

China

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What's new?

Summary of updates/Changes to R&D and government incentives from 1 January 2019 through 31 October 2020

- The R&D super deduction rate, which was increased in 2018 to 75% (from 50%) for all companies, will continue through 2020.
- If a taxpayer does not apply for an R&D super deduction in the year in which the expenses are incurred (after 1 January 2016), the taxpayer may still enjoy the benefit retroactively provided an application for the super deduction is made within the following three years.
- Many attractive incentive schemes have been introduced to promote certain special economic zones including in the Greater Bay Area, the Lingang area of Shanghai, and the Hainan Free Trade Port. In the Greater Bay Area, individual income tax (IIT) subsidies were introduced for certain highly skilled foreign employees. In Lingang, the enterprise income tax (EIT) rate has been reduced to 15% (from 25%) for taxpayers with substantial business activities in Lingang in the integrated circuit, artificial intelligence, biomedicine, and civil aviation sectors, for five years from the date of establishment in Lingang. In Hainan, the EIT rate also has been reduced to 15% for taxpayers substantially engaged in encouraged business activities in Hainan.

Featured government incentives

Incentive name	Description	Maximum percentage	Qualification standards	Key exclusions or issues
High and New Technology Enterprise (HNTE)	A qualifying enterprise can enjoy a preferential EIT rate of 15% (the normal EIT rate is 25%).	15% preferential EIT rate	Annual qualifying R&D expense must meet a certain percentage of annual sales revenue: 5% if revenue is up to RMB 50 million; 4% if revenue is between RMB 50 million and 200 million; and 3% if revenue is above RMB 200 million. Qualifying R&D expenditure includes the following: <ul style="list-style-type: none"> • Labor expenses; • Direct expenses incurred in the R&D project; • Depreciation and amortization expenses; • Design and testing expenses; and • Other directly related R&D expenses. Other criteria (e.g., R&D personnel percentage, etc.) must be met to qualify as an HNTE.	Qualification for HNTE status must be obtained and specific criteria met annually to enjoy the preferential tax treatment.
R&D super deduction	A super deduction of 75% is available for eligible R&D expenditure.	75% super deduction	The following R&D expenditure may qualify for the super deduction: <ul style="list-style-type: none"> • Labor expenses; • Direct expenses incurred in the R&D project; • Depreciation and amortization expenses; • Design and testing expenses; and • Other directly related R&D expenses. 	Certain industries and activities are excluded from R&D super deduction eligibility.



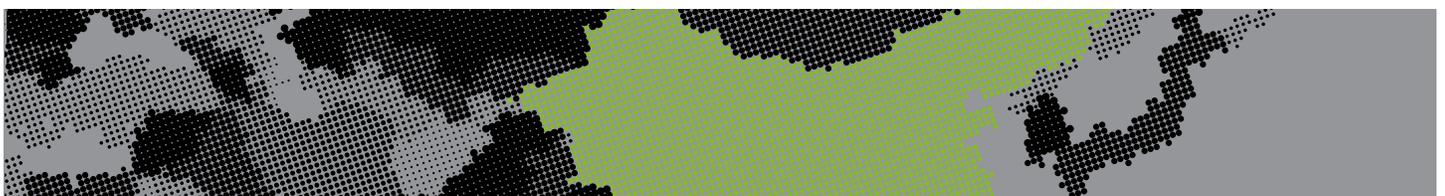
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Industries most often affected by government incentives in country

Technology, Media & Telecom	Financial Services
● Telecom, Media & Entertainment	● Banking & Capital Markets
● Technology	● Insurance
Consumer	● Investment Management
● Consumer Products	● Real Estate
● Retail, Wholesale & Distribution	Life Sciences & Health Care
● Automotive	● Health Care
● Transportation, Hospitality & Services	● Life Sciences
Energy, Resources & Industrial	Government & Public Services
● Power & Utilities	● Health & Social Care
● Mining & Metals	● Defense, Security & Justice
● Oil, Gas, & Chemicals	● Civil Government
● Industrial Products & Construction	● International Donor Organizations
	● Transport



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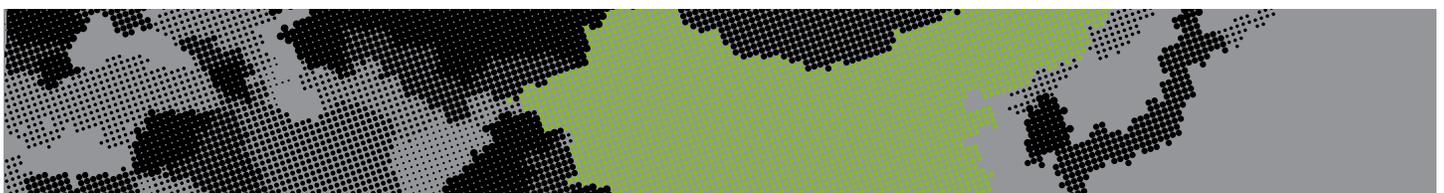
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Type	National incentive?	State, provincial, regional or local incentives? ¹	Filing deadlines imposed?	Is the claim made in advance or arrears? ²	Nature of incentive	Maximum benefit available to large enterprises	Maximum benefit available to small and medium-sized enterprises
Innovation							
Research & development (R&D)	●	●	● ●	National: Arrears Local: Not applicable	All enterprises (both foreign and domestic) with qualifying R&D expenditure may be eligible for a EIT super deduction rate of 75%	75% super deduction rate results in tax savings of 18.75% if normal EIT rate is 25%	75% super deduction rate results in tax savings of 18.75% if normal EIT rate is 25%
Patent box	●	●	● ●	National: Advance Local: Not applicable	Tax exemption or rate reduction for resident enterprises transferring technology	100% exemption; rate reduction varies	100% exemption; rate reduction varies
R&D grant: national or EU	●	●	●	Not applicable	Not applicable	Not applicable	Not applicable
R&D grant: State/Province	●	●	● ●	Varies	Varies depending on the locality, type of R&D project, and government budget	Varies	Varies
High new technology enterprise (HNTE)	●	●	● ●	National: Advance Local: Not applicable	Qualified HNTEs (i.e., Chinese enterprises conducting certain R&D activities, with a minimum amount of expenditure incurred in China) may be entitled to a reduced 15% EIT rate (from 25%) and a super deduction rate of 75% for qualified R&D expenditure	15% EIT rate (rather than 25%); 75% super deduction rate results in tax savings of 11.25% if 15% EIT rate applies	15% EIT rate (rather than 25%); 75% super deduction rate results in tax savings of 11.25% if 15% EIT rate applies

Key: ● = PERMANENT INCENTIVE (■) = TEMPORARY INCENTIVE (▨) = NEGOTIABLE ● = NO ● = LIMITED APPLICABILITY ● = NOT APPLICABLE

- Notes:
- Green means that this incentive is currently in effect. Yellow means that the incentive has limited applicability, i.e., the requirements for this incentive limit its value to most companies. Red means that there is no incentive.
 - If the response is advance, this means that the government must approve the award of the incentive prior to the commencement/completion of the project/activity. If the response is arrears, this means that the award of the incentive is determined at the end of the tax period or after the completion of the qualifying project or activity. Most tax incentives are considered to be claimed in arrears because they are reported on tax returns.



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Innovation (continued)							
Technology advanced service enterprise (TASE)	●	●	● ●	National: Advance Local: Not applicable	Qualified TASEs (i.e., Chinese enterprises performing a minimum amount of offshore outsourcing in certain technology services) may be entitled to a 15% EIT rate (rather than 25%)	15% EIT rate (rather than 25%)	15% EIT rate (rather than 25%)
Offshore outsourcing services	●	●	●	National: Advance Local: Not applicable	Chinese entities and individuals carrying out certain cross-border activities are exempt from value-added tax (VAT)	100% VAT exemption	100% VAT exemption
Investment							
Capex	●	●	●	National: Not applicable Local: Advance	Refunds of local taxes are available (plus other benefits on a case-by-case negotiated basis)	Varies	Varies
Employment	●	●	● ●	National: Advance Local: Not applicable	Tax credits are available if certain criteria are fulfilled	Varies	Varies
Training	●	●	●	Not applicable	Not applicable	Not applicable	Not applicable
Environmental Sustainability							
Sustainability	●	●	● ●	National: Advance Local: Not applicable	Tax credits are available if certain criteria are fulfilled	Varies	Varies

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Country background

The standard enterprise income tax (EIT) rate in China is 25%. China offers a variety of tax incentives to encourage R&D, including an R&D super deduction on taxable income, High and New Technology Enterprise (HNTE) status, Small and Medium-sized Science and Technology Enterprise (SMSTE) status, Technology Advanced Service Enterprise (TASE) status, a patent box regime, and VAT/customs duty benefits. A reduction in the EIT rate also is granted in certain instances.

The Chinese government offers various incentives related to investment at both the national and local levels. To promote foreign investment, China allows local governments to introduce investment incentive policies within their statutory limits. The local governments are authorized to support investment projects that make a substantial contribution to local employment, economic development, and technological innovation to lower the cost of the investment and operation of foreign enterprises.

Most incentives offered by local governments are based on negotiation on a case-by-case basis. Incentives commonly include tax refunds, tax credits, and free leasing of office space.

Many attractive incentive schemes have been introduced in recent years to promote certain special economic zones (e.g., Greater Bay Area, Lingang area of Shanghai, Hainan Free Trade Port).

Innovation Incentives

R&D super deduction

Nature of incentives

Under the EIT law, a resident enterprise may deduct 150% of qualifying R&D expenses actually incurred (i.e., an additional 50% deduction on top of the normal expense deduction) in computing its tax liability if the expenses do not result in the creation of an intangible asset. If intangible assets are developed, the qualifying R&D expenses that have been capitalized may be amortized based on 150% of the actual R&D costs.

Previously, a 175% deduction (i.e., an additional 75% deduction on top of the normal expense deduction) was available only to SMSTEs for qualifying R&D expenses, but the government has expanded the scope of the 175% super deduction to include all enterprises during the period 2018-2020.

Eligible industries and qualifying costs

A “negative list” sets out industries and activities that do not qualify for the super deduction:

Industries not eligible	Activities not eligible
<ul style="list-style-type: none"> • Tobacco • Hospitality and catering • Wholesale and retail • Real estate • Rental and commercial services • Entertainment • Other industries specified by the Ministry of Finance (MOF) and State Tax Administration (STA) 	<ul style="list-style-type: none"> • Regular upgrades of products and services • Direct application of research findings • Support activities following commercialization of a product • Duplication or simple alteration of existing products, services, technology, materials, or processes • Market research, efficiency studies, or management research • Quality control, testing, and analysis or repair and maintenance activities related to industrial service processes that are routine in nature • Research in the social sciences, arts, or humanities

Expenses that are eligible for the super deduction include:

- Labor expenses (including costs for seconded or temporary personnel);
- Direct expenses incurred in the R&D project;
- Depreciation expenses (even if the equipment is not used exclusively for R&D);
- Amortization expenses;
- Design and testing expenses (including for trial products); and



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- Other directly related R&D expenses, such as expert consultation, “high and new technology” R&D insurance, IP application costs, and travel and meeting costs. Eligible expenses in this category are limited to 10% of all eligible expenses for expenditure incurred on or after 1 January 2016; for example, if all qualifying R&D costs (except other directly related R&D expenses) are CNY 90, the maximum amount of such other directly related expenses cannot equal or exceed CNY 19.

Up to 80% of fees paid to contractors (both from domestic or cross-border activities) to perform R&D activities on the taxpayer’s behalf qualify for the super deduction provided the fees and related terms reflect an arm’s length transaction. In the case of cross-border contract R&D arrangements with overseas entities (excluding individuals), a payment not exceeding two-thirds of the qualified domestic R&D expenses will qualify for the super deduction.

The administrative procedures to apply for the super deduction were streamlined as from 2016:

- Advance approval of the relevant tax authorities is not required, i.e., taxpayers simply must comply with tax return filing procedures.
- Companies undertaking R&D projects at the provincial or ministerial level or above, or projects that span multiple years and that have been verified, need not obtain annual verification by the competent science and technology authorities.
- A company may apply for the super deduction retroactively, within three years after the expenses are incurred.
- Companies are not required to set up special accounts for R&D expenses; however, in addition to complying with the standard accounting treatment under the prevailing financial accounting rules, companies must prepare supplementary financial records to accurately track the actual expenses that are eligible for the super deduction in the current year.

The Chinese tax authorities are required to intensify their administration of super deduction claims through regular inspections and monitoring, with audits covering at least 20% of all cases annually.

IP and jurisdictional restrictions

The IP must be held by the Chinese applicant.

HNTES

Companies qualifying for HNTES status are eligible for the 150% (or 175% during the period 2018-2020) super deduction for qualified R&D expenses in addition to a reduced EIT rate of 15%.

Eligible industries and qualifying costs

To be eligible for HNTES status, the technology that plays a core supporting role in the company’s main product/service must fall into one of the following state-encouraged technology areas:

- Electronic information;
- Biological and medical;
- Aviation and space;
- New materials;
- High technology services;
- New energy and energy conservation;
- Resources and the environment; and
- Advanced manufacturing and automation.

For HNTES recognition purposes, qualifying activities include the development of new technology, new products, and new production techniques. HNTES status is granted for a three-year period and reviewed annually.

To further develop potential HNTES, many local governments have launched an HNTES incubation program, with the result that SMEs that have difficulty qualifying for HNTES status still will be subsidized by the local government.

IP and jurisdictional restrictions

Although less than 40% of the R&D expenses qualifying for the HNTES incentive may be incurred outside China, the authorities may consider whether IP has been created and retained in China in granting HNTES status.

SMSTES

For the period 2017-2019, SMSTES are entitled to a super deduction of 175% of R&D expenses (which has been extended through 2020 for all enterprises).

Eligible industries and qualifying costs

To qualify as an SMSTE, an enterprise must meet all the following requirements:

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- Be an enterprise registered in the China (excluding Hong Kong, Macau, and Taiwan);
- Employ fewer than 500 individuals, have annual sales revenue less than CNY 200M, and total assets less than CNY 200M;
- Not have any products or services that fall within a prohibited or restricted category;
- In both the previous year and the current year of registration, not have any major safety or quality incidents, not commit any serious illegal acts relating to environmental protection or fraudulent acts relating to scientific studies, and not be included on the list of enterprises that have engaged in “abnormal” operations or the list of “dishonest enterprises” with serious violations; and
- Achieve a satisfactory level of “integrated evaluation” for SMSTEs.

An enterprise that meets the requirements in 1–4 can qualify immediately as an SMSTE if it also fulfills any of the following conditions:

- It holds a valid HNTe qualification certificate;
- It has been awarded a national level science and technology prize within the last five years and was ranked in the top three enterprises winning the award;
- It has an R&D department that has been identified as one that meets certain standards by departments at or above the provincial or ministerial level; or
- It has played a leading role in formulating international, national, or industrial standards in the previous five years.

TASEs

A reduced 15% EIT rate applies to TASEs. To qualify as a TASE, a company must meet the following requirements (which are reviewed annually):

- It must be registered within China (excluding Hong Kong, Macao, and Taiwan);
- It must be engaged in one or more advanced technology service businesses listed in the Scope of Recognized Advanced Technology Services (for Trial Implementation) and adopt advanced technologies or have strong R&D capabilities;
- More than 50% of its staff must hold a college degree or above;
- More than 50% of its total revenue in the current year must come from revenue generated from listed advanced technology services; and

- Its revenue generated from offshore outsourcing service businesses may not be less than 35% of total revenue in the current year.

TASEs generally are not entitled to the R&D super deduction.

Patent box regime

A patent box regime exists for technology and software companies with the following benefits:

- The first CNY five million of annual income from qualifying technology transfers (including income from a nonexclusive license with a license term of at least five years) is exempt from EIT; annual income in excess of CNY five million is taxed at 50% of the standard EIT rate.
- Newly established software companies often are granted tax holidays.
- Taxable software companies may be granted preferential VAT treatment on qualifying revenue.
- Qualifying software companies may be eligible for an exemption from import duties on self-used equipment and materials.

VAT and customs duty incentives

A VAT exemption (with input VAT refundable) is available for providing R&D and offshore outsourcing services, or transferring technology to foreign entities. An exemption (with input VAT not creditable or refundable) also is provided for technology transfers or R&D services (including relevant consulting services) between domestic parties.

Qualifying private nonenterprise technology institutions may be eligible for an exemption from VAT, import duty, and consumption tax on the import of items for scientific R&D use.

Investment incentives

Tax incentives for the venture capital industry

Tax incentives are granted to support the development of the venture capital industry. A venture capital company or an individual investor may deduct 70% of the amount invested in a “start-up” technology company (hereinafter referred to as a “start-up”) from the taxable income derived from such investment, if the investment has been held for at least two years (the deduction may be used in the second year the investment is held and any unused balance may be carried forward and deducted in subsequent tax years).

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A venture capital company must satisfy the following criteria:

- It must be a venture capital company or partnership that is not a promoter of the start-up and that is tax resident and registered in China (excluding Hong Kong, Macau, and Taiwan), subject to tax assessment based on examination of accounts;
- It must comply with the Provisional Measures on Administration of Venture Capital Enterprises (Order No. 39 issued by 10 ministries including the National Development and Reform Commission) or the Provisional Measures on Supervision and Administration of Privately-offered Investment Funds (China Securities Regulatory Commission Order No. 105) by filing and operating pursuant to such provisions; and
- Within the two-year period after the initial investment, the total equity that the venture capital company (and its related parties) holds in the start-up must be less than 50%.

An individual investor must satisfy the following criteria:

- The investor must not be a promoter of, or have an employment relationship with, the start-up (or be related to such person including as a spouse, parent, child, grandparent, grandchild, or sibling); and
- Within the two-year period after initial investment, the total equity that the investor and their relatives (as described above) hold in the start-up must be less than 50%.

A start-up must satisfy the following criteria:

- It must be tax resident and registered in China (excluding Hong Kong, Macau, and Taiwan) and subject to tax assessment based on examination of accounts;
- It must not have more than 200 employees when the investment is made, 30% of such employees must hold a bachelor's degree or higher, and neither total assets nor annual sales revenue must exceed CNY 30 million;
- It must have been incorporated for less than 60 months when the investment is made;
- It must not be listed on any domestic or foreign stock exchange at the time, or within two years, of the investment; and
- Its total R&D expenses must constitute at least 20% of its total expenses in the year in which the investment is made and the following tax year.

Tax incentives for the Hainan Free Trade Port

Several tax measures have been implemented to support the development of the Hainan Free Trade Port (HFTP), which are effective as from 1 January 2020 through 31 December 2024.

A reduced 15% EIT rate is available for taxpayers engaged in "encouraged" business activities in the HFTP. In order to obtain this rate, a taxpayer must meet the following tests:

- Its primary business activity must be an encouraged business (as set forth in specific industry catalogues);
- The revenue from such primary business activity must account for 60% or more of gross revenue; and
- It must carry out substantial business operations in the HFTP including having its substantive and comprehensive place of management over the business operations, staff, and accounts in the HFTP.

Also, an EIT exemption may apply to certain new foreign-source income (from new foreign direct investment) of taxpayers in the tourism, modern services, and high- and new-technologies industries established in the HFTP. The exemption applies to income from operating profits of newly established foreign branches or dividend income from newly increased foreign direct investment in which the taxpayer holds a 20% or more equity interest (inclusive of the new investment). Furthermore, the foreign jurisdiction in which the branch is located or investment is made must impose a minimum statutory income tax of 5%.

In addition, taxpayers established in the HFTP may accelerate the deduction of the cost of fixed assets (excluding buildings) or intangible assets (if purchased, constructed, or developed by the taxpayer) as follows:

- For assets valued at CNY 5 million or less, an immediate tax deduction is allowed; and
- For assets valued at more than CNY 5 million, an accelerated depreciation or amortization schedule is allowed.

Tax incentives for the Lingang area of Shanghai

For companies that are registered and have substantial business operations in the Lingang area of Shanghai, a reduced EIT rate of 15% will be granted for the first five years from the establishment of any such companies engaged in the integrated circuit, artificial intelligence, biomedicine, or civil aviation industries.

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Employment incentives

China encourages enterprises to increase the number of job opportunities for persons with a disability and provides tax incentives for qualifying enterprises to achieve a specified ratio for employment of such persons.

Enterprises that employ persons with a disability are eligible for an additional 100% deduction on related salary expenses for EIT purposes, if the following conditions are met:

- An employment or service agreement (of at least one year) must be entered into with each such person;
- All required monthly payments and payroll contributions must be made for the employee with regard to social insurance (e.g., medical, endowment, unemployment, occupational injury);
- Wages must be paid to the employee (through a bank or other financial institution) that are not less than the minimum wage approved by the provincial government as applicable to the locality where the enterprise is located; and
- Accommodations must be made for the employee to perform properly their job duties.

For businesses (including individually owned businesses) employing persons with a disability, a VAT refund is available, if the following conditions are met:

- The business must employ at least 10 persons with a disability and the monthly ratio of such employees to the total number of employees must be at least 25%;
- An employment or service agreement (of at least one year) must be entered into with each person with a disability;
- All required monthly payments and payroll contributions must be made for the employee with regard to social insurance (e.g., medical, endowment, unemployment, occupational injury); and

- Wages must be paid to the employee (through a bank or other financial institution) that are not less than the minimum wage approved by the provincial government as applicable to the locality where the enterprise is located.

Environmental sustainability incentives

China offers various preferential tax incentives to support different types of production and use of energy-saving technologies and products (e.g., an EIT credit is available equal to 10% of the total investment in designated energy-saving equipment and facilities).

Income derived by an enterprise engaged in an environmental protection or energy and water conservation project may be exempt from EIT for three tax years from the first tax year in which business revenue is derived from such project, after which the EIT would be imposed on 50% of such revenue for the next three tax years.

Where an enterprise has purchased special equipment for environmental protection, energy and water conservation, and work safety (as stipulated in specific catalogues of corporate income tax incentives for such areas), 10% of the amount invested in the special equipment may be set off against the enterprise's tax amount payable for the current year (i.e., used as a tax credit); the balance after set off may be carried forward to the following five tax years. In addition, the enterprise must use the special equipment purchased; if the enterprise transfers or leases the special equipment within five years, it may no longer avail itself of the tax credit and must make supplementary tax payments for any tax credit it has used.

Environmental protection and energy and water conservation projects include public sewage treatment, public trash disposal, comprehensive development and utilization of biogas, and digital transformation related to energy savings, reduced emissions, and desalination.

