

## INDUSTRY OVERVIEW

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### AGRICULTURAL INDUSTRY IN THE PRC

#### Contribution of Agricultural Industry on Gross Domestic Product and Gross Output Value

With a population of approximately 1.31 billion at the end of 2006, as stated by the National Bureau of Statistics of the China, the PRC has become the world's most populous country. The PRC is highly acclaimed for its ability to feed over one fifth of the world population with only approximately 7% of the world's arable land<sup>1</sup>, indicating that the agricultural economy of the PRC and its relationship with the global market are important. Agriculture and agricultural trade (including farming, forestry, animal husbandry and fishery) play an important role in the PRC national economies. According to the data provided by the National Bureau of Statistics of the China in 2007, the added value output from the agricultural industry in the PRC amounted to approximately RMB2,470 billion in 2006, representing approximately 11.80% of the total gross domestic product of the PRC of approximately RMB20,940.7 billion.

The table below illustrates the growth in gross output value of the agricultural industry and its sub-category, farming industry, in the PRC from 1995 to 2005, indicating that the total agricultural industry and the farming industry in the PRC experienced the CAGR of approximately 6.85% and 5.14% from 1995 to 2005 respectively.

#### Gross Output Value of the Agricultural Industry in the PRC

	<b>Farming</b> <i>(RMB' billion)</i>	<b>Total agricultural industry</b> <b>(including farming, forestry,</b> <b>animal husbandry and fishery)</b> <i>(RMB' billion)</i>
1995	1,188.5	2,034.1
1996	1,354.0	2,235.4
1997	1,385.3	2,378.8
1998	1,424.2	2,454.2
1999	1,410.6	2,451.9
2000	1,387.4	2,491.6
2001	1,446.3	2,618.0
2002	1,493.2	2,739.1
2003	1,487.0	2,969.2
2004	1,813.8	3,623.9
2005	1,961.3	3,945.1
CAGR	5.14%	6.85%

Source: China Statistical Yearbook, 2006

<sup>1</sup> "China's agriculture, trade, and productivity in the 21st Century", Jikun Huang, Scott Rozelle, Francis Tuan.

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### Agricultural Investment in the PRC

During the economic reforms of the PRC in the late 1970s, the importance of agriculture in the PRC's economy had declined which was indicated by the decreasing contribution of agricultural industry to the gross domestic product of the PRC. According to the China Agriculture Yearbook, 2006, the contribution of the agricultural industry to the total gross domestic product of the PRC decreased from approximately 30.1% in 1980 to approximately 12.5% in 2005. The total sown area of farmland in the PRC also decreased by approximately 885,000 hectares, from 156.4 million in 1999 to approximately 155.5 million hectares in 2005. However, the population of the PRC increased from approximately 1,257.9 million as at the end of 1999 to approximately 1,307.6 million as at the end of 2005. This represents a reduction in the total sown area per capita by approximately 4.03% from approximately 0.124 hectare to approximately 0.119 hectare from 1999 to 2005. The table below illustrates the total sown area and the total sown area per capita in the PRC during the period from 1999 to 2005:

**Total Sown Area and Total Sown Area per Capita in the PRC**

	<b>Total Sown Area</b> <i>(million hectares in approximation)</i>	<b>Population</b> <i>(million persons in approximation)</i>	<b>Total Sown Area per Capita</b> <i>(hectares in approximation)</i>
1999	156.4	1,257.9	0.124
2000	156.3	1,267.4	0.123
2001	155.7	1,276.3	0.122
2002	154.6	1,284.5	0.120
2003	152.4	1,292.3	0.118
2004	153.6	1,299.9	0.118
2005	155.5	1,307.6	0.119

*Source:* China Statistical Yearbook, 2006

Due to the reduction in the total sown area per capita, the development of the PRC agricultural industry has relied on adopting new technology to increase production and productivity of agricultural output. Recent studies<sup>2</sup> show that technological change has become the primary motivator of agricultural growth. As science and technology play a very important role in improving agricultural productivity, the PRC Government concludes in the Outline of Agricultural Technology Development 2001-2010 that the PRC would rely on new technology to raise future agricultural production. According to the Outline of Agricultural Technology Development 2001-2010, the PRC Government has begun an ambitious program promoting biotechnology and has pushed a number of high profile technology projects. In the last decade, the capital construction investments in

<sup>2</sup> "China's agriculture, trade, and productivity in the 21st Century", Jikun Huang, Scott Rozelle, Francis Tuan.

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agricultural industry in the PRC had increased from RMB7.66 billion in 1995 to RMB58.78 billion in 2002, with a CAGR of 33.79%, while the ratio of investment in agricultural industry to the total investments had increased from 1.0% in 1995 to 3.3% in 2002 as shown in the table below:

### Agricultural Investment in the PRC

	<b>Investments in Agricultural Industry (RMB' billion)</b>	<b>Total Investments (RMB' billion)</b>	<b>Proportion of Investment in Agricultural industry to Total Investments (%)</b>
1995	7.66	740.36	1.0
1996	11.13	861.08	1.3
1997	15.39	991.70	1.6
1998	22.54	1,191.64	1.9
1999	29.90	1,245.53	2.4
2000	36.09	1,342.73	2.7
2001	43.46	1,482.01	2.9
2002	58.78	1,766.66	3.3
CAGR	33.79%	13.22%	

Source: China Statistical Yearbook, 2004

From 2003 to 2005, China's fixed asset investments in agriculture as a percentage of total fixed asset investments ranged between 2.6% to 3.1%. The table below indicates the fixed asset investments and agricultural fixed asset investments in China from 2003 to 2005:

	<b>Fixed asset investments in agriculture (RMB' billion)</b>	<b>Total fixed asset investments (RMB' billion)</b>	<b>Fixed asset investments in agriculture as a percentage of total fixed asset investments (%)</b>
2003	1.7	55.57	3.1
2004	1.9	70.48	2.7
2005	2.3	88.77	2.6

Source: China Statistical Yearbook, 2006

### Agricultural Production and Consumption

Since the total sown area of farmland in the PRC declined in recent years, the growth in the yield of crops in the PRC is affected. In particular, the decrease in CAGR of grain and beetroots from 1999 to 2006 are 0.31% and 1.52% respectively indicating that the supply of crops like grain and beetroots in the PRC is declining. However, the demand of agricultural products in the PRC maintains a growth momentum which is in line with the growing population. From 1997 to 2003, the trading volume of grain and oil, vegetables and dried and fresh fruits in the PRC consumer market

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had increased from RMB441.16 billion to RMB697.18 billion in 2003, representing a CAGR of 7.93%. This situation shows that the demand and supply of agricultural products in the PRC are unbalanced in recent years as the supply is decreasing while the demand is increasing.

The below table and figures illustrate the yield of different categories of major crops in the PRC and the trading volume of major agricultural products in the PRC consumer market:

### Yield of Major Farm Crops in the PRC

*Unit: (million tonnes)*

	1999	2000	2001	2002	2003	2004	2005	2006	CAGR (%)
Grain	508.39	462.18	452.64	457.06	430.70	469.47	484.02	497.46	-0.31
Oil-bearing Crops	26.01	29.55	28.65	28.97	28.11	30.66	30.77	30.62	2.36
Cotton	3.83	4.42	5.32	4.92	4.86	6.32	5.71	6.73	8.39
Fiber Crops	0.47	0.53	0.68	0.96	0.85	1.07	1.11	—	15.40
Sugarcane	74.70	68.28	75.66	90.11	90.24	89.85	86.64	109.87	5.67
Beetroots	8.64	8.07	10.89	12.82	6.18	5.86	7.88	—	-1.52
Tobacco	2.47	2.55	2.35	2.45	2.26	2.41	2.68	2.47	0.00
Silkworm Cocoons	0.49	0.55	0.66	0.70	0.67	0.73	0.78	—	8.06
Tea	0.68	0.68	0.70	0.75	0.77	0.84	0.94	1.02	5.96
Fruits	62.38	62.25	66.58	69.52	145.17	153.41	161.20	170.50	15.45

*Source:* China Statistical Yearbook, 2006 and Publication of Statistics of the National Economic and Social Development of the People's Republic of China for 2006

### Trading Volume of Major Agricultural Products in the PRC Consumer Market

*Unit: (billion RMB)*

	1997	1998	1999	2000	2001	2002	2003	CAGR (%)
Grain and oil	136.06	146.48	159.11	195.95	186.85	209.55	232.49	9.34
Vegetables	194.46	220.70	242.55	266.18	269.52	288.77	293.81	7.12
Dried and fresh fruits	110.64	123.47	139.82	154.62	158.44	169.22	170.88	7.51

*Source:* China Statistics Yearbooks, 2000 and 2004

### Irrigated Area and Water Resources

According to China Statistics Yearbook 2006, the total irrigated area in the PRC in 2005 was approximately 55.03 million hectares, representing an increase of approximately 0.55 million hectares when compared to the previous year, of which approximately 21.34 million hectares or approximately 38.78% of the total irrigated area is categorised as the water saving irrigated area.

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This shows that water saving irrigation has become increasingly important in the PRC agricultural industry in recent years. The below table shows the total irrigated area and the water saving irrigated area in the PRC for the period from 2000 to 2005:

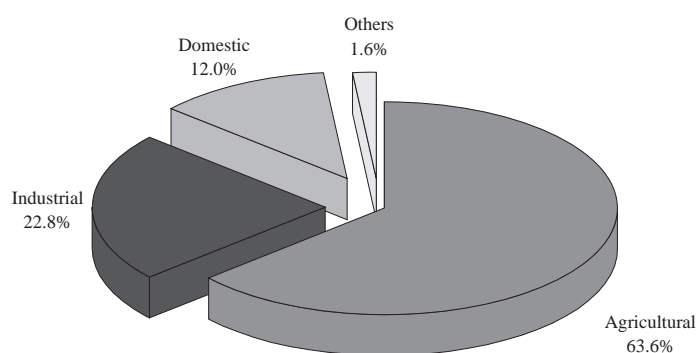
**Total Irrigated Area and Water Saving Irrigated Area in the PRC**

	<b>Water Saving Irrigated Area</b> <i>(million hectares in approximation)</i>	<b>Total Irrigated Area Area</b> <i>(million hectares in approximation)</i>	<b>Proportion of Water Saving Irrigated Area to Total Irrigated Area</b>
2000	16.39	53.82	30.45
2001	17.45	54.25	32.17
2002	18.63	54.35	34.28
2003	19.44	54.01	35.99
2004	20.35	54.48	37.35
2005	21.34	55.03	38.78
CAGR	5.42%	0.45%	

*Source:* China Statistics Yearbooks, 2003 and 2006

Agricultural water consumption accounts for a significant portion of the total annual water consumption of the PRC. In 2005, total water consumption amounted to approximately 563.3 billion cubic meters, including agricultural water consumption amounted to approximately 358.0 billion cubic meters or approximately 63.6% of total water consumption of the PRC. The chart below indicates the composition of total consumption of water in the PRC in 2005.

**Composition of the Total Consumption of Water in the PRC in 2005**



*Source:* China Statistics Yearbook, 2006

There has been water shortage in the PRC. According to the Bulletin of National Economic and Social Development of the People's Republic of China 2006, water resources in the PRC amounted to 2,550 billion cubic meters in 2006, representing a decrease of 9.1% compared to the previous year. Water resources per capita in China amounted to approximately 1,945 cubic meters, representing a decrease of approximately 9.6% compared to the previous year. Throughout the

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year, the yearly average volume of rainfall was approximately 604mm, representing a reduction of approximately 6.2% when compared to the previous year. Total amount of water consumption in the PRC was approximately 567.0 billion cubic meters, representing an increase of approximately 0.7% when compared to the previous year, out of which domestic, industrial and agricultural consumption increased by 0.7%, 1.9% and 0.2%, respectively. National water consumption per capita amounted to 432 cubic meters, which was basically unchanged compared to the previous year. During the year, 35.78 million people and 29.36 million livestock in the country were subject to temporary undersupply of drinking water because of drought. According to reports of the Xinhua News Agency on 30 November 2005, more than 400 out of over 660 cities in China were subject to water shortage in varying degrees, among which 136 cities were subject to serious water shortage.

### **Enhancement of farmland drainage and ecological facilities**

According to “The Opinions on Certain Policies for Further Strengthening the Affairs of Rural Areas and Enhancing the Composite Production Capacity of Agricultural Industry” promulgated by the Central Committee of the Communist Party and the State Council at the end of 2004, the construction of large-scale auxiliary drip zones focusing on the reform of water saving should be speeded up. The new investment in fixed assets should focus on the construction of large-scale auxiliary drip zones coupled with an increasing commitment in executing better field construction development, upgrading and reforming obsolete machinery and equipments, perfecting drip and discharge systems, and developing and continuing construction of trial points of late-class drainage in auxiliary drip zones. Demonstration of water saving irrigation system is continued to be undertaken, under which standardised construction trial points are established at the main regions of food production. The pace of drainage modernisation in qualified areas should be speeded up. The regions with better water sources have to be fitted with main drainage convergent facilities to expand irrigation areas. Water saving agriculture method has to be developed extensively in the drought-affected areas and the construction of demonstration zones on drought agriculture should be continued. The measurement of irrigation water utilisation has to be emphasised in all areas and the control of total water consumption and fixed-amount management should also be actively implemented. Certain areas have been selected as pilot areas where the farmers are granted subsidies for purchasing water saving equipments in selected regions since 2005.

The PRC Government called for faster development of water saving irrigation and ongoing construction of complementary facilities and upgrades for enhancing water saving features at large irrigation zones as a continued focus for agricultural fixed asset investments, increased efforts in the technological upgrade of water discharge and pumping stations, the construction of ancillary field works, vigorous promotion of water saving technologies and the gradual increase of special subsidies for water conservancy works at small fields jointly undertaken by the central government and provincial governments in the document entitled “Opinions on Driving the Building of New Socialist Agricultural Villages” promulgated by the Central Committee of the Communist Party and the State Council in December 2005.

In the document entitled “Opinions on the Developing Modern Agriculture and Making Solid Progress in the Building of New Socialist Agricultural Villages” promulgated by the Central Committee of the Communist Party and the State Council in January 2007, the PRC Government called for the active development and application of various energy saving agricultural technologies, enhanced efficiency for the use of agricultural resources and input, vigorous promotion water saving irrigation technologies and start-up of demonstrative projects on water saving agricultural devices for drought seasons.

### Supply and demand of agricultural usage of plastic water saving irrigation system equipment and background of agricultural industry in Xinjiang

The agricultural industry in Xinjiang plays a relatively important role in the economy of Xinjiang. In 2006, Xinjiang's added value output from the agricultural industry amounted to approximately RMB53.32 billion, representing an increase of approximately 5.7% when compared to 2005, and representing approximately 17.66% of Xinjiang's GDP which amounted to approximately RMB301.898 billion in 2006. This percentage is much higher than the average of approximately 11.80% in China as a whole. Xinjiang's long daylight time, high heat retention rate, great temperature difference between day and night and long frost-free period are highly beneficial to the growth of crops. Xinjiang's major agricultural products are crops, oil materials, cotton, beet, vegetables and fruits. The major types of crops are wheat and corn, and agricultural products such as cotton, safflower, matrimony vine, hami melon, Turpan grapes and Korla pears which are well known worldwide. Also, Xinjiang is the largest manufacturing base of commodity cotton, hops and tomato paste in the PRC. The total production and quality of Xinjiang's cotton ranks number one in the PRC. Cotton output in Xinjiang reached approximately 2.18 million tonnes in 2006, representing approximately 32.39% of the total cotton output in the PRC. Xinjiang has approximately 4,107,100 hectares of farmland. In 2006, sowing area for grain was approximately 1,465,800 hectares, sowing area for cotton was approximately 1,286,600 hectares, and the sowing area for oil materials, beet, vegetables and fruits were approximately 151,700 hectares, 94,400 hectares, 186,800 hectares and 74,000 hectares, respectively.

Xinjiang has a typical sub-tropical and continental dry climate with an annual rainfall amounting to approximately 155 mm. In 2005, Xinjiang's total water resources amounted to approximately 96.28 billion cubic metres, comprising surface water annual runoff of approximately 91.07 billion cubic metres and underground water of approximately 56.26 billion cubic metres, with an overlapping volume between surface water and underground water of approximately 51.04 billion cubic metres. The area of Xinjiang represents approximately 17.0% of the total area of the PRC, the total water resources in the area of Xinjiang represented only approximately 3.4% of the PRC's total water resources of approximately 2,805.3 billion cubic metres in 2005. In 2005, the amount of water used in Xinjiang was approximately 50.85 billion cubic metres, of which approximately 47.26 billion cubic metres was used in production, representing about 92.9% of the total water used; city and town residents used approximately 1.05 billion cubic metres, representing approximately 2.1% of the total water used; biological environment used approximately 2.54 billion cubic metres, representing approximately 5.0% of the total water used. Out of the water used in production, approximately 46.44 billion cubic metres was used in agricultural irrigation and approximately 820 million cubic metres was used for industrial usage. The average amount of water used in agricultural irrigation was approximately 12,315 cubic metres per hectare, representing nearly 2 times of the average water used in agricultural irrigation in the PRC, according to the 2003 Bulletin of Water Resources of the PRC and the 2003 Bulletin of Water Resources of the Xinjiang Uyghur Autonomous Region. Given that (i) water resources in Xinjiang are affected by seasonal factors; (ii) distribution is very uneven and a lot of surface water is evaporated; and (iii) economic development and population growth in cities would lead to an increasing demand on water used in agriculture, industries and daily lives, resulting in insufficient water resources in Xinjiang. Accordingly, developing water saving irrigation agriculture is in the core strategy of agricultural development in Xinjiang and the PRC as a whole.

*Source:* Website of the Government of Xinjiang Uyghur Autonomous Region  
"Bulletin of National Economic and Social Development of the Xinjiang Uyghur Autonomous Region 2006"  
China Statistics Yearbook, 2006

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According to China Plastics Industry Yearbook, 2006, there were 402 plastic products enterprises in Xinjiang in 2005; among which, 327 enterprises had an annual capacity of under 2,000 tonnes; 52 enterprises had an annual capacity between 2,000 tonnes to 3,000 tonnes; 18 enterprises had an annual capacity of over 3,000 tonnes to 10,000 tonnes and 5 enterprises had an annual capacity of over 10,000 tonnes. Total output of those 23 enterprises with an annual capacity of over 3,000 tonnes is estimated to be approximately 204,500 tonnes, representing approximately 52.2% of Xinjiang's estimated total output of plastic products of 391,700 tonnes in 2005. The output of agricultural plastic water saving irrigation system equipment amounted to approximately 103,000 tonnes in 2005, representing approximately 26.3% of the then estimated total output of plastic product of 391,700 tonnes.

### Relevant policies and laws and regulations

The State Council issued "Opinions of Implementation of Certain Policies and Measures related to the Development of the Western Region" which stated and emphasised that "More subsidies will be granted by the Central Government of the PRC to local projects in the Western region, which will enhance the development of agricultural technology in the Western Region, the protection and establishment of un-irrigated agriculture, water saving irrigation agriculture and agriculture ecology, and the prevention and salvage of agricultural pests, etc."; "financial support will be given to the development of distinguished agriculture, water saving irrigation agriculture and ecological agriculture"; "a preferential enterprise income tax rate of 15% will be enjoyed by domestic and foreign investment enterprises established in the Western regions so as to encourage the setting up of business entities in the Western regions". Water saving irrigation agriculture and the recycling of agricultural films are industries highly encouraged for development by the State.

Members of the Standing Committee of the People's Congress of the Xinjiang Uyghur Autonomous Region amended the "Administrative Rules of Water Resources for the Talimu River watershed of the Xinjiang Uyghur Autonomous Region", which requires the farming industry structure of agricultural production within the watershed be adjusted and to adopt the water saving cultivation technology, implement water saving irrigation in order to increase water usage efficiency and benefits; and to establish a water saving management system and to develop water saving irrigation agriculture.

The "Notice Related to Certain Preferential Enterprise Income Tax Policies by the Ministry of Finance, the State Administration of Taxation" implemented on 1st January, 1994 stipulates that "Enterprise Income Tax for newly established enterprises in the minority areas confirmed by the State can be reduced or waived periodically after obtaining approval from the taxation authority in charge".

The "Notice Related to the Issues of Preferential Taxation Policies in the Development of the Western Region by the Ministry of Finance, State Administration of Taxation and China Customs" stipulates that: "Enterprise Income Tax for domestic enterprises in autonomous regions can be reduced or waived regularly after obtaining approval from the Provincial People's Government".

On 28th April, 2002, the People's Government of the Xinjiang Uyghur Autonomous Region issued the "Opinions of Implementation on Issues Related to Preferential Taxation Policies of the Development of the Western Region by the Xinjiang Uyghur Autonomous Region", which came into effect on 1st January, 2001, stipulates that "Save for enterprises overtly forbidden and eliminated by the State, Enterprise Income Tax of domestic enterprises newly established in the autonomous regions will be waived within the first three years of establishment after obtaining approval from the taxation department of the autonomous region".



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The “Provisional Regulations of Value-added Tax of the PRC” which was implemented on 1st January, 1994 stipulates that value-added tax rate for the sales of agricultural machinery is 13%.

The “Notice on Value-added Tax Policies Related to Scrapped Materials Recycling Operations by the Ministry of Finance and the State Administration of Taxation” which came into effect on 29th April, 2001 stipulates that: “From 1st May, 2001, the selling of scrapped materials to scrapped materials recycling operating units are exempt from value-added tax.”

The “Notice on Policies of the Imposition and Exemption of Value Added Tax Related to Certain Agricultural Production Information by the Ministry of Finance and the State Administration of Taxation” which came into effect on 20th July, 2001 stipulates that agricultural films are exempt from value-added tax.

The “Provisional Regulations of Business Tax of the PRC” which came into effect on 1st January, 1994 stipulates that agricultural drip films and flood storage businesses are exempt from business tax. On 5th September, 2003, the local taxation department of the Xinjiang Uyghur Autonomous Region clarified that agricultural drip films projects are exempt from business tax from 1st October, 2003 in the “Supplementary Notice Related to Certain Business Tax Policy Issues” in accordance with the requirements in respect of the business tax policy issues required by the Ministry of Finance, the State Administration of Taxation and the State Administration of Taxation.

The “Notice of Exemption of Value-added Tax on Drip Films and Drip Assemblies and Pipelines Products” which was issued by The Ministry of Finance and the State of Administration of Taxation in the PRC on 30th May, 2007, and came into effect on 1st July, 2007, stipulates that the value-added tax on the production, wholesaling and retailing of the products of drip films and drip assemblies and PVC/PE pipelines are exempted. On 12th July, 2007, the Company submitted its application to the State Administration of Taxation for exemption from value-added tax for producing and selling the drop films and drip assemblies and PVC/PE pipelines. As at the Latest Practicable Date, the Company still has not received any reply from the State Administration of Taxation.

Pursuant to the Income Tax Law of the PRC to be enacted on 1st January, 2008, income deriving from engagement in the agricultural, forestry, husbandry and fishery industries as well as qualified environmental protection and energy and water conservation projects shall be entitled to tax exemptions and reductions. Enterprises currently entitled to preferential tax rates shall conform to the new tax rates gradually over a period of five years after the enactment of the law. The enterprises, which are originally enjoying fixed period tax exemptions and reductions, may continue to enjoy such tax exemptions and reductions after the implementation of the law until it expires.

### **Encouragement of foreign investment by XCPR in the PRC**

In order to adapt the needs under the open policy of the PRC Government, such as attracting more foreign enterprises to invest in the area of XCPR and further enhancing the quality and standard of the use of foreign investment by XCPR, according to the laws and regulations of Law of the PRC on Regional National Autonomy, the Law of PRC on Sino- Foreign Equity Joint Ventures, the Law of PRC on Sino- Foreign Cooperative Joint Ventures, the Law of PRC on Foreign Capital Enterprises, the Law of PRC on Income Tax of Foreign Investment Enterprises and Foreign Enterprises and the Opinion on the Implementation of Certain Policies and Measures regarding the Western Exploration issued by the State Council and the Requirement of Certain Policies on the Encouragement of Foreign Investment in Uyghur Autonomous Region, Xinjiang, the XCPR encourages foreign investment in the focal industry of manufacture of water saving irrigation technologies and equipments.

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### **Concessionary policies for agricultural forestry and husbandry industries in the PRC**

The foreign investment enterprises engaging in agricultural, forestry and husbandry industries and those established in the farm at the border of the Regiment, with an operation terms of over 10 years are exempted from the Enterprise Income Tax for the first and second year starting from the first profitable year, a 50% reduction for the third year to the fifth year and at a rate of 15% for the sixth to eighth year. Subsequent to the tax free and reduction concessionary periods, with the approval from the taxation filing bureau upon the application by the foreign investment enterprises, such enterprises are subject to the Enterprise Income Tax at a reduction rate ranging from 15% to 30% on the tax payable for 10 years thereafter.