DEZAN SHIRA & ASSOCIATES
Your Partner for Growth in Asia

Tax Incentives in China

- How businesses can successfully utilize them

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Content

- Overview of China's major tax incentive schemes
- FAQs and case sharing in R&D tax incentives application
- Challenges with the new global minimum tax and potential impacts on MNCs

Overview of China's Major Tax Incentive Schemes

Overview of China's Major Tax Incentive Schemes

Small businesses

Technology Innovation

Special Economic Zones

Overview of China's Tax Incentive Scheme
- Small Business

CIT

- 2.5% for the portion of taxable income below RMB 1 million (Jan 1, 2021- Dec 31, 2022)
- 10% for the portion between 1 million to 3 million

VAT

- VAT exempt: small-scale taxpayer with VAT taxable sales less than RMB 150,000 per month (April 1, 2021 – Dec 31, 2022)
- 1% for VAT taxable sales between RMB 150,000 to RMB 416,667

Local taxes and fees

- UCMT, ES, LES: exempt with the monthly VAT taxable sales less than RMB 150,000
- 50% reduction on six local taxes and two fees

IIT

- 50% reduction on IIT for annual taxable income less than RMB 1 million

Overview of China’s Tax Incentive Scheme
- Technology Innovation

Seed Stage

- 70% of the amount invested in qualified technology company can be credited against the annual taxable income from the second year
- Individual ”business angel” investor: 70% of the investment amount can be credited against taxable gains on transfer for IIT purposes

Growth Stage

- 175% R&D super deduction for all industries (except those in the negative list)
- 200% R&D super deduction for advanced manufacturer
- Accelerated depreciation of machinery and equipment used in R&D (immediate write-off up to RMB 5M, and declining balance depreciation at a rate of 40% above this limit)
- Custom duty and VAT relief for purchases of R&D equipment
- VAT exemption on R&D services

Maturity Stage

- 15% CIT for High-tech company and advanced technology service company
- 10-year loss carry-forward period for High-tech and qualified technology SMEs
- 2+3 or 3+3 or 5+5 years tax holidays
- VAT exemption or zero rate for contract R&D to overseas entities

Exit Stage

- CIT exemption on technology transfer income up to RMB 5M (increased to 20M in Zhongguancun), 50% reduction above this

Overview of China's Tax Incentive Scheme
- Hainan Free Trade Port (FTP)

CIT

- 15% for companies engaged in encouraged activities with "substantive operations" in Hainan
- Tax exemption for certain foreign-source income from newly formed foreign branch or subsidiaries

IIT

- 15% on qualified talents working at Hainan FTP from 2020 – 2024
- IIT brackets off 3%, 10% and 15% from 2025 to 2035

Import Duty

- Import duty exemptions for products processed in Hainan with an added value of over 30%

Tax Incentives – A comparison across regions

A Glance of Tax Incentives Offered in Different Regions of China				
Region	**CIT**			**IIT**
	15% CIT rate	CIT exemption on ODI income derived by firms of certain sectors	One-off or accelerated tax deductions for capital expenditures	15% IIT rate
Western regions	✓			
Hainan FTP	✓	✓	✓	✓
GBA				✓
Shanghai Lingang	✓			✓
Shenzhen Qianhai	✓			
Fujian Pingtan	✓			
Zhuhai Hengqin	✓	✓	✓	✓
Certain areas in Beijing				✓

FAQs and case sharing in R&D tax incentives application

Q1: How do I qualify for R&D super deduction? Should I be a high-tech enterprise?

Exclusions for R&D Super Deduction

Negative List

- Tobacco manufacturing industry
- Accommodation and catering industry
- Wholesale and retail industry
- Real estate industry
- Leasing and commercial service industry
- Entertainment industry

Out-of-scope Activity

- Regular product upgrade
- Use of R&D results that are publicly available
- Post-commercialization support
- Repeat or simple update of existing products, services, technologies, materials or processes
- Market research and studies, efficiency research or management studies
- Industrial processes or regular qualify control, testing, analysis, maintenance
- Humanities and social sciences related studies

Partial Deduction on Contract R&D

Contract R&D expenses paid to domestic entrusted party:

up to **80%** in relation to expenses incurred on a project

Contract R&D expense paid to a foreign entrusted **company**:

up to **80%** in relation to expenses incurred on a project but the overseas expenses cannot be higher than **2/3** of domestic expenses

Case Sharing
- R&D Super Deduction

Client's Issues

A client is a manufacturer of traditional machinery. They continue to develop automated solutions to enable operators to use the machinery naturally and easily. Their China entity has some engineers to carry out the R&D activities.

They would like to apply for R&D super deduction, but they realized that most of the IPs generated from their R&D activities were registered in their headquarter's name.

DSA's Advices

1. Review the R&D activities and identify which R&D activities are eligible
2. Identify the eligible R&D activities whose IPs are owned by the China entity
3. Identify the staff participated in the R&D activities and keep track of the necessary time sheet for allocation
4. Keep track of the materials or products used for R&D activities and usage of fixed assets for R&D purposes
5. Establish an effective system for R&D expense capture and calculation

Q2: How do I qualify for VAT zero rating or exemption on service income from overseas entities?

Criteria for VAT Zero-rating/VAT exemption

VAT Zero Rate

- R&D services

- Design services

- Technology transfer
- Software services
- Circuit design and testing services
- Offshore outsourcing services (ITO, BPO and KPO)

VAT Exemption

- Authentication and consulting services
- Professional technical services
- Business auxiliary services

Case Sharing
- VAT Zero-rating/VAT Exemption

Client's Issues

A client is a R&D center of a company headquartered in the U.S.. They develop the new technology with respect to firewalls and cybersecurity. The outcomes of the development are owned by the U.S. parent who provide solution to customers in the world. The US entity pays a fee to cover local R&D expenses with a mark up.

The management was not sure if the R&D income satisfied all requirements for VAT concessions, so they paid 6% VAT on the income from the US.

DSA's Advices

1. Income from R&D activities are generally eligible for VAT zero rated treatment. The scope of R&D activities for VAT zero-rating is broader than that for R&D super deduction.
2. A written R&D agreement shall be in place to specify the detail description of R&D activities, estimated time frame, the R&D staff to be involved and the contract value.
3. They have large input VAT credits from purchase of equipment and technical services. It is more beneficial to apply for VAT zero-rating than VAT exemption.

Q3: I’m doing the R&D activities, but I’m not quite sure which tax incentives I can apply for, HNTE or ATSE?

High & New Technology Enterprise (HNTE) vs Advanced Technology Service Enterprises (ATSE)
- Tax Incentives

Tax Incentives for HNTE	Tax Incentives for ATSE
• Reduced CIT rate of 15% (standard CIT rate is 25%) • 10-year loss carry-forward period (5-year for normal enterprises) • R&D super deduction – 175% or 200% super deduction • VAT exemption for qualified technology transfer	• Reduced CIT rate of 15% (standard CIT is 25%) • Zero VAT Rate for R&D services provided to overseas entities • VAT exemption for technical services provided to overseas entities or R&D services and associated technical consulting services provided to domestic entities

High & New Technology Enterprise (HNTE) vs Advanced Technology Service Enterprises (ATSE)
- Major Criteria

Qualifications	Qualifications

• Registration & History: "proven track record" & registered in PRC for 1+ year
• Technology: Business type & core technology applied is within *High-tech Catalogue* (300+ Items)
• **IP Ownership: possession of self-developed IP & IP registered w/ relevant authorities**
• Income from high-tech product / service: > 60% of income in last year derived from products / services in *Catalogue*
• Staff: > 10% R&D staff
• R&D Expenditures: > 60% incurred in China &
  ▪ >5% if last year turnover < RMB 50 million
  ▪ >4% if last year turnover > RMB 50 million but < RMB 200 million
  ▪ >3% if last year turnover > RMB 200 million
	• Registration & History: "proven track record" & registered in PRC
	• Advanced technology services: ITO, BPO or KPO in the Scopes of Recognized Advanced Technology Service Businesses and adopts advanced technology or has a strong R&D capacity
	• **IP Ownership: N/A**
	• Income from advanced technology service: > 50% of total revenue for the year
	• Staff: > 50% of staff holding college degrees or above
	• Income from offshore outsourcing services: > 35% of total revenue of the year

High & New Technology Enterprise (HNTE)
- Application process

- IP Details & Certificates
- Staff List
- Special Audit for High-tech income & R&D Expenses
- Project Planning & Completion Report
- CIT Filings
- Application Form & Other Requested Information

HNTE Certificate Application

Ministry of Science and Technology (MOST)

Issuance of HNTE Certificate

Ministry of Science & Technology (MOST)

- Expert assessment
- Review and public comments

- HNTE Certificate
- Other current & previous tax information

Record Filing in Annual CIT Return Package

State Tax Bureau (SAT)

Follow-up Supervision and Administration

- Annual Filing (prior to May 31)
- HNTE Certificate Renewal (every 3 years)

Advanced Technology Service Enterprises (ATSE)
- Application process

Step 1	**TASE Certificate Application** *Ministry of Science and Technology (MOST)*	• Description of Business • Staff List • Income Breakdown • Statutory Audit • Offshore income exchange clearance documents • Application Form & Other Requested Information
Step 2	**Issuance of TASE Certificate** *Ministry of Science & Technology (MOST)*	• The ATSE Platform: http://tas.innocom.gov.cn/
Step 3	**Record Filing in Annual CIT Return Package** *State Tax Bureau (SAT)*	• TASE Certificate • Other current & previous tax information
Step 4	**Maintenance & Administration**	• TASE Certificate Renewal (every 3 years) • Sample inspections

Challenges with the new global minimum tax and potential impacts on MNCs

Two-Pillar Solution

Pillar 1

1

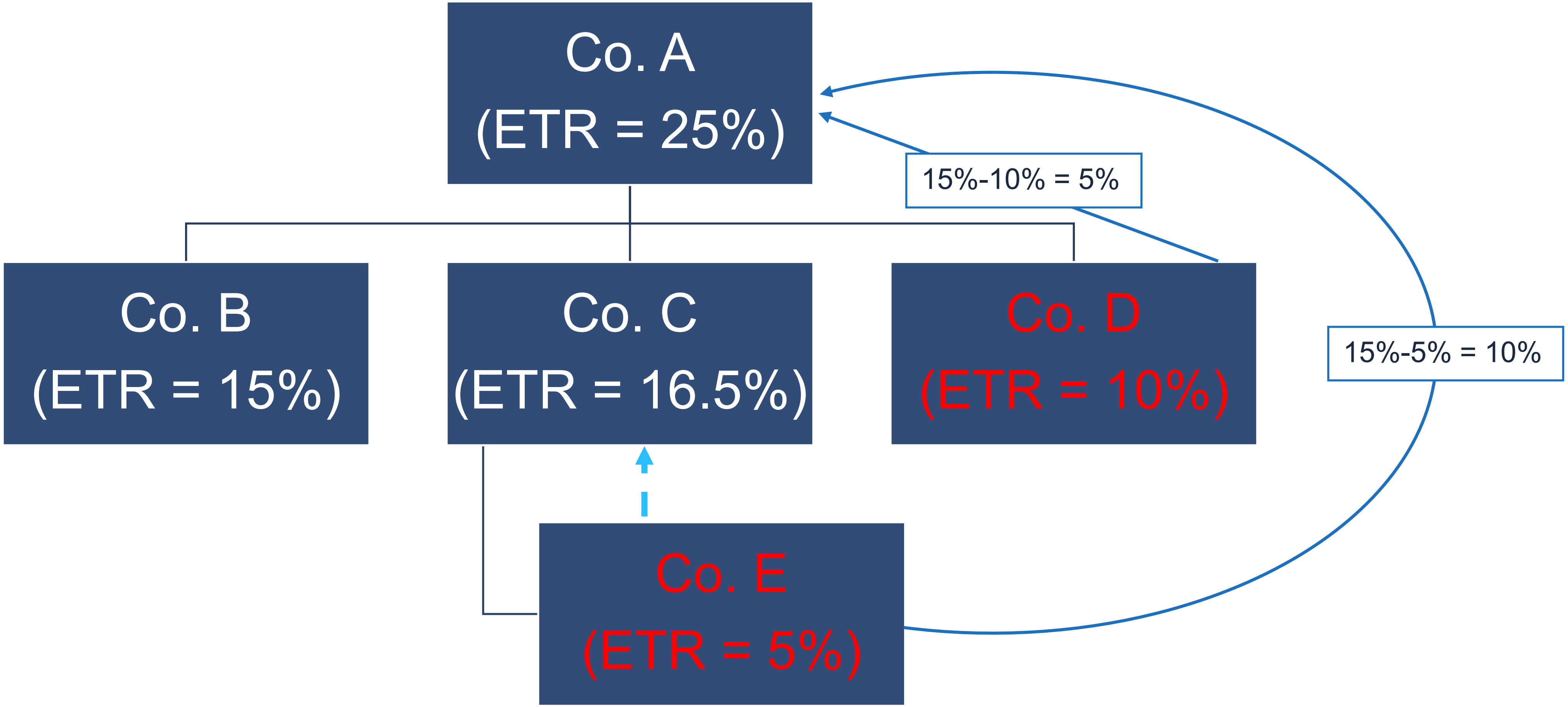
- Amount A - new taxing right to reallocate 25% residual profit to market jurisdiction
- In-scope MNCs - only applicable to the world's largest and most profitable MNEs

Pillar 2

2

- Set a global minimum tax of 15%
- In-scope MNCs - MNE groups with global turnover above €750 million

How will Pillar Two Work?



What's Next

2021

<u>Oct 2021</u>:

BEPS 2.0 Two-Pillar Solution was finalized

<u>Oct-Nov 2021</u>:

Detailed implementation plan for both pillars and resolution of remaining issues

2022

- More details on Amount B in Pillar One
- Multilateral instruments be adopted through domestic legislation

2023

Implementation of Pillar One and Pillar Two

2030

Review of Pillar One including potential reduction of the scope threshold

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