government inaction toward illegal logging should be investigated as a government subsidy because the authority's failure to enforce its laws regarding logging fees and forestry regulations resulted in the provision of a good (standing timber) to the Indonesian industry for less than adequate remuneration. See *Coated Free Sheet Paper from Indonesia: Notice of Preliminary Affirmative Countervailing Duty Determination*, 72 Fed. Reg. 17498, 17499 (April 9, 2007).

¹³⁸ Seneca Creek Associates & Wood Resources International, "Illegal" Logging and Global Wood Markets: *The Competitive Impacts on the U.S. Wood Products Industry* (November 2004) at 65. See also Andy White, et al., *China and the Global Market for Forest Products: Transforming Trade to Benefit Forests and Livelihoods* (March 2006) at 14. See Exhibit F-10.

¹³⁹ Peter S. Goodman and Peter Finn, *Corruption Strains Timber Trade*, THE WASHINGTON POST (April 1, 2007) at A01. See Exhibit F-14.

¹⁴⁰ Michael Casey, *Group: China Buying Threatened Hardwood*, THE WASHINGTON POST (April 17, 2007). See Exhibit F-40.

¹⁴¹ Peter S. Goodman and Peter Finn, *Corruption Strains Timber Trade*, THE WASHINGTON POST (April 1, 2007) at A01. See Exhibit F-14.

research paper similarly found: “Across East Asia, there is evidence to suggest that large quantities of illegally-sourced wood products are heading for China.”¹⁴²

Environmental and industry groups recently started taking measures to encourage Chinese wood producers to use only legally-harvested logs. The Forest Stewardship Council (“FSC”) established its China National Working Group in March 2006 in Beijing, and has started issuing certificates for wood products producers that use only legal timber. A domestic wood products certification system similar to the FSC scheme is under development. A number of companies that import wood products from China, notably in the EU and the United States, are seeking to source their imports from certified producers in China in order to meet consumer demand for certified wood products in their markets. Wood products producers in China have reportedly reacted positively. Four months after inception, the FSC has certified that 146 Chinese producers have passed its Chain of Custody certification.¹⁴³ There are reports, however, that the effective monitoring of the actual use of the type of timber remains problematic.¹⁴⁴ On the government side, some efforts have been made to curtail illegal logging through bilateral agreement. For example, in 2000, China signed a Memorandum of Understanding with Indonesia, in which the countries pledged to establish a joint action plan to identify sources of

¹⁴² See Andy White, *et al.*, *China and the Global Market for Forest Products: Transforming Trade to Benefit Forests and Livelihoods* (March 2006) at 14. See Exhibit F-10.

¹⁴³ See USDA, Foreign Agricultural Service, *PRC Solid Wood Products Annual, 2006*, GAIN Report CH6052 (July 13, 2006) at 5. See Exhibit F-6.

¹⁴⁴ Peter S. Goodman and Peter Finn, *Corruption Strains Timber Trade*, THE WASHINGTON POST (April 1, 2007) at A01. See Exhibit F-14.

illegally-harvested timber, combat trade in such timber, and improve enforcement of forestry laws.¹⁴⁵

F. PROVINCIAL PROGRAMS

The provincial and local government plays an important role in providing support to the wood products industry. Most subsidy programs launched by the central government are implemented through the local government. For instance, in the laminate flooring investigation, the CBSA found that, with regard to the tax benefit granted to the productive FIEs with operational periods longer than 10 years, notwithstanding that “[t]he authority responsible for administering this program is the *State Administration of Taxation of the People's Republic of China*, [the] local tax offices are responsible for implementing State policy and all relevant matters related to income tax assessment and collection, including examination and approval of applications relating to preferential income tax treatment.”¹⁴⁶

In addition, provincial and local governments have been active in exercising their legal authority to initiate their own industrial promotion programs. Article 9 of the FIE Income Tax Law explicitly delegates to provincial governments the authority to grant local income tax exemptions or deductions to FIEs operating in encouraged industries, which include the forestry industry. The local governments have also been active in establishing special economic zones (SEZs) and granting various favorable treatment to the enterprises operating in these SEZs.

¹⁴⁵ *Memorandum of Understanding between the Government of the Republic of Indonesia and the Government of the People's Republic of China Concerning Cooperation in Combating Illegal Trade of Forest Products*. See Exhibit F-41.

¹⁴⁶ CBSA, *Laminate Flooring Statement of Reasons* (June 1, 2005) at Appendix 3 (program 1).

The AF&PA report noted that the provinces of Gansu and Xinjiang maintained some preferential policies for afforestation projects. Enterprises have been given free land to be used for afforestation purposes, and the terms of land-use-rights granted have been longer than what Chinese national law allows. The Chinese national land law provides that land-use-rights for commercial usage should not be extended for a period longer than 50 years, but, in Gansu and Xinjiang, enterprises are granted land-use-rights for 70 years and 60 years, respectively, for plantation development purposes.¹⁴⁷

The AF&PA report also found that, in practice, local governments have the potential to provide support to companies in the forestry sector in a number of ways. For instance, local governments “allowed enterprises to utilize land at no charge.”¹⁴⁸ In another instance, a local government agreed to transfer water resources from other areas to support a foreign-invested wood products project. In addition, local governments decide certain tax rates and fee waivers, and have a great influence on the terms of the loans extended to the wood products enterprises.¹⁴⁹

The annual reports of some forestry enterprises listed on Chinese stock exchanges also indicate that local governments are significant sources of public funds. Shandong Chenming Paper Holdings Limited, one of the two mandatory respondents in the CFS case, as well as other paper makers named in the investigation, listed in their respective 2006 annual reports the following seven local programs from which they benefited in 2006.

¹⁴⁷ AF&PA, *China's Subsidization of its Forest Products Industry* (July 2004) at 15. See Exhibit F-9.

¹⁴⁸ *Id.* at 50. See Exhibit F-9.

¹⁴⁹ *Id.* See Exhibit F-9.

Programs Identified In Company Annual Reports for 2006

Program: *Local Award for Leading Exporters*
Recipient: *Shandong Chenming*
Description: In its Circulation No. 8 for 2006, the Treasury Bureau of Shouguang City in Shandong Province allows awards for leading exporters of the city. Shandong Chenming received RMB 4.929 million under this program in 2006. One of Chenming's subsidiaries located in Nanchang city, Jiangxi Province, received a similar award from the city authority totaling RMB 445,900.¹⁵⁰

Program: *Local Award for Leading Tax Payers*
Recipient: *Shandong Chenming*
Description: In its Circulation No.9 for 2006, the Treasury Bureau of Shouguang City granted Shandong Chenming a governmental award totaling RMB 13.071 million for being among the leading tax payers of the city.¹⁵¹

Program: *Local Government Grants for Technological Renovation Program*
Recipients: *Shandong Chenming*
Ningxia Meili
Description: In its Circulation No. 10 for 2006, the Treasury Bureau of Shouguang City granted Shandong Chenming RMB 36.144 million to support the company's technological renovation program related to its coated paper production. Its subsidiary in Wuhan City received a similar subsidy for a technological renovation program in the amount of RMB 2.8 million. For similar reasons, authorities in the city of Hailare, Inner Mongolia provided another RMB 2.7 million to a Shandong Chenming subsidiary in that city.¹⁵²

In another instance, in 2006, the Zhongwei city authority granted RMB 7.71 million in technological innovation aid to Ningxia Meili Paper.¹⁵³

¹⁵⁰ Shandong Chenming Paper Group, *2006 Annual Report* at 44, 45. See Exhibit F-42.

¹⁵¹ Shandong Chenming Paper Group, *2006 Annual Report* at 44. See Exhibit F-42.

¹⁵² Shandong Chenming Paper Group, *2006 Annual Report* at 44, 45. See Exhibit F-42.

¹⁵³ Ningxia Meili Paper Industry Co., Ltd., *2006 Annual Report* at 51. See Exhibit F-43.

Programs Identified In Company Annual Reports for 2006

Program: *Local Tax Rebate*
Recipient: *Shandong Chenming*
Description: The General Office of the Shouguang city government, in its Circulation No. 188, allowed the company a local tax rebate of RMB 1.345 million. The company's annual report also disclosed that the Shouguang local government exempts companies in a local industrial district from local tax in the first year, followed by a 50 percent reduction in local tax for the subsequent two years. A similar rebate was provided by the local authority in Jilin Yanbian Korean autonomous county, Jilin Province. A subsidiary of Shandong Chenming located in that county received RMB 6.61 million in local tax rebates in 2006.¹⁵⁴

Program: *Local Policy Grants*
Recipient: *Shandong Chenming*
Description: Shandong Chenming received from Chibi City Treasury Bureau, Hubei Province, policy grants of RMB 9.7 million in 2006. The Qihe City Authority in Shandong Province granted the company another RMB 28.35 million.¹⁵⁵

Program: *Local Environmental Protection Program Subsidy*
Recipient: *Ningxia Meili*
Description: Ningxia autonomous region government granted Ningxia Meili RMB 400,000 in 2006 to support its environmental protection projects.¹⁵⁶

Program: *High-Tech R&D Subsidy*
Recipient: *Ningxia Meili*
Description: In 2006, the Zhongwei city authority granted RMB 500,000 to Ningxia Meili in support its R&D activities.¹⁵⁷

¹⁵⁴ Shandong Chenming Paper Group, *2006 Annual Report* at 44, 45. See Exhibit F-42.

¹⁵⁵ Shandong Chenming Paper Group, *2006 Annual Report* at 45. See Exhibit F-42.

¹⁵⁶ Ningxia Meili Paper Industry Co., Ltd., *2006 Annual Report* at 51. See Exhibit F-43.

¹⁵⁷ *Id.* See Exhibit F-43.

G. THE MAGNITUDE OF GOVERNMENT SUBSIDIES RECEIVED AT THE ENTERPRISE LEVEL

Several Chinese forestry enterprises were involved in the two CVD investigations conducted in the United States and Canada. The annual reports of these companies provide some limited information on the level and types of government assistance extended to companies in the forestry sector. The financial reports of these companies reflect certain benefits that they record as subsidies but the reports do not necessarily cover all subsidies received by the companies. The following reviews financial information reported in the annual reports of six Chinese companies in the forestry sector.

1. Shandong Chenming Paper Group

Shandong Chenming Paper Group is a major Chinese Paper producer. It is one of the two mandatory respondents in the U.S. CFS paper countervailing duty investigation. The company is listed on the Shanghai Stock Exchange. Its annual report for 2006 lists government support totaling RMB 153.088 million for the year.

Shandong Chenming Paper Group	RMB
Total government grants and tax benefits	153,088,569.48
Sales revenue	11,814,092,426.30

Source: Shandong Chenming Paper Group, 2006 Annual Report¹⁵⁸

¹⁵⁸ Shandong Chenming Paper Group, *2006 Annual Report at 5, 44*. See Exhibit 42.

Shandong Chenming Paper Group: Break Down of Grants Received
(RMB '000)

	2006	2005
Shandong Chenming Paper Group	56,634	45,673
Shandong Chenming Paper Group Qihe Linerboard Paper Company Limited	33,424	47,336
Shandong Chenming Paper Group Qihe Linerboard Paper Company Limited	28,350	--
Chibi Chenming Paper Company Limited	9,700	12,060
Yanbian Chenming Paper Company Limited	6,611	6,649
Wuhan Chenming Hanyang Paper Company Limited	2,800	5,803
Hailaer Chenming Paper Company Limited	2,700	2,240
Shandong Chenming Panels Company Limited	1,521	771
Jiangxi Chenming Paper Company Limited	446	245
Heze Chenming Panels Company Limited	--	950
TOTAL GRANTS:	142,186	121,727
TAX REBATE:	10,902	
TOTAL SUBSIDY:	153,088	

Source: Shandong Chenming Paper Group, Auditor's Report and Consolidated Financial Statements for the Year Ended 31 December 2006¹⁵⁹

2. Shandong Huatai Paper Company, Ltd.

The petitioner in the in the CFS paper investigation listed Shandong Huatai Paper Company, Ltd. as a recommended respondent. The company is China's largest newsprint producer, and is listed on the Shanghai Stock Exchange. In 2006, its paper production capacity was 1.2 million tonnes. All of the reported subsidy received by Shandong Huatai Paper Company, Ltd. was in the form of VAT export rebates.

¹⁵⁹ Shandong Chenming Paper Group, *Auditor's Report and Consolidated Financial Statements for the Year Ended 31 December 2006* at 26. See Exhibit F-92.

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Shandong Huatai Paper Company, Ltd.	RMB
Grants income	1,185,316.90
Sales revenue	3,739,619,064.92

Source: Shandong Huatai Paper Co., Ltd., 2006 Annual Report¹⁶⁰

3. Ningxia Meili Paper Industry Company, Ltd.

Ningxia Meili Paper Industry Company, Ltd. is another recommended respondent in the CFS paper case. It is a major paper maker, ranking 8th in the industry, with annual production capacity of 450,000 tonnes. It is listed on the Shenzhen Stock Exchange, and is certified as a Dragon Head enterprise in the Ningxia province. It also has pulp production capacity of 350,000 tonnes, and owns a plantation covering an area of 0.5 million ha.

Ningxia Meili Paper Industry Company, Ltd.	RMB
Subsidy Income	8,910,000.00
Sales Revenue	904,740,197.69

Ningxia Meili Paper Industry Company, Ltd.: Break Down of Grants Received (RMB)

	2006
Technology Renovation Grants by the Local Government	7,710,000.00
Environmental Protection Grants	400,000.00
Packaging Technology R&D Development	500,000.00
Government Rewards	300,000.00
TOTAL	8,910,000.00

Source: Ningxia Meili Paper Industry Co., Ltd., 2006 Annual Report¹⁶¹

¹⁶⁰ Shandong Huatai Paper Co., Ltd., 2006 Annual Report at 4, 60. See Exhibit F-44.

¹⁶¹ Ningxia Meili Paper Industry Co., Ltd., 2006 Annual Report at 51 and section 3 (financial highlights). See Exhibit F-43.

4. Yueyang Paper Company, Ltd.

Yueyang Paper Company, Ltd. is a producer of newsprint and coated paper. Its stock is listed on Shanghai Stock Exchange. Yueyang Paper has paper production capacity of 400,000 tonnes, pulp capacity of 450,000 tonnes, and owns a plantation covering 850,000 ha. The VAT exemption reported by Yueyang Paper was granted for timber that was produced by the company and consumed in the company's pulp production.

Yueyang Paper Company, Ltd.	RMB
Subsidy Income	4,776,807.49
Sales Revenue	1,872,841,583.44

Yueyang Paper Company, Ltd.: Break Down of Subsidies Received (RMB)

	2006
VAT Exemption	4,659,807.49
Plantations Development Subsidy	117,000.00
TOTAL	4,776,807.49

Source: Yueyang Paper Co., Ltd., 2006 Annual Report¹⁶²

5. An Hui Shan Ying Paper Industry Company, Ltd.

An Hui Shan Ying Paper Industry Company, Ltd. is a major paper board producer with annual paper and paper board production capacity of 500,000 tonnes. It is a public company listed on the Shanghai Stock Exchange.

¹⁶² Yueyang Paper Co., Ltd., 2006 Annual Report at 5, 65. See Exhibit F-45.

An Hui Shan Ying Paper Industry Company, Ltd.	RMB
Government Subsidy	32,045,089.22
Sales Revenue	1,628,186,684.47

**An Hui Shan Ying Paper Industry Company, Ltd.: Break Down of Subsidies Received
(RMB)**

	2006
Policy grants VAT exemption	2,399,500.00
Tax rebate Plantations Development subsidy	21,927,871.40
Subsidy for utilizing recycled paper	7,717,717.82
TOTAL	32,045,089.22

Source: An Hui Shan Ying Paper Industry Co., Ltd., 2006 Annual Report¹⁶³

**6. Fujian YongAn Forestry Group Joint-Stock Company,
Ltd.**

Fujian YongAn is one of the largest wood panel producers in China. It was the first forestry company listed on the Shanghai Stock Exchange. The company was involved, as an exporter, in the Canadian countervailing duty investigation of laminate flooring. The entire subsidy reported by Fujian YongAn Forestry Group was received as VAT rebates for various reasons.

Fujian YongAn Forestry Group Ltd.	RMB
Government Subsidy	7,158,749.97
Sales Revenue	345,825,405.86

Source: Fujian YongAn Forestry Group Joint-Stock Co., Ltd., 2006 Annual Report¹⁶⁴

¹⁶³ An Hui Shan Ying Paper Industry Co., Ltd., *2006 Annual Report* at 2, 56. See Exhibit F-46.

¹⁶⁴ Fujian YongAn Forestry Group Joint-Stock Co., Ltd., *2006 Annual Report* at 5, 66. See Exhibit F-47.