

China Tax Alert

Issue 27, October 2017

China to boost foreign direct investment - Service outsourcing tax incentives

Regulations discussed in this issue:

- Notice to Improve Corporate Income Tax (CIT) Policies for Advanced Technology Service Enterprises (ATSEs) (Cai Shui [2014] No. 59, Circular 59), issued on 8 October 2014, by Ministry of Finance (MOF), State Administration of Taxation (SAT), Ministry of Commerce (MOFCOM), Ministry of Science and Technology (MOST) and National Development and Reform Commission (NDRC), effective from 1 January 2014 to 31 December 2018
- Notice on Newly-added Exemplary Service Outsourcing Cities Apply to CIT Incentives for ATSEs (Cai Shui [2016] No. 108), issued on 12 October 2016, by MOF, SAT, MOFCOM, MOST and NDRC, effective from 1 January 2016 to 31 December 2018

Background

On 28 July 2017, an executive meeting of the State Council outlined a series of measures to further boost foreign direct investment in China. One of the new State Council measures extends nationwide the pilot city Corporate Income Tax (CIT) incentives for advanced technology services enterprises (ATSEs).

At present the ATSE incentives are available for enterprises registered in 31 pilot cities, mostly in the developed east of China, with some central and western region cities also in scope. The existing ATSE incentive is a temporary incentive, currently effective until the end of 2018, although it is generally expected that it will be repeatedly extended further.

Qualifying ATSEs engaging in service outsourcing businesses are offered preferential CIT treatment, including:

- (i). Reduced CIT rate of 15% (standard rate is 25%); and
- (ii). Ability to tax deduct employee education expenses up to a limit of 8% of total employee expenses (otherwise limited to 2.5%).

In this Alert we outline the advantages for foreign investors of the nationwide rollout of the ATSE incentives.

KPMG observations

While both the ATSE and high and new technology enterprise (HNTE) incentives offer a 15% CIT rate, ATSE treatment is more accessible to multinational enterprises (MNEs). A HNTE must own the intellectual property (IP) for the core technologies used in their business, while this is not a requirement for an ATSE.

An ATSE must provide one or more of the technically advanced services stipulated in Circular 59. This includes information technology outsourced services (ITO), technical business process outsourced services (BPO) and technical knowledge process outsourced services (KPO). In addition the ATSE must:

- Obtain more than 50% of its annual income derive from the technically advanced service;
- Obtain not less than 35% of its annual income from offshore service outsourcing;
- Have at least 50% college-educated staff.

Many foreign MNEs have R&D facilities and shared service centres in China. These may undertake research, design, finance, logistics and procurement, and management activities for related operations in China, Asia-Pacific, and further afield. With the expansion of the ATSE regime nationwide, foreign investors may be further encouraged to establish such facilities, particularly where these can be established as an adjunct to existing China operations.

With respect to ATSE tax management and in particular transfer pricing policies it might be noted that, as ATSEs must provide services utilizing advance technology, and/or have strong abilities in R&D, tax authorities may expect ATSEs to earn higher returns than ordinary service outsourcing enterprises. Some MNEs historically viewed their domestic R&D facilities/service centres as limited risk operations for which low margins are appropriate. In view of this, MNEs will need to balance their application for ATSE status with their group transfer pricing policy.

Details are anticipated by end of this year, and KPMG China will follow up with further updates on the clarified CIT incentive expansion.

Other 28 July State Council meeting measures include:

- The foreign direct investment “Negative List” approach will continue to be rolled out and foreign investment laws improved.
- Reinvestment of distributed profits of foreign invested enterprise will be permitted without imposition of dividend withholding tax.
- Relaxes/ eliminates requirements for foreign investors to have Chinese co-investors for their China investments. Local governments are encouraged to promote the establishment of multinational enterprise ASPAC regional headquarters in China with local tax incentives, and efforts will be made to enhance the protection of foreign enterprise intellectual property rights.
- Further development of national (high tech) development zones with facilitation of land grants to foreign invested projects, and provision of financial support to technology and green projects in western and northeast China.
- Streamline the working permit/visa process for foreigner workers.

This is the third in a series of articles, titled “China to boost foreign direct investment”, covering the announced policy changes from the 28 July State Council meeting. Further articles are to follow. See other previous articles in this series:

- [Limits on foreign equity stake in Chinese enterprises to be lifted](#)
 - [Dividend WHT deferral for reinvestment](#)
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