KPMG

China Tax Alert

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75% R&D super deduction extended, raised to 100% for manufacturers

Summary:

The 2021 government work report announced an extension of the existing 75% research and development (R&D) expense super deduction rules – these had been due to expire by December 31, 2020. A further enhanced R&D super deduction will now be granted to manufacturing enterprises, i.e., the deduction rate for such enterprises will be raised to 100%. This will bring more significant tax-saving for enterprises.

Background

On March 5th, Premier Li Keqiang delivered the government work report at the Fourth Session of China's 13th National People's Congress, with new goals on innovation-driven development during the 14th Five-Year Plan period (i.e., 2021 to 2025). Among the specific measures are continuance of the existing 75% R&D expense super deduction rules and an enhanced 100% super deduction for manufacturing enterprises. This encourages enterprises to increase their R&D outlays.

In the subsequent circulars released by China's Ministry of Finance (MOF), State Taxation Administration (STA), a three year extension was provided for the 75% R&D expense super deduction rules, i.e., the rules have been extended to December 31, 2023. The MOF and STA also set out the implementation rules on the enhanced 100% super deduction rule for the manufacturing industry.

KPMG observations

China initially rolled out its R&D expense super deduction corporate income tax (CIT) policy in 1996, and it was originally solely applicable to state-owned and collectively-owned industrial enterprises. The policy has since been extended to cover most of industries, and the bonus deduction rate raised to 75% (i.e. RMB1.75 deductible for every RMB1 of expenditure incurred) from the original 50%. Tax savings were RMB88 billion in 2018 and RMB350 billion in 2020. In 2019, the China Innovation Environment Index indicated that the proportion of enterprises enjoying the R&D expense super deduction has increased significantly, with a growth rate of 38.9%.

The latest increase of the R&D expense super deduction rate to 100% for the manufacturing industry is in line with the national strategic focus on manufacturing innovation. Together with other fiscal and tax support measures, this will drive manufacturing enterprises to increase their R&D outlays and better leverage new advanced technologies such as internet, 5G, big data and artificial intelligence.

According to the latest implementation rules (i.e. Caishui [2021] No. 13) , the new regulations will take effect from 2021 onwards and a definition is provided for "manufacturing enterprises". In addition, the implementation rules also introduce a new policy to allow enterprises to pre-claim the R&D super deduction for the first half of a tax year, during their quarterly or monthly filing in September.

KPMG suggestions

We would suggest enterprises to consider the following:

- For enterprises who intend to enjoy the 100% super deduction for the manufacturing industry, we recommend a review of the current operating model in order to 1) identify potential tax savings via separation of manufacturing activities into a standalone legal entity; 2) self-assess qualification in accordance with the《National Economic Industry Category》（GB/T 4574-2017).
- Review internal management processes for the R&D expenses super deduction to enjoy the policy benefit in compliance with the regulations.
- Manufacturing enterprises should analyse industry-specific technical and tax rule features and pain points to maximize tax-saving benefits. For example, from the technical perspective, enterprise R&D chains in the manufacturing industry are typically long, with many departments and segments involved. In view of this, enterprises should comprehensively analyse and evaluate the R&D nature of each segment to define a complete R&D chain. This will deal with the issues arising where certain conventional technical activities might be identified as R&D activities. From the tax perspective, accounting systems used in the manufacturing industry are complex, and enterprises should establish an effective R&D management system for R&D expense capture and calculation.

KPMG is monitoring the latest policy developments on technological innovation nationally and locally. With its rich experience, the firm can provide deep insights, advice and services in relation to R&D management systems establishment/improvement, tax incentives and subsidies application and intellectual property planning and application. Please contact KPMG professionals for policy interpretation and practical solutions.

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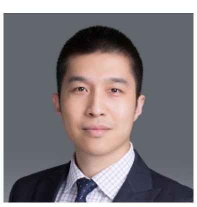

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