KPMG cutting through complexity

KPMG TaxWatch Webcast:
Taxation in China—Tax Incentives

November 30, 2012

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY KPMG TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Today's Speakers

- Linda Zhang, Tax Partner, Head of U.S. China Practice, KPMG LLP
- Rod Lawrence, Tax Principal, Head of International Corporate Services (ICS), KPMG LLP
- Sam Fan, Tax Partner, KPMG China
- Penny Chen, ICS Senior Manager, U.S. China Practice, KPMG LLP
- Doreen Dai, Chief Representative & Managing Director, North American Representative Office of Shenzhen, P.R. China

Administrative

- CPE regulations require online participants take part in online questions
  - You must respond to a minimum of four questions per 50 minutes in order to be eligible for CPE credit
  - Polling questions will appear on your media player on top of the slides
  - Results will be reviewed in aggregate and may be published as a "pulse survey" of the marketplace in the aggregate. Please note that no responses will be tracked back to any individual or organization
- To ask a question, use the "Ask A Question" icon on your media player or send an e-mail to us-taxwatch@kpmg.com
- Help Desk: 1-877-398-1471 or outside the U.S. at 1-954-969-3342

Agenda

- Key considerations for U.S. multinationals
- Tax incentives under the new Corporate Income Tax (CIT) law
- Government subsidies scheme and practical considerations
- Preferential policies for Qianhai Cooperation Zone
- Q&A

Key considerations for U.S. multinationals

Financial picture

- China is becoming more sensitive to the need to provide incentives to multinationals.
- Many of the incentives are permanent in nature and represent an opportunity to reduce the effective tax rate and cash taxes.
- Ongoing tax reserve concerns related to post-approval tax examinations mean clients are reviewing compliance with all application criteria at least annually.
- An emerging trend amongst larger companies is to ask the local controller for a certificate of compliance at the same time as the corporate tax return is filed.

Clients with existing Chinese operations

- Opportunities to eliminate permanent cost of BT.
- Opportunity to review existing operations for qualification for some of the new incentives
- The use of a CHC may facilitate cash redeployment which has become one of our clients' chief planning issues in China.

Clients considering expansion/fresh investment

- If you are prepared to be flexible on location, China is increasingly looking like the United States in terms of state and local incentives.
- Our clients still see that local authorities may approve applications very quickly, but that the real test is in the following examinations where a multitude of authorities will examine facts to ensure compliance.

Direction of tax incentives under new CIT law

From geographically-based to industry/project/product based

Industry-specific (Primary)

- High and new technology enterprises (HNTE)
- Infrastructure construction
- Renewable energy project
- Agricultural development
- Venture capital
- Software and semiconductor
- Outsourcing – Advanced technology service enterprises (ATSE) …

Geography-specific (Supplemental)

- Western regions
- Qianhai, Shenzhen, Guangdong Province
- Hengqin, Zhuhai, Guangdong Province
- Yuzhong, Chongqing
- Pingtan, Fujian Province

…

8

Industry/project/product based CIT incentives

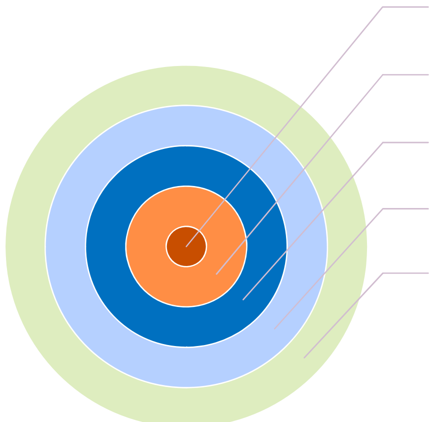
Types of enterprises	CIT incentives
HNTE	Reduced tax rate to 15%
ATSE	Reduced tax rate to 15% (2009 – 2013)
Qualified software or semiconductor enterprises	Reduced tax rate to 10% or 15%
VC enterprise investment into certain encouraged industries/projects	Investment credit
Enterprise engaging in farming, forestry, animal husbandry, fishery	CIT preferential treatment (50% reduction / exemption)
Enterprise engaged in infrastructure construction or environmental protection and energy or water conservation industries/project	"3+3" Tax holidays
Security investment fund enterprise	Exemption on trading income, dividends, interests from stocks / debts in open market
Enterprise in autonomous regions	Reduction/exemption of local portion of CIT
Small scale enterprise with minimal profit	Reduced CIT rate to 20%

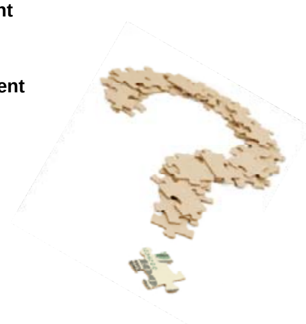
Polling question #1

- The trend of the tax incentives in China under new CIT law is more industry/project/product based rather than geographically based.
  - True
  - False

Case study #1: HNTE

Recognition criteria





Case study #1: HNTE

Administrative procedures

Recognition

- Recognized HNTE is eligible to enjoy preferential CIT rate of 15% subject to application with the tax authority in-charge
- Validity period for HNTE status is three years

Review

- Enterprises should apply for review of the HNTE status three months before expiration date

Case study #1: HNTE

What are the challenges?

- Core proprietary IP right (due to global IP management strategy, especially for MNCs)
- Headcount of scientific technology / R&D personnel (due to the corporate/ operational structure)
- Qualified R&D expenditures (due to mega-size sales revenue)
- R&D outcome may not be self-owned (in case of contract R&D)
- “Look back” requirement (three years prior to 2008)
- “Score-card system” is most difficult as it is a “live” examination

13

Case study #2: ATSE

- Applicable in 21 pilot cities
- Incentive period: January 1, 2009 to December 31, 2013
- Tax Incentives
  - Preferential CIT at 15%
  - BT exemption for offshore outsourcing service income
  - Pre-CIT deduction of staff education charges incurred, up to a limit of 8% of the total payroll

14

Case study #2: ATSE

Scope of qualifying services of ATSE

A qualifying ATSE will need to engage in one or more "advanced technology services":

Information Technology Outsourcing (ITO)	Business Process Outsourcing (BPO)	Knowledge Process Outsourcing (KPO)
• Software development • Information technology development • Information system operation and maintenance	• Internal management functions such as human resources, finance and audit and tax, and front office outsourcing - which include customer-related services such as contact center services, after sales • Supply chain design and database service • Operation flow design service…	• Research & development services • Intellectual property research • Animation & simulation services • Data research and analytics • Medical, pharmaceutical and biotechnology services • Writing/ content development services …

Polling question #2

- Only HNTE can enjoy reduced CIT rate of 15 percent under the new CIT law.
  - True
  - False

Possible tax planning ideas

HNTE vs. ATSE

- IP ownership
- Industry – HNTE Catalogue (8 domains)
- Capabilities of the company satisfying the criteria
- Location for preferential tax treatment
- 21 cities for ATSEs – BT exemption
- Overall group structuring and development plan

Consideration for location of IP ownership

- Ownership: domestic vs. overseas
- Registration: domestic vs. overseas
- Patent vs. non-patent

Possible tax planning ideas

Group structuring arrangement

- Maintaining the high-new technology status
- Setting up new company with IP ownership
- Export of advanced technology service

Location of HNTE

- Special Economic Zones/ Shanghai Pudong New Area vs. other locations

Location of ATSE

- Any preference among the 21 cities?

Geographically-based CIT incentives

Location	CIT incentives
Western region enterprises	Reduced CIT rate at 15% for encouraged projects
Qianhai district, Shenzhen	Reduced CIT rate at 15% for qualified companies newly incorporated
Hengqin, Zhuhai	Reduced CIT rate at 15%
Yuzhong, Chongqing	Reduced CIT rate at15% for qualified encouraged service industry
Pingtan, Fujian	Reduced CIT rate at 15%

Other CIT incentives

Types of items	Income	Deduction	CIT exemption / reduction
Dividend income from tax resident enterprises (TRE)			Exemption
Income derived from qualified technology transfers			Exemption / 50% reduction
R&D expenditures		Super deduction	
Salary for disabled employees		Super deduction	
Depreciation of certain fixed assets		accelerated	
Income derived from products manufactured from comprehensive utilization of resources	Taxable income reduction		
Investment on energy and water saving, environmentally friendly and safety production equipment			Investment cost tax credit

Government subsidies scheme and practical considerations

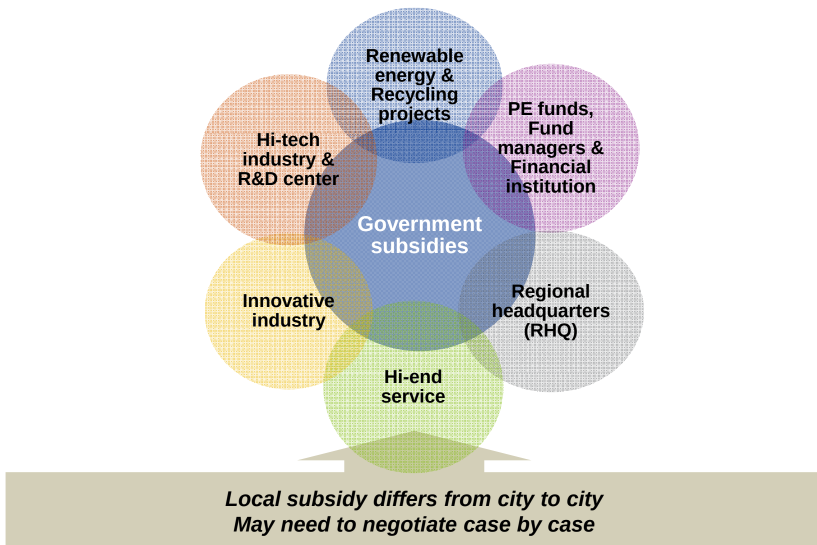
21

Government subsidies – general rules

- Usually granted by local government, rather than central government
- Location-specific, normally no centralized stipulations
- Negotiable at district level on a case-by-case basis
- Generally taxable for CIT purposes
- For all form of foreign investment, government subsidies would most likely be available, if it could qualify for RHQ status
- Need to take a comprehensive approach and weigh the pros and cons when seeking to obtaining these government subsidies

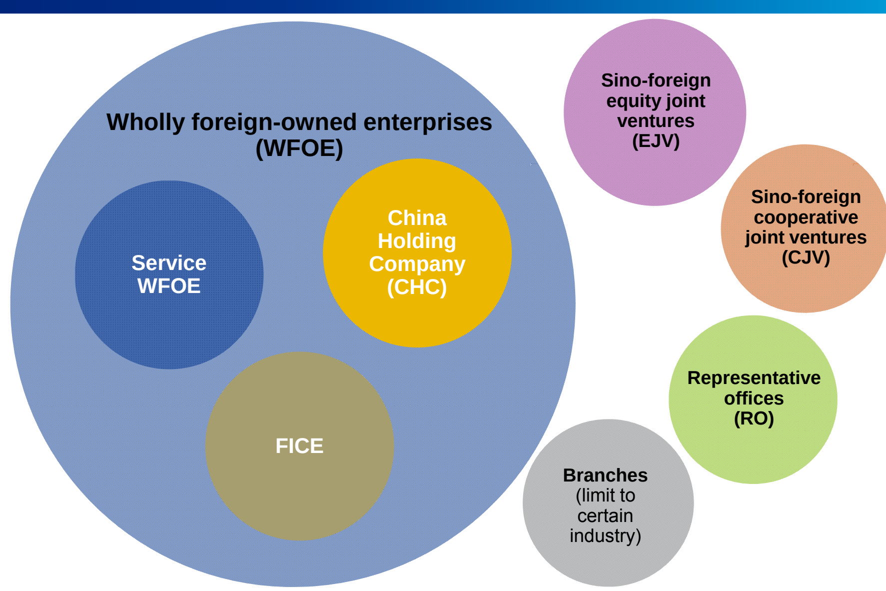
22

Government subsidies – encouraged industries



 23

Commonly used forms of foreign investment



 24

Government subsidies for RHQ in Beijing and Shanghai

Beijing RHQ	Shanghai RHQ
■ Subsidy for paid-in capital – a lump sum subsidy of RMB5 – 10 million for registered capital of more than RMB100 million – The subsidies shall be paid in three years at the rate of 40%, 30% and 30%	■ Establishment subsidy – For a CHC recognized as Shanghai RHQ, either newly registered in Shanghai or relocated to Shanghai, an opening subsidy of RMB5 million will be granted – The subsidy will be provided to the CHC over three years at the percentages of 40%, 30% and 30% from the year of registration or relocation of the CHC
■ Subsidy related to annual revenue (first reaches the following scales) – RMB100 million to RMB500 million: RMB1 million – RMB500 million to RMB1 billion: RMB5 million – Over RMB1 billion: RMB10 million	■ Subsidy related to annual revenue – Nil unless it is recognized as a National RHQ. For Shanghai RHQ recognized as a National RHQ, an one-off financial subsidy of RMB10 million would be granted when its annual revenue exceeds RMB1 billion

Government subsidies for RHQ in Beijing and Shanghai

Beijing RHQ	Shanghai RHQ
■ Subsidy on rental/property purchase (for Chaoyang District only) – RMB1,000 per square meter, and the areas thereof shall generally not exceed 5,000 square meters for self use office building constructed or purchased by the Beijing RHQ – 30%, 20% and 10% of the rental for the consecutive three years with the maximum office premise of 3,000 square meters	■ Subsidy on rental/property purchase – For a newly registered Shanghai RHQ, which leases office space for its own use, an annual rental subsidy will be provided for three years at a rate of 30% of the rent of RMB8 per square meter per day for 1,000 square meters of office space – When a Shanghai RHQ purchases or builds its own office space, a one-off subsidy will be provided based on the sum of three-year rental subsidy as calculated above
■ Other Subsidies – One key management personnel could be eligible for the award calculated based on the fiscal contribution of the Beijing RHQ with the maximum amount of RMB0.5 million. The award will be exempt from Individual Income Tax (IIT).	■ Other Subsidies – District subsidies

Financial subsidies for RHQ in Guangzhou and Shenzhen

Guangzhou RHQ	Shenzhen RHQ
■ Subsidies – Up to RMB 50 million of one-off establishment subsidies – Up to RMB 5 million of annual financial performance subsidies – Additional RMB10 million if it could maintain annual financial performance for a consecutive five year – Rental subsidies	■ Subsidies – RMB 50 million depending on an enterprise's revenues for set-up – Settlement prize of RMB10 million in first year of recognition – RMB 500 per square meter, per year, for rentals of headquarters offices – One-time subsidy worth 5% of the total purchase office space cost

 27

Polling question #3

- Government subsidies at district level are negotiable on a case-by-case basis.
  - True
  - False

 28

Preferential policies for Qianhai Cooperation Zone

Overview of Qianhai new area

Location and area

- Nanshan District, Shenzhen
- 18.04 km2 region

"Centre of Hong Kong and Shenzhen"

- More development on the transportation infrastructure
- 7 mins from SZ Bao'an International Airport
- 10 mins from HK International Airport
- 10 mins from Central Business District of SZ
- 30 mins from Central Business District of HK

"Strategic Significance" in the Pearl River Delta region

- "An Economic Special Zone in an Economic Special Zone"
- Futian is the "Centre" of SZ, Qianhai is the "Centre" of Pearl River Delta

Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone

Close co-operation with Hong Kong

Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone

Cooperation Territory

- Public Service
- Innovative Financial
- Capital Market
- Innovative Insurance
- Modern Logistics
- Innovative Technology
- Innovative Design
- Professional Service

31

Business opportunities
Development zones – Shenzhen Qianhai

State Council Circular [2012] No.58, issued on 27/06/2012

Encouraged Industry	• Finance • Modern logistics • Information service • Science and technology service • Other professional services
Tax Incentives	• Eligible companies - 15% preferential CIT rate • Eligible professionals - IIT exemption • Eligible modern logistics enterprises - BT preferential policy
Financial Innovation	• Pilot area for cross-border RMB business • Encourage development of foreign equity investment funds • Support companies in Qianhai to issue RMB bonds in Hong Kong • Establishment of Qianhai equity investment fund

How to benefit from these policies?

32

Tax incentives

CIT

- A reduced CIT rate of 15 percent for qualified companies newly incorporated in Qianhai
- Higher deduction threshold for staff education expenses

IIT

- The excess of China IIT over the personal income tax on employment income in an individual's home jurisdiction will be subsidized for highly skilled individuals or those whose skills are in shortage in Qianhai.
- The subsidies will be exempt from China IIT.

BT

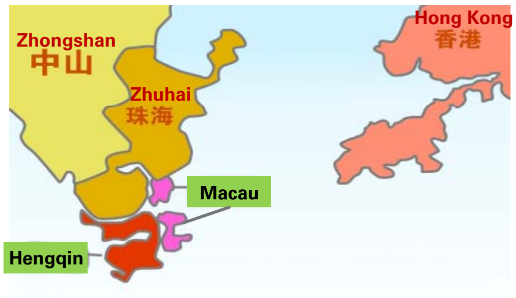
- Exemption of Business Tax (BT) for income derived from international transportation insurance services provided to companies registered in Qianhai by insurance corporations registered in Shenzhen

Polling question #4

- Existing companies relocated to Qianhai can enjoy the reduced CIT rate of 15 percent.
  - True
  - False

Other special areas - Zhuhai Hengqin

State Council Circular [2011] No.85, issued on 14/07/2011



Encouraged industry

Tourism, technology research, Chinese medicine research, financial services, high technology, and creative media

Tax incentives

Duty-free entry of goods
Eligible companies – 15% preferential CIT rate
Eligible professionals – IIT exemption

Other special areas - Fujian Pingtan

Encouraged industry

Modern service, logistics, high technology, Port / Marine industry and Tourism

Tax incentives

Eligible companies – 15% preferential CIT rate
Eligible professionals – IIT equalization

Summary – Key Takeaways

37

Summary of Key Takeaways

1. The direction of tax incentives under new CIT law in China is shifting from previously geographically-based to more industry/project/product based.
2. Even those geographically-based tax incentives are usually granted to qualified enterprises that are within corresponding eligible industries.
3. MNCs should adopt a comprehensive approach to research and review on available tax incentives when contemplating investment plans to China.
4. Upon successful application to relevant tax incentives, MNCs also need to watch out the potential claw-back exposure of tax benefits enjoyed, should MNCs fail to maintain or satisfy conditions of relevant tax incentives.
5. There are various government subsidies available to eligible forms of foreign investments, such as RHQ or CHC.
6. In addition to the CIT incentives and government subsidies, MNCs could also take advantages of various other preferential policies on BT / VAT / IIT / CD, etc. that are available to qualified enterprises located in certain special areas (such as Qianhai, Hengqin, Pingtan, etc.).

38

Closing considerations

Do

- Proactively reach out to your local affiliates to understand whether any fresh opportunities for incentives
- At least consider the CHC as a mechanism to facilitate cash redeployment and simplification of cross border transactions/approval of transactions

Don't

- Assume that you cannot qualify for any new incentives. There is a degree of flexibility in most of the programs.
- Assume that a local government signoff means that the incentives will be realized.
- Assume that your local affiliate is complying with all conditions of the approval; instead consider some form of annual review/certification.

Polling question #5

- Would you like a KPMG professional to contact you regarding the topics discussed today?
  - Yes
  - No

KPMG
cutting through complexity™

Q&A

41

Q&A (continued)

click 'ask a question' on your media player to ask a question

Today's Presenters

Penny Chen	+1 408-367-2829	pennychen@kpmg.com
Doreen Dai	+1 213-628-9888	doreendai@shenzhenoffice.org
Sam Fan	+86 755 2547 1071	sam.kh.fan@kpmg.com
Rod Lawrence	+1 312-665-5137	rlawrence@kpmg.com
Linda Zhang	+1 212-954-2423	lindazhang@kpmg.com

42

KPMG

cutting through complexity™

Thank you for joining us. Please send any questions to us-taxwatch@kpmg.com

Visit www.kpmgtaxwatch.com for a calendar of upcoming events.