



R&D Tax Concessions: Opportunities and Challenges

SPEAKERS



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Agenda

1. **Overview of R&D tax incentives in China and correlation of IP arrangements and R&D tax concessions**
2. **Pain points in R&D incentives application**
3. **Case sharing**
4. **Other concessions**
5. **Q&A**





01

Overview of R&D tax incentives
in China and correlation of
IP arrangements and
R&D tax concessions

1. Overview of R&D tax incentives in China and correlation of IP arrangements and R&D tax concessions

Contract R&D



- Advanced Technology Service Enterprise (“ATSE”) – reduced CIT rate of 15%
- VAT zero rate on R&D services provided to overseas entity
- VAT exemption on outsourcing services provided to overseas companies or technical development, consulting or associated services provided to domestic companies

Self-developed or co-developed R&D



- High and New Technology Enterprises (“HNTE”) – reduced CIT rate of 15%
- R&D super deduction for R&D expenses – 175% super deduction
- VAT exemption for technology transfer

Reduced CIT rate of **15%** for qualified HNTE

1. IP requirement

- ✓ Ownership over core IPs for main products/services acquired through independent development, assignment, acceptance of gift, merger and acquisition, etc.

2. Revenue requirement for HNTE product/services

- ✓ The percentage of the revenue from sales of HNTE products/services account for $\geq 60\%$ of total revenue in the past year

6. Innovation capacity

- ✓ Comprehensive innovation capacity evaluation result ≥ 70

5. R&D expenses percentage requirement

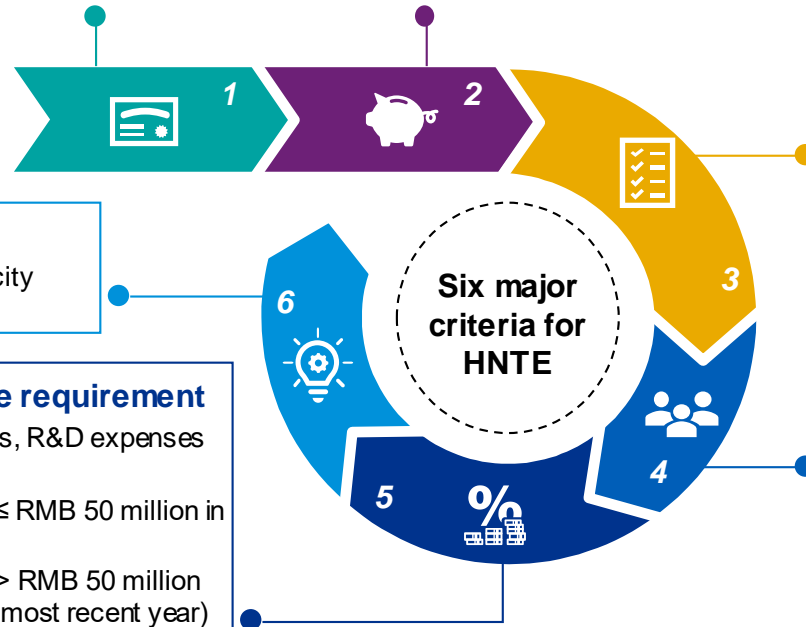
- ✓ In the past three accounting years, R&D expenses account for:
 - 1) $\geq 5\%$ of total sales revenue (\leq RMB 50 million in the most recent year)
 - 2) $\geq 4\%$ of total sales revenue ($>$ RMB 50 million but \leq RMB 200 million in the most recent year)
 - 3) $\geq 3\%$ of total sales revenue ($>$ RMB 200 million in the most recent year)
- ✓ R&D expenses incurred in China account for $\geq 60\%$ of the total R&D expenses

3. Core technology for main products/services fall under national HNTE catalogue

- ✓ Eight HNTE technology areas, including electronic information technology, advanced technology services, etc.

4. Composition of R&D personnel

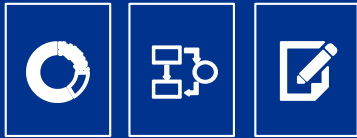
- ✓ Personnel engaged in R&D activities account for $\geq 10\%$ of total workforce



R&D Super deduction

175%
Super
deduction

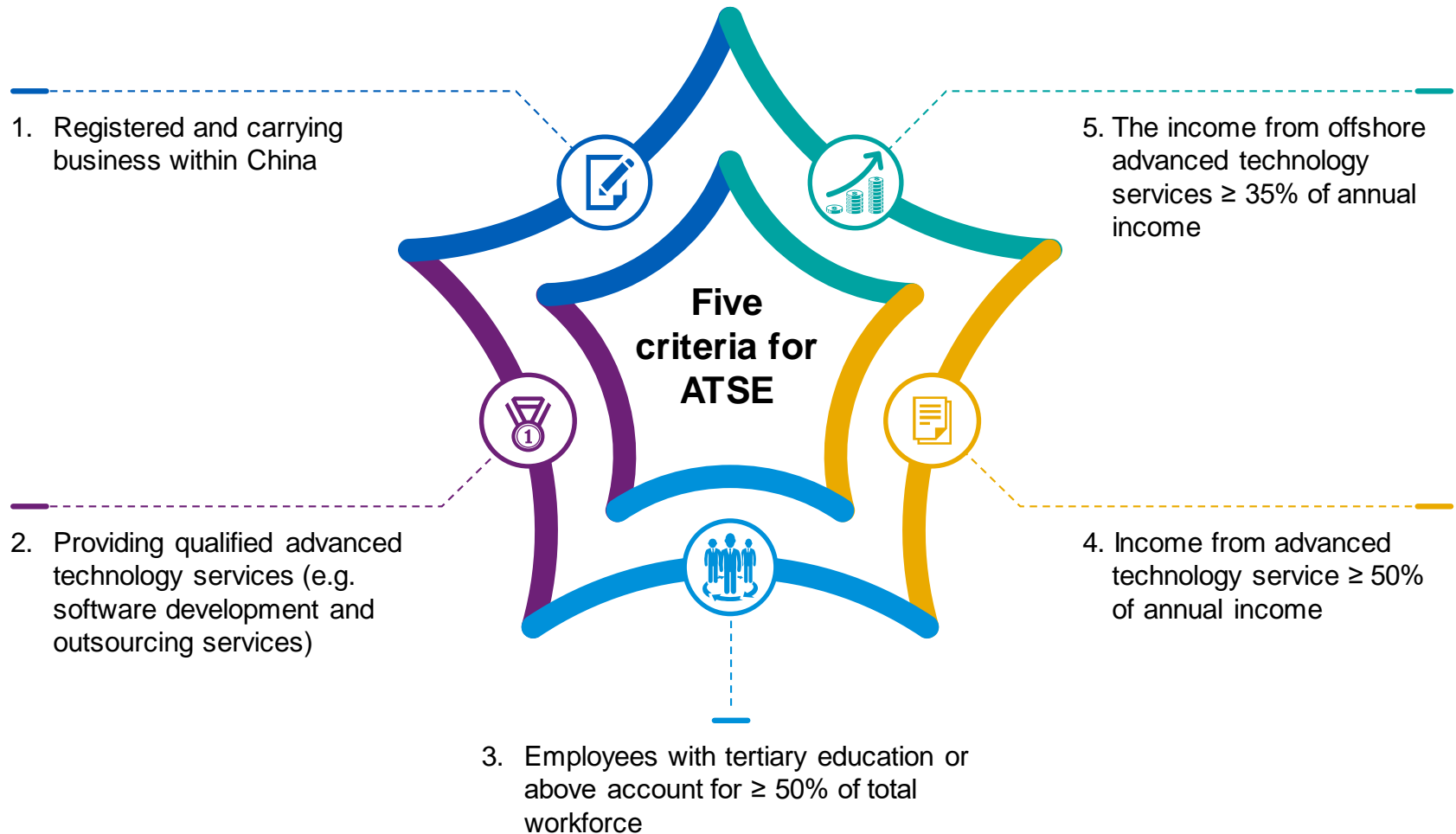
- Additional 75% tax deduction on qualified R&D expenses incurred
- Capitalized R&D expense can be amortized at 175% for CIT purposes



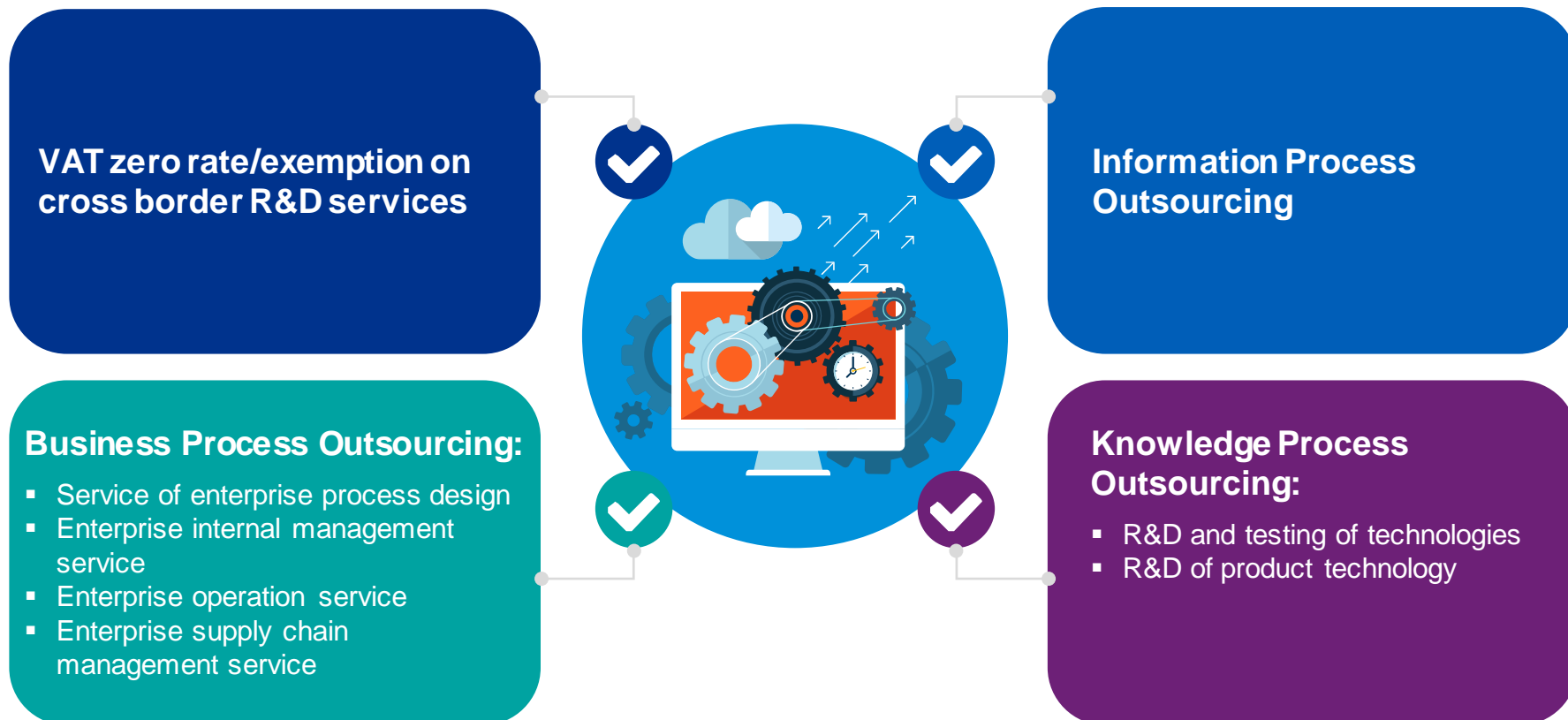
| | Normal Deduction | Super Deduction |
|---|------------------|-----------------|
| profit before tax | 3000 | 3000 |
| super deduction (assuming R&D expense to be 10million) | 0 | 750 |
| taxable income | 3000 | 2250 |
| CIT rate | 25% | 25% |
| CIT | 750 | 562.5 |

18.75%
Net saving

Reduced CIT rate of **15%** for qualified ATSE



VAT zero rate/exemption on qualified R&D/outsourcing activities





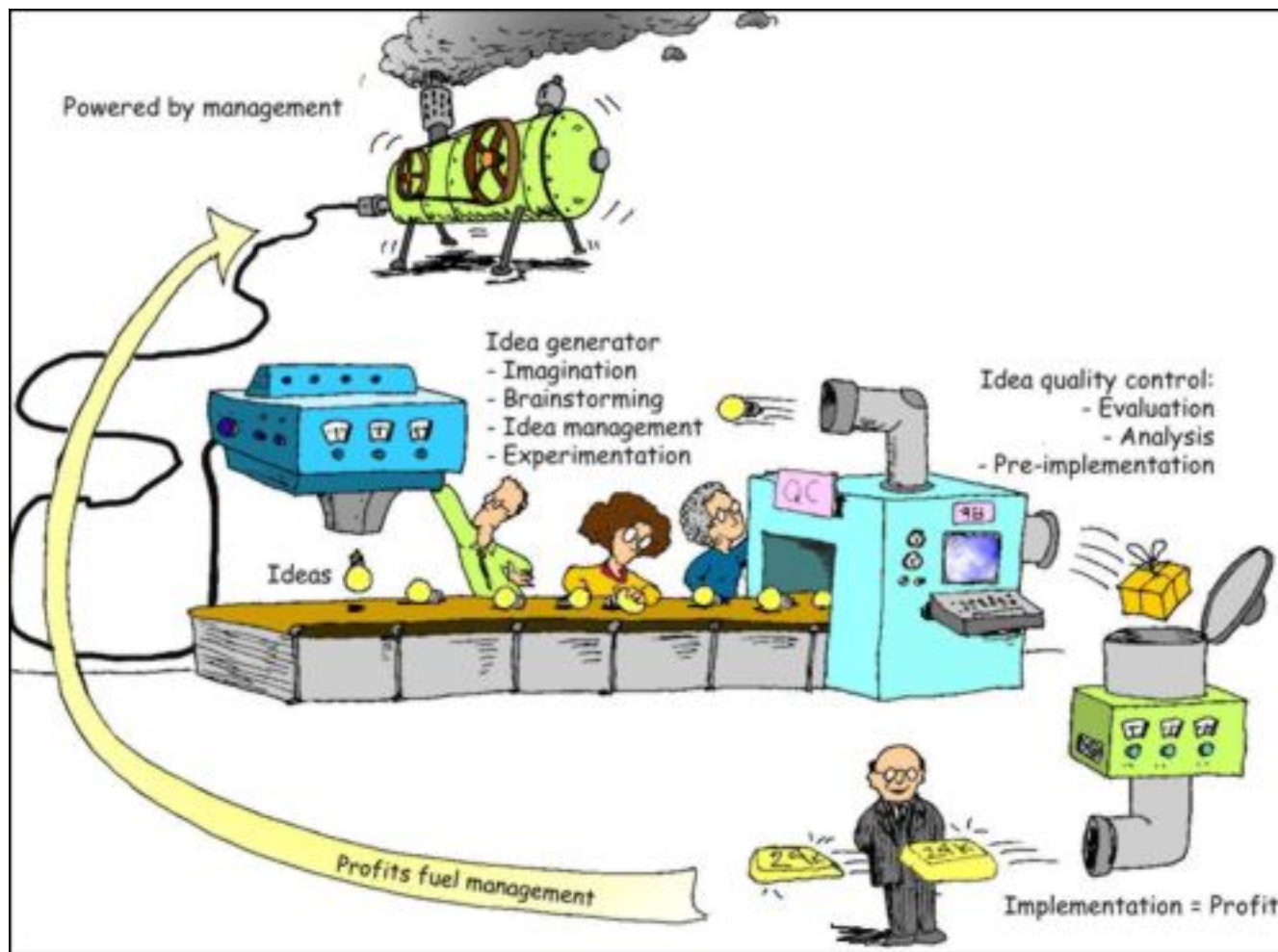
02

Pain points in R&D
incentive application

Incompetency in identifying eligible R&D projects due to lack of cross functional collaboration (e.g. R&D, finance, IP departments)



Lack of understanding on R&D definition from a tax point of view



Lack of understanding on R&D definition from a tax point of view (Cont'd)

Are there projects that failed for technical reasons?

Did the technical objectives cause headaches for your tech team?

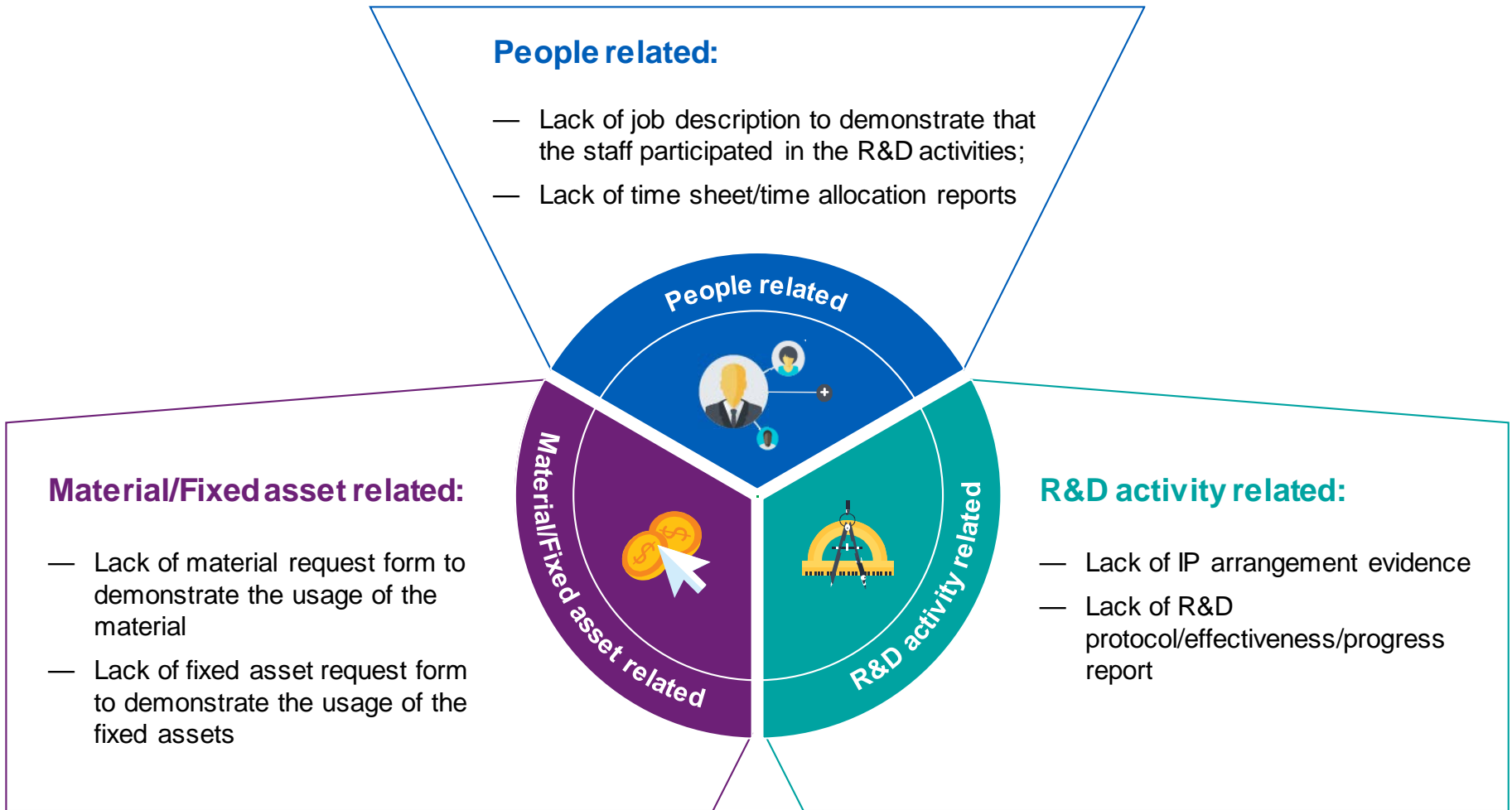
Are new or existing technologies developed to deliver services in new ways?

Was the tech team over time / over budget – because of technical issues?

Are there projects that attempted to develop an existing process in a new or improved manner?

Is there an award of a patent or innovation award for the product, process or information?

Insufficient documentation



KPMG R&D tax service team

Partners/Directors
with tax and
technology
background



Partners/Directors with tax and technology background will lead and coordinate and monitor the whole life cycle of the R&D projects to ensure the optimization of the benefit and the minimization of the risks.

Engineers
With knowledge
in diversified
industries



Our engineer team will deploy the professional understanding in the relevant industries to analyze and identify the R&D aspects of the relevant projects systematically. Moreover, our local engineer team has access to the global engineer network of KPMG when necessary.

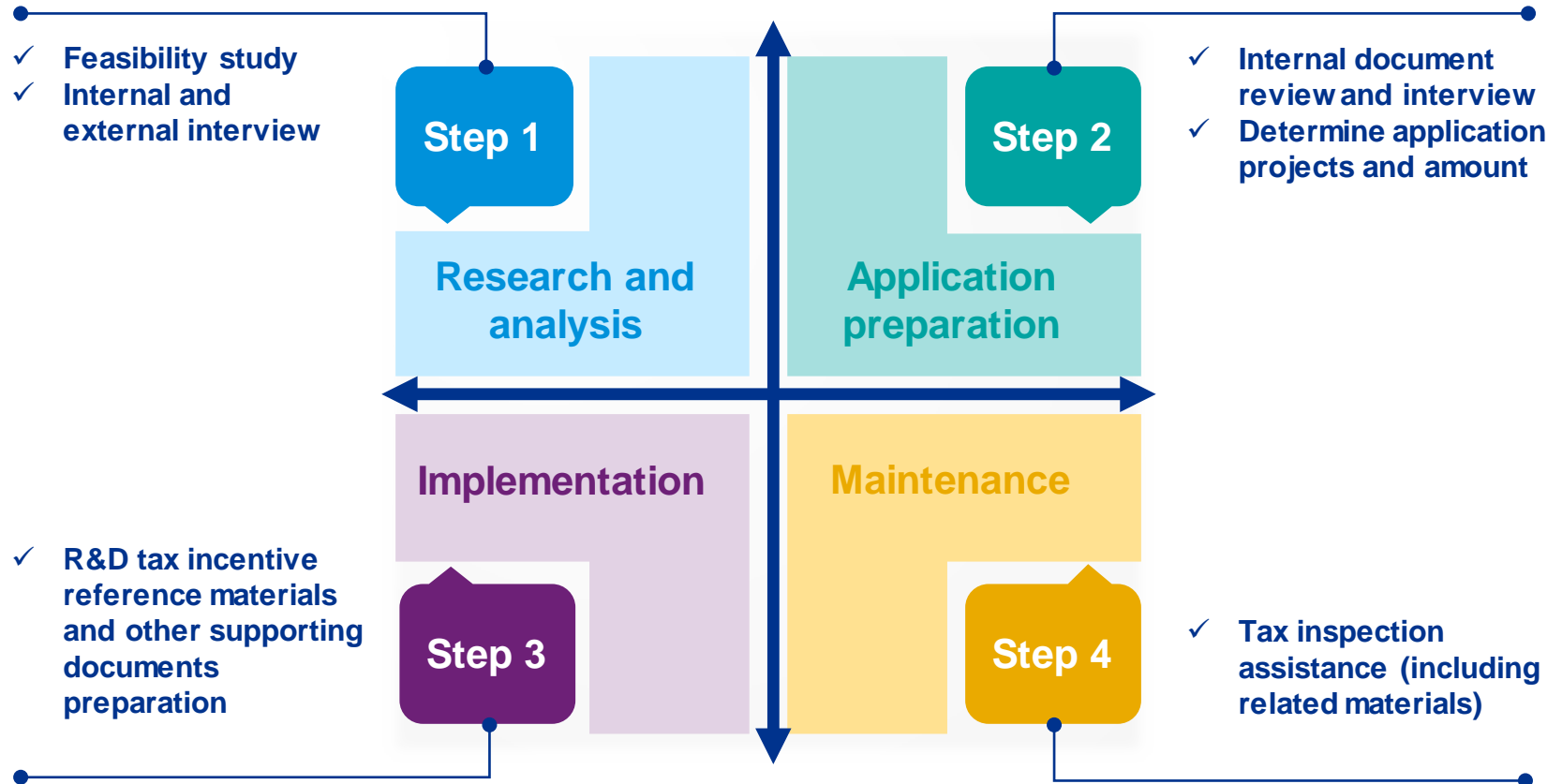
Tax professionals
with working
experience
in tax bureaus



Our tax professionals with working experience in tax bureaus will assist in communication with tax authorities in cases whereby there are uncertainties with respect to the application. They can also participate in the rehearsal session with you regarding post application Q&A/inspections based on their previous working experiences.

Our R&D tax service team with diversified backgrounds can provide a comprehensive solutions in the application of R&D tax concessions, control the risks and optimize the benefit.

HOW KPMG can help





Case sharing

Case Sharing 1 - A true Story of KPMG

Client challenge

The client is a manufacturer of automotive components. In 2015, it considered to renew the HNTÉ certificate of its subsidiary in China ("China Sub") but the management was quite concerned that China Sub may not satisfy all the requirements for HNTÉ due to limited R&D resources and unqualified R&D expenses.

KPMG's response

KPMG interviewed with several managers from the R&D department of China Sub to have a full picture of its R&D processes in China. After analysing the technical impediments and innovations in a series of "small-sized R&D projects", KPMG realized that some "material R&D projects" can be used as the main reference standard for the future project management. Besides, KPMG assisted in designing the method for R&D expenses to be allocated to different projects in accordance with HNTÉ criteria. More importantly, KPMG's strategic advice played a significant role in the decision-making procedure of the client regarding whether to renew the HNTÉ certificate.

KPMG also helped communicate with the approving authorities in some uncertain points and get clarify from the government before decision making. The client successfully renewed its HNTÉ status and achieved saving of around RMB 30 million.

Client can trust in KPMG's ability to provide efficient and high-quality R&D services.

Case Sharing 2 - A true Story of KPMG

Annual tax saving around **RMB 10 million**

Client challenge

The client would like to apply for tax concession application with respect to R&D super deduction in China. One of the core requirement to qualify for R&D super deduction in China is to have ownership over the know-how derived from the R&D activities. However, as a MNC, most of the know-how generated from the R&D activities was owned by headquarter in overseas.

KPMG's response

KPMG helped the client by way of:

- discussing with engineers and legal team of the client to identify R&D activities whose know how will potentially be owned by the China entity.
- discussing with HR team to compile the detailed people cost
- discussing with finance team to collate other costs eligible for R&D super deduction purpose

The key deliverables include:

- Technical assessment paper on eligible R&D activities
- Application package to be submitted to science bureau and tax bureau
- Communication support with respect to questions from science bureau and tax bureau on the application

Client can trust in KPMG's ability to provide efficient and high-quality R&D services.

Case Sharing 3 - A true Story of KPMG

Annual tax saving around **RMB 38 million**

Client challenge

The client mainly provides shared services for its overseas related parties. Previously client paid VAT and CIT on the income derived from the related parties

KPMG's response

After KPMG's review of client's business, KPMG considers that the client's services may be eligible for business process outsourcing services. KPMG helped the client to communicate the case with the government. The government did a couple of on sites visit to understand the nature of services. KPMG assisted in the whole communication and application process. Client achieved the ATSE status and VAT exemption status with the assistance from KPMG.

Client can trust in KPMG's ability to provide efficient and high-quality R&D services.



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Other concessions

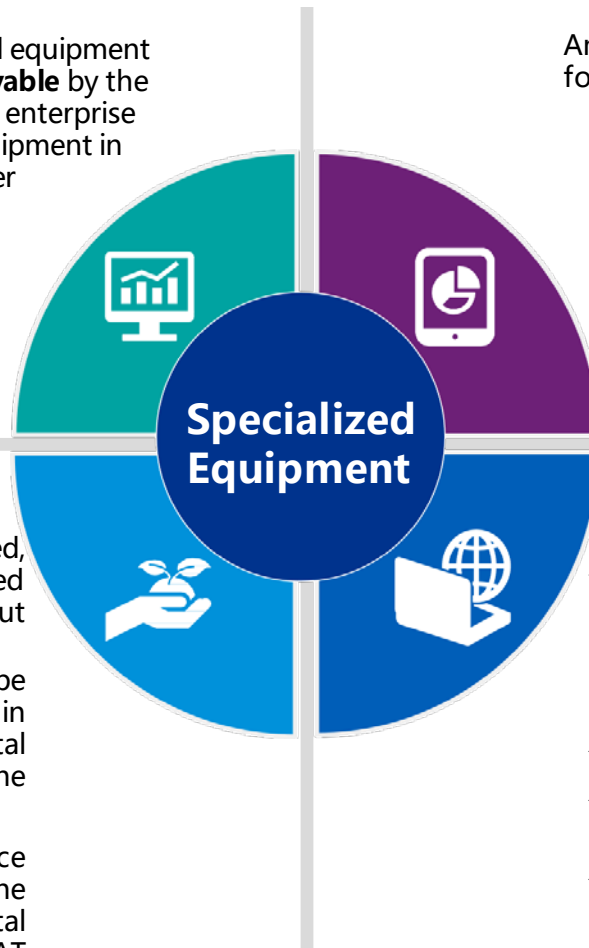
Government Incentives for R&D Activities

| Item | In-charge Authority | Administrative Level | Field | Details |
|-------------------------------|--|----------------------|----------------|---|
| Patent subsidy | XX Intellectual Property Administration | Municipal | Technology R&D | Patent subsidy: RMB 2,000 per item |
| New product subsidy | XX Ministry of Finance | Municipal | Technology R&D | Tax refund: 50% of the local retention of VAT incurred by sales of the new product in 2 years (3 years for the product with patent for invention) |
| R&D investment subsidy | XX Ministry of Finance | Municipal | Technology R&D | No more than 3% of the stock amount of R&D investment; No more than 10% of the increment amount of R&D investment |
| HMP digital equipment subsidy | XX Commission of Economy and Informatization | Municipal | Technology R&D | No more than 10% of the equipment investment amount (No more than 3 million for each project) |
| WHT subsidy | Finance bureau | District level | Technology R&D | If total WHT contribution exceeds certain threshold, around 15%-20% WHT can be refunded. |

CIT Incentives on Specialized Equipment for Energy Saving and Water Conservation

10% of the amount invested in qualified equipment that may be **credited** against the **CIT payable** by the enterprise for the current year, where the enterprise purchases and actually uses qualified equipment in environmental protection, energy or water conservation, safe production, etc.

Any excess in such credit may be carried forward for no more than **5 succeeding tax years**.



CIT Incentive

CIT Incentive

Specialized Equipment

Determination of Credit Base

- ❖ If the input VAT is allowed to be credited, the investment amount in specialized equipment shall not include the input VAT;
- ❖ If the input VAT is not allowed to be credited, the investment amount in qualified equipment shall be the total amount (i.e. tax inclusive) stated on the special VAT invoice;
- ❖ If enterprise obtains normal VAT invoice for purchasing specialized equipment, the investment amount shall be the total amount stated on the normal VAT invoice.

Relevant Materials Preserved for Future Inspection

- ❖ Enterprise enjoying incentives like tax credit shall adopt the method of self assessment, declaration of incentives enjoyed, retention of the relevant materials for future inspection. Relevant materials preserved for future inspection include:
 - ✓ List of specialized equipment and invoice;
 - ✓ Contract or agreement for the specialized equipment obtained;
 - ✓ **Explanation letter for the specific item in the «Catalogue» that the specialized equipment was referred to;**
 - ✓ Explanation letter for the time when the equipment come into operation.



Q&A

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