

CHINA TAX NEWSLETTER

NATIONWIDE IMPLEMENTATION OF THE RELEVANT TAX COLLECTION PILOT POLICIES OF THE NATIONAL INNOVATION DEMONSTRATION ZONE

PAGE 2

IMPROVEMENTS TO POLICIES OF PRE-TAX ADDITIONAL DEDUCTION OF RESEARCH AND DEVELOPMENT ("R&D") EXPENSES

PAGE 3



CLARIFICATION ON ISSUES RELATING TO FOLLOW-UP ADMINISTRATION AFTER CANCELLATION OF APPROVAL ITEMS FOR APPLICATION OF SIMPLIFIED LEVYING AND SPARING CREDIT FOR OVERSEAS INCOME OF ENTERPRISES

With effect from 10 October 2015, where the overseas income of an enterprise complies with the provisions of item (1) and item (2) of Article 10 of the Notice of the Ministry of Finance and the State Administration of Taxation on Issues Relating to Overseas Income Tax Credit of Enterprises (Cai Shui [2009] No. 125), the enterprise may adopt the simplified method to compute tax credit for tax paid on the overseas income.

The original provision of approval from tax administration has been adjusted to retrospective filing, which means an enterprise shall consider whether its overseas income satisfies with the conditions of simplified levying and sparing credit according to current provisions, and shall submit filing materials to the tax authorities in-charge during the annual computation and settlement period accordingly.

CONTENTS

Clarification on Issues Relating to Follow-up Administration After Cancellation of Approval Items for Application of Simplified Levying and Sparing Credit for Overseas Income of Enterprises

Nationwide Implementation of the Relevant Tax Collection Pilot Policies of the National Innovation Demonstration Zone

Notice on Zero-rated Value-added Tax Policies Applicable for Certain Export Services Including Movies and Television Programs

Improvements to Policies of Pre-tax Additional Deduction of Research and Development ("R&D") Expenses

NATIONWIDE IMPLEMENTATION OF THE RELEVANT TAX COLLECTION PILOT POLICIES OF THE NATIONAL INNOVATION DEMONSTRATION ZONE

The Ministry of Finance and the State Administration of Taxation have expanded the scope of implementation of four income tax pilot policies from the National Innovation Demonstration Zone to nationwide pursuant to the spirit of the decisions of the State Council's executive meetings.

(1) ENTERPRISE INCOME TAX POLICIES PERTAINING TO LEGAL PERSON PARTNERS OF LIMITED PARTNERSHIP VENTURE CAPITAL ENTERPRISES

With effect from 1 October 2015, for limited partnership venture capital enterprises within the nationwide scope which have invested in a non-listed small or medium high-tech enterprise in the form of equity investment for two years (24 months) or more, a legal person partner of the said limited partnership venture capital enterprise may offset the taxable income amount distributed by the limited partnership venture capital enterprise to such legal person partner based on 70% of the amount of its investment in the said non-listed small or medium high-tech enterprise, where the amount is insufficient for the current year's offsetting, the shortfall may be brought forward from subsequent tax years for offsetting.

(2) ENTERPRISE INCOME TAX POLICIES PERTAINING TO INCOME FROM TECHNOLOGY TRANSFER

With effect from 1 October 2015, income from technology transfer pertaining to non-exclusive license of more than five years derived by resident enterprises within the nationwide scope shall be included in the scope of income from technology transfer subject to enterprise income tax incentives. The portion of the annual income from technology transfer of a resident enterprise which does not exceed RMB5 million shall be exempted from enterprise income tax; the portion which exceeds RMB5 million shall be subject to enterprise income tax at 50% reduction.

(3) INDIVIDUAL INCOME TAX POLICIES FOR ENTERPRISE CAPITALIZATION

With effect from 1 January 2016, when small and medium high-tech enterprises within the nationwide scope use undistributed profits, surplus reserve or capital reserve for enterprise capitalization targeted at individual shareholders, where an individual shareholder has genuine difficulties in making one-off payment of individual income tax, he/she may formulate an installment tax payment plan based on the actual circumstances



and pay installments within five calendar years (inclusive), and shall file the relevant materials with the tax authorities in-charge for record.

Share capital obtained by individual shareholders in an enterprise capitalization shall be subject to individual income tax based on the tax rate of 20% as per "income from interest, dividends and bonuses".

(4) INDIVIDUAL INCOME TAX POLICIES PERTAINING TO SHARE OPTION REWARDS

With effect from 1 January 2016, where high-tech enterprises within the nationwide scope with commercialization of technological achievements grant share option rewards to the relevant technical personnel of the enterprises, if an individual has genuine difficulties in making one-off tax payment, he/she may formulate an installment tax payment plan based on the actual circumstances and pay installments within five calendar years (inclusive), and shall file the relevant materials with the tax authorities in-charge for record.

When an individual obtains share option rewards, he/she shall compute and determine the tax payable amount as per "income from wages and salaries" with reference to the relevant provisions of the Notice of the Ministry of Finance and the State Administration of Taxation on Issues relating to Collection of Individual Income Tax on Personal Income from Shares and Options (Cai Shui [2005] No. 35). The taxable price of the share option rewards shall be determined with reference to the fair market price at the time when the share options are obtained.

NOTICE ON ZERO-RATED VALUE-ADDED TAX POLICIES APPLICABLE FOR CERTAIN EXPORT SERVICES INCLUDING MOVIES AND TELEVISION PROGRAMS

Zero-rated value-added tax policies shall apply to the following taxable services provided by domestic organizations and individuals to overseas organizations:

- (1) Production and distribution of radio and television programs (works).
- (2) Technology transfer services, software-related services, circuit design and testing services, information system services, business process management services, and contract energy management services for which the contract subject matter is located overseas.
- (3) Offshore service outsourcing business. Offshore service outsourcing shall include information technology outsourcing (ITO), business process outsourcing (BPO) and knowledge process outsourcing (KPO), and the specific business activities involved shall comply with the business activities corresponding to the Notes on Scope of Taxable Services (Cai Shui [2013] No. 106).

This Notice shall be implemented with effect from 1 December 2015.

IMPROVEMENTS TO POLICIES OF PRE-TAX ADDITIONAL DEDUCTION OF RESEARCH AND DEVELOPMENT ("R&D") EXPENSES

With effect from 1 January 2016, the Notice of the Ministry of Finance, the State Administration of Taxation, and the Ministry of Science and Technology on Improvements to Policies of Pre-tax Additional Deduction of Research and Development Expenses (Cai Shui [2015] No. 119) shall be implemented and applicable to pre-tax additional deduction of R&D expenses. The Notice of the State Administration of Taxation on Printing and Distribution of the Administrative Measures on Pre-tax Deduction of Research and Development Expenses of Enterprises (Trial Implementation) (Guo Shui Fa [2008] No. 116) and the Notice of the Ministry of Finance and the State Administration of Taxation on Issues Relating to Policies on Pre-tax Additional Deduction of Research and Development Expenses (Cai Shui [2013] No. 70) shall be repealed simultaneously.

▶ CONTINUED FROM PAGE 3

IMPROVEMENTS TO POLICIES OF PRE-TAX ADDITIONAL DEDUCTION OF RESEARCH AND DEVELOPMENT (“R&D”) EXPENSES

TIPS FROM BDO CHINA

The new policy features the following changes:

(1) Changes in the scope of applicable industries

It is required in the original policies that enterprises eligible for additional deduction shall engage in R&D activities of projects stipulated in the Key High-tech Fields Supported by the State and the Guide of Current Priority Areas of Focus of High-tech Industries (Year 2007) promulgated by the National Development and Reform Commission etc. The new policy lists out the industries for which the policies of pre-tax additional deduction are not applicable, i.e. tobacco manufacturing, lodging and food & beverage, wholesale and retail, real estate, leasing and commercial services, entertainment, and any other industries stipulated by the Ministry of Finance and the State Administration of Taxation. The new policy has changed the administrative measures from “Positive List” to “Negative List”. Some newly developed industries are also eligible for additional deduction if they not on the negative list, which actually greatly expands the scope of industries for which the additional deduction policies are applicable.

(2) Changes in the scope of applicable R&D activities

The provision of item (2) of Article 1 has listed a “Negative List” of R&D activities which are not eligible to pre-tax additional deduction of R&D expenses. All the R&D activities not on the “Negative List” shall be eligible to the pre-tax additional deduction policy, by which the scope of eligible R&D activities has been greatly expanded.

Meanwhile, the provision of Article 2 of “Dealing with Special Matters” specially mentions the “creative design activities” and clarifies that the relevant R&D expenses incurred by an enterprise in carrying out creative design activities are eligible for the pre-tax additional deduction if the expenses meet the provisions.

(3) Changes in the scope of applicable R&D expenses

a. The new policy has concluded and classified the expenses allowed for pre-tax additional deduction from “8+5” into 7 categories, i.e. staff and labour expenses, direct costs,

depreciation, amortization of intangible assets, design fees for new products, fees for formulation of new processes, clinical trial fees for new drugs, onsite testing fees for exploration and development technologies, other relevant expenses, and any other expenses stipulated by the Ministry of Finance and the State Administration of Taxation.


b. The new policy has added five new categories of R&D expenses allowed for additional deduction, i.e. the service fees of external R&D personnel, inspection expenses for trial products, expert fees, insurance premiums for R&D of advanced technologies, business trip expenses and conference expenses directly related to R&D activities, etc. Meanwhile, the new policy has added limitation of additional deduction to some other expenses directly related to R&D activities, such as technical books and materials expenses, material translation expenses, expert fees, etc. and the total amount of these expenses shall not exceed 10% of the total amount of R&D expenses allowed for additional deduction.

(4) Simplified examination and approval procedure

The new policy clarifies that enterprises are not required to go through project evaluation with the science and technology administrative authorities when applying for additional deduction of R&D expenses. Where the tax authorities object to an enterprise’s claim for additional deduction incentives with respect to its R&D project(s), the tax authorities may request for the science and technology administrative authorities of prefectural level and above (inclusive) to issue an evaluation opinion.

(5) Changes in dealing with matters relevant to entrusted R&D activity

The new policy has a significant change concerning entrusted R&D activity, clarifying that for expenses incurred by R&D activities carried out by an external organization or individual entrusted by an enterprise, 80% of the actual amount shall be included in the entrusting party’s R&D expenses and allowed for additional deduction. Where the entrusting party and the entrusted party are not related, the entrusted party does not need to provide a detailed breakdown of research and development expenses to the entrusting party.



The Newsletter is published for the clients of BDO China Shu Lun Pan Certified Public Accountants LLP and Lixin Certified Tax Agents Co., Ltd. The contents are for reference only which should be kept confidential. Although we try to ensure the accuracy, please note that the content is just the extract of related documents with our brief unbiased comments, thus detailed information should be referred to the full regulation mentioned when in practice. Readers are advised to consult tax advisors before acting on any information in this newsletter. For more information or advice on the above subjects or other tax issues, please contact:

JESSE WANG

Tel: +86-755-82900993

E-mail: jesse.wang@bdo.com.cn / info@bdo.com.cn

JASON HU

Tel: +86-755-82966512

E-mail: jason.hu@bdo.com.cn

ROBERT PEDERSEN

Partner, International Tax Services

Tel: 212-885-8398

E-mail: rpetersen@bdo.com

To ensure compliance with US Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the US Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

BDO International is a worldwide network of public accounting firms, called BDO Member Firms. Each BDO Member Firm is an independent legal entity in its own country. The network is coordinated by BDO Global Coordination B.V., incorporated in The Netherlands, with its statutory seat in Eindhoven (trade register registration number 33205251) and with an office at Boulevard de la Woluwe 60, 1200 Brussels, Belgium, where the International Executive Office is located.

