China alert

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Value Added Tax incentives for foreign invested R&D centres to continue

Regulation discussed in this issue:

- Circular on the Continuous Implementation of Tax Policies for Equipment Purchase of Research and Development Institutions, Cai Shui [2011] No. 88, issued by the Ministry of Finance, the Ministry of Commerce, the General Administration of Customs and the State Administration of Taxation on 10 October 2011, effective from 1 January 2011 to 31 December 2015

Background

The Ministry of Finance (MoF), the Ministry of Commerce (MOFCOM), the General Administration of Customs (GAC) and the State Administration of Taxation (SAT) jointly issued Cai Shui [2011] No. 88 (Circular 88). Circular 88 stipulates the continuation of the relevant import tax exemption on purchases of certain R&D equipment and devices by foreign invested R&D centres and the Value Added Tax (VAT) refund on purchase of domestically-manufactured equipment available for domestic and foreign invested R&D institutions. This exemption was specified in a previous circular, Cai Shui [2009] No.115 (Circular 115). Circular 88's effective period is from 1 January 2011 to 31 December 2015.

For details of Circular 115, please refer to KPMG China's China alert 2009 Issue 89.

The key points of Circular 88 and our comments are highlighted below:

1. What are the criteria for foreign invested R&D centres to be eligible for tax incentives?

Parameters	R&D centres set up on or before 30 September 2009 (Note a)	R&D centres set up on or after 1 October 2009 (Note a)
R&D expenses		
• Independent legal entity – total investment (Note b)	≥ USD 5 million	≥ USD 8 million
• Non-independent legal entity (internal department or branch)– total R&D contribution (Note c)	≥ USD 5 million	≥ USD 8 million
• All foreign invested R&D centres – annual R&D expenditures (Note d)	≥ CNY 10 million	Not applicable
Full time R&D personnel (Note e)	≥ 90 persons	≥ 150 persons
Accumulated equipment value (Note f)	≥ CNY 10 million	≥ CNY 20 million

Notes:

a. The status of qualified R&D centres is subject to review and verification of the department in charge of commerce and other departments. Please refer to Point 2 below for detailed review and verification procedures.

b. "Total investment" refers to the amount of total investment specified in the approval certificate of the foreign investment enterprise (FIE).

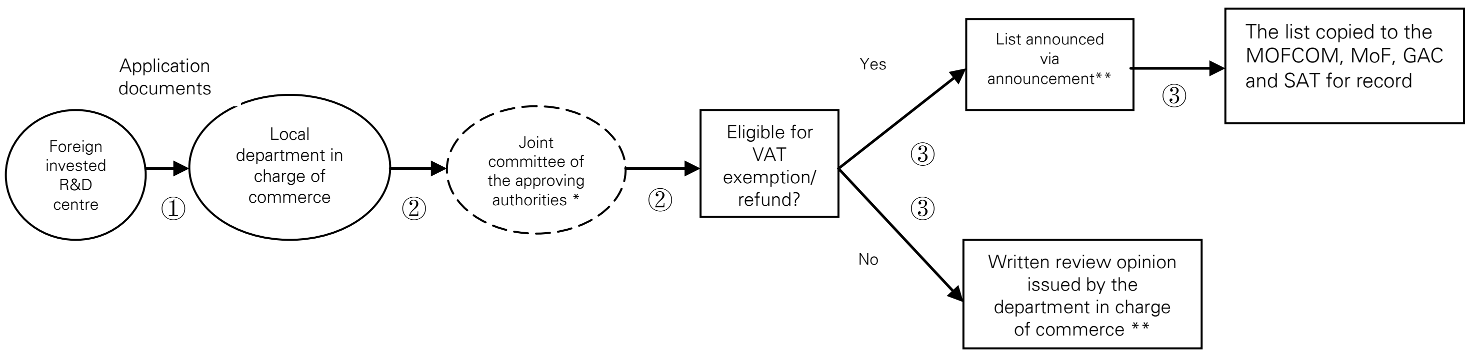
c. "Total R&D contribution" refers to the assets invested by the relevant FIE for the setup and development of its R&D centre, including assets to be delivered pursuant to executed purchase contracts. The R&D centre shall provide the approving authorities with the lists of assets that have been purchased and the contracts for assets to be purchased.

d. "Annual R&D expenditures" refers to the average annual expenditures incurred for R&D activities during the most recent two fiscal years. Where the operation period of the said R&D centre is less than two fiscal years, the annual R&D expenditures shall be calculated according to its R&D expenses actually incurred in any 12 consecutive months since its establishment. The expenditures in cash and contribution in kind for R&D activities shall be no less than 60% of the total R&D expenditures.

e. "Full time R&D personnel" refers to those full time R&D personnel involved in basic research, application research and experimental development, including (1) personnel participating in the above activities directly; (2) relevant full time technology management personnel; (3) personnel directly providing services for research document preparation, supply of materials and equipment. All the above personnel shall have employment contracts with the R&D centre or the FIE with a term of more than one year.

f. "Equipment" as referred to here includes experimental equipment, apparatus and appliance necessary for scientific research, teaching and scientific development. Both imported and domestically-manufactured equipment shall be taken into account when arriving at the accumulated equipment value. Equipment to be delivered within the current year under executed purchase contracts shall also be covered. A list of purchase contracts with the delivery term shall be provided. All the above equipment shall fall within the scope of "*Equipment List for Scientific Development, Scientific Research and Teaching*".

2. What are the review and verification procedures for the qualification of R&D centres?



* The approving authorities include the department in charge of commerce at the provincial level and its counterparts in charge of finance, tax and customs.

** The approving authorities shall release the announcement and issue a review opinion within 45 working days from the date on which the application is accepted.

Every two years, the approving authorities will perform a re-assessment of the qualifications of foreign invested R&D centres that have already been granted a tax exemption or refund incentive.

3. What are the tax incentives available for qualified foreign invested R&D centres?

<u>Import tax exemption</u>

Qualified foreign invested R&D centres shall be exempt from import Customs Duty, VAT and Consumption Tax on imported equipment specified in "*Equipment List for Scientific Development, Scientific Research and Teaching*".

<u>VAT refund on domestically-manufactured equipment</u>

Qualified foreign invested R&D centres shall be entitled to a VAT refund on purchases of certain domestically-manufactured equipment specified in "*Equipment List for Scientific Development, Scientific Research and Teaching*".

4. Effectiveness of Circular 88

The effective period of the tax incentives set out in Circular 88 is from 1 January 2011 to 31 December 2015. Incentives specific to an R&D centre shall take effect from the first day of the month following the month in which it obtains the qualification ("Effective Day").

R&D centres established within the period from 1 January to 1 November 2011 can apply to the customs bureau for a refund of the taxes it has already paid on imported equipment during the period from the abovementioned Effective Day to1 November 2011, if any.

KPMG Observation

The tax incentives for domestic and foreign invested R&D centres stipulated in Circular 115 shall continue to apply under Circular 88, which is in line with the vision of “stimulating technology innovation” under the 12th Five Year Plan. Going forward, the new policy allows the authorities to approve qualified R&D centres more quickly (45 working days under Circular 88 vs. 60 working days under Circular 115), which will facilitate the application process for tax incentives.

Circular 115 ceased to be effective on 31 December 2010, and Circular 88 was just released this past October. We suggest that R&D centres established during the above “gap period” apply to the customs bureau for a tax refund as soon as possible if they have overpaid taxes due to interim regulatory uncertainty.

In addition, we suggest that the relevant enterprises and R&D centres watch closely for the issuance of the forthcoming implementation rules on VAT refunds for domestically-manufactured equipment to ensure that their refund application falls within the stipulated time frame to take full advantage of the tax incentives granted by the State.

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