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CHINA TAX ALERT

ISSUE 29 I October 2015

R&D Super Deduction and Innovation Demonstration Zones expanded and improved

Premier Li Keqiang chaired a State Council executive meeting on October 21 and announced (1) improvements to the R&D Super Deduction policy, and (2) increased enterprise support to increase innovation.

R&D Super Deduction

In relation to the R&D Super Deduction, Wang Jianfan, the department head of the Tax Policy Department of Ministry of Finance, explained the revised policy as follows:

From 1 January 2016:

- The scope of eligible R&D activities will expand. The adjusted policy may apply the Negative List method. All R&D expenses shall be eligible for the R&D super deduction, unless specifically listed as ineligible. The encouraged R&D technical 'categories' specified in the original policy will no longer be applicable. This means that companies will need to satisfy the definition of R&D activities but will no longer need to match the activity to one of eight High New Technology categories.

- Companies will be able to deduct previously unclaimed R&D expenses for the preceding 3 year period. However, for such retroactive claims, the old policy may apply.

- The allocation and accounting of R&D expenses will be simplified. According to the original policy, special account management for R&D expenses was required. The new policy may allow companies to use auxiliary or supplementary accounts to support the relevant R&D expenses.

- Companies will experience streamlined R&D validation procedures and adopt post-filing management for the R&D super deduction. However, contemporaneous and post-filing record keeping and auxiliary account management will be important to manage tax compliance.

- In addition to expenses listed in Guo Shui Fa [2008] No.116 and Cai Shui (2013) No.70, additional expenses such as: expatriate fees, trial product testing and inspection fees, consulting fees, cooperative or contract R&D related costs, etc. will be eligible R&D Super Deduction expenses.

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We are expecting more detailed R&D Super Deduction guidance materials to be released to clarify specifically how the above initiatives will work in practice. KPMG is liaising with government authorities and providing company feedback to enhance the operation of the R&D Super Deduction.

The deadline for the R&D Super Deduction is fast approaching for the year ending 2015 and companies should start now to identify how these benefits can drive innovation, improve processes and allow the company to reinvest the tax savings into future corporate growth.

Preferential income tax policy in innovation demonstration zones

A preferential income tax policy piloted in innovation demonstration zones will be expanded to the whole country. Specifically, it includes the following points:

- Starting from October 1, 2015 where a capital venture enterprise with a limited partnership that has invested in the form of equity in a non-listed small or medium-sized High and New Technology Enterprise for two years or more, its corporate partner may offset 70% of its investment against its taxable income for Corporate Income Tax purposes.

- Where a resident company conducts non-exclusive technology transfer for a term over 5 years, the portion of income from the transfer that does not exceed RMB 5 million shall be exempt from Corporate Income Tax; the portion of income that exceeds RMB 5 million shall enjoy a 50% reduction.

- Starting from January 1, 2016, where a small or medium-sized High and New Technology Enterprise that converts the amount of retained earnings, surplus reserve and capital reserve to additional share capital of individual investor(s), and reward is given to scientific and technological personnel in the form of stock options to a transformation project of new and high-tech achievements, the abovementioned personnel may pay Individual Income Tax by instalments over a 5 year period.

For further information regarding the R&D Super Deduction and other Chinese incentives for innovation, please contact your KPMG advisor and refer to the attached links for relevant KPMG R&D publications:

1. *R&D Incentives: Adding value across ASPAC*

2. *IP Tax Management in China - Navigating the thicket in a BEPS environment*

3. *[China Looking Ahead 4th Edition] Created in China: The fast pace of innovation, R&D incentives and economic development*

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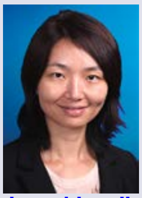

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