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Extension of Super Deduction on R&D Expenses

On 25th June 2018, the Ministry of Finance (“MOF”), State Administration of Taxation (“SAT”) and Ministry of Technology (“MOT”) jointly issued Announcement No. 64 [2018]. The announcement stipulates that 80% of the eligible expenses incurred by enterprises in commissioning overseas research and development (“R&D”) activities will be super deductible before Corporate Income Tax, provided that it does not exceed two-thirds of the qualified R&D expenses incurred in China. Announcement No. 64 [2018] which became effective on 1st January 2018 would supersede Caishui No. 97 [2015] which did not allow deduction of this part of R&D expenses.

The standard ratio for super deduction of R&D expenses is 50%. To encourage small and medium-sized scientific and technological enterprises to put more resources into research and development, Caishui No. 34 [2017] increased the deduction ratio from 50% to 75% for these enterprises.

Furthermore, Premier Li Keqiang announced during the standing committee of the state council on 23rd July that the increased super deduction rate of 75% for R&D expenses will shortly be extended from small and medium-sized scientific and technological enterprises to all enterprises. The details are currently under discussion.

The existing criteria for super deduction of R&D expenses are as follows:

1. For intangible assets that are yet to fulfill the recognition criteria, the additional deduction shall be 150% of the actual expenses incurred (175% for scientific and technological small and medium-sized enterprises);

   Super Deduction = Actual Eligible Amount x 150% (or 175%)

2. For intangible assets that have fulfilled the recognition criteria, they shall be amortized at 150% of the cost of intangible assets (175% for scientific and technological small and medium-sized enterprises);

   Amortized Amount = Cost of Intangible Asset x 150% (or 175%)

The R&D super deduction policy has come a long way since its introduction more than two decades ago. Not only has the coverage of the policy been extended from state-owned and collective industrial enterprises to small and medium-sized scientific and technological enterprises, the additional deduction threshold has also been increased from 50% to 75% for eligible enterprises. The series of changes are testaments to China's commitment to encourage businesses to invest more in research and development for long-term innovation and sustainability.

Detailed rules for the implementation of the updated super deduction of R&D expenses have yet to be released to answer specific questions, such as, if the 75% ratio can be applied retrospectively and whether the scope of eligible costs will be further relaxed. We will pay close attention to any updates and share with our clients and readers in due course.

Change of Social Security Administration

The administration of different types of taxes by different departments of the government has become a thing of the past as the merger of the State Tax Authorities and Local Tax Authorities in various regions of China was completed in July 2018.

The General offices of the Communist Party of China Central Committee and State Council issued the "Reform Plan for the System of National Taxation and Local Taxation Administration" ("Reform Plan") in July 2018. The Reform Plan stipulates that, from 1st January 2019 onward, the payments of basic endowment insurance, basic medical insurance, unemployment insurance, work-related injury insurance, and maternity insurance will be uniformly collected by the local tax authorities.

The Reform Plan has successfully unified the collection of insurance premiums which were previously mostly collected by social security institutions under the separate levy mode. The separate levy mode arose from the "Interim Regulations on the Collection and Payment of Social Insurance Premiums" (1999), which specifies that social insurance premiums can be collected by tax authorities or social security institutions.

This reform will have different implications for different stakeholders. While it is likely to bring improved tax data analytics and enhanced efficiency of tax inspection and collection for the government, non-compliant companies are unlikely to find this reform to be in their favour. This is because tax authorities now have more information to identify non-compliant companies and they are likely to bear a heavier tax burden as a result of this reform. Employees can also be affected if enterprises choose to transfer the increased cost onto them through reducing their salary.

Refund of VAT Credit Balance in Certain Industries

In order to reduce the tax burden for enterprises, the Ministry of Finance and the State Administration of Taxation issued Caishui [2018] No. 32 in the first half of this year. Caishui [2018] No. 32 stipulates that the original applicable tax rates of 17% and 11% will be adjusted to 16% and 10% for VAT general payers.

In addition to the above and as a measure to boost the economy, the Ministry of Finance and State Administration of Taxation jointly issued Caishui [2018] No. 70 on 27th June 2018, announcing a refund of VAT credit balance as at 31st December 2017 for relevant industries. The key points are summarized below:

- The rebate will be given to advanced manufacturing industries such as equipment manufacturing and modern services providers (see appendix for further information).

- To be eligible for the tax refund, the taxpayers must have a credit rating of A or B.

- Refundable VAT amount = VAT credit balance as at 31st December 2017 x Refundable Ratio (calculated according to the formula given by the tax authority according to different scenarios)

- The refund amount is capped at the VAT credit balance as at 31st December 2017.

The return will be completed by 30th September 2018. This is unquestionably great news for relevant companies.

Appendix

Industry catalogue of VAT refund

No.	Industry
1	Chemical raw materials and chemical products manufacturing
2	Pharmaceutical manufacturing
3	Chemical fiber manufacturing
4	Non-metallic mineral products
5	Metal products
6	General equipment manufacturing
7	Special equipment manufacturing
8	Automobile manufacturing
9	Railway, shipping, aerospace and other transportation equipment manufacturing
10	Electrical machinery and equipment manufacturing
11	Computers, communications and other electronic equipment manufacturing
12	Instrument manufacturing
13	Internet and related services
14	Software and information technology services
15	Research and experimental development
16	Professional and technical services
17	Technology promotion and application of services
18	Ecological protection and environmental governance

Service Highlight

To create a more relaxed and modernized business environment for enterprises, the Chinese government has been moving in the direction of reducing tax and compliance burdens. The current reform is only a small step and we believe more will come to benefit businesses operating in China. To learn more about updates to laws and regulations of China, please keep an eye on the China Business Advisory for the latest information. Our Marketing Executive, Ms. Kimme Chan, looks forward to hearing from you at (852) 3579 8745 or kimmechan@sinobridge-consulting.com for any assistance and support we can provide you with.

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