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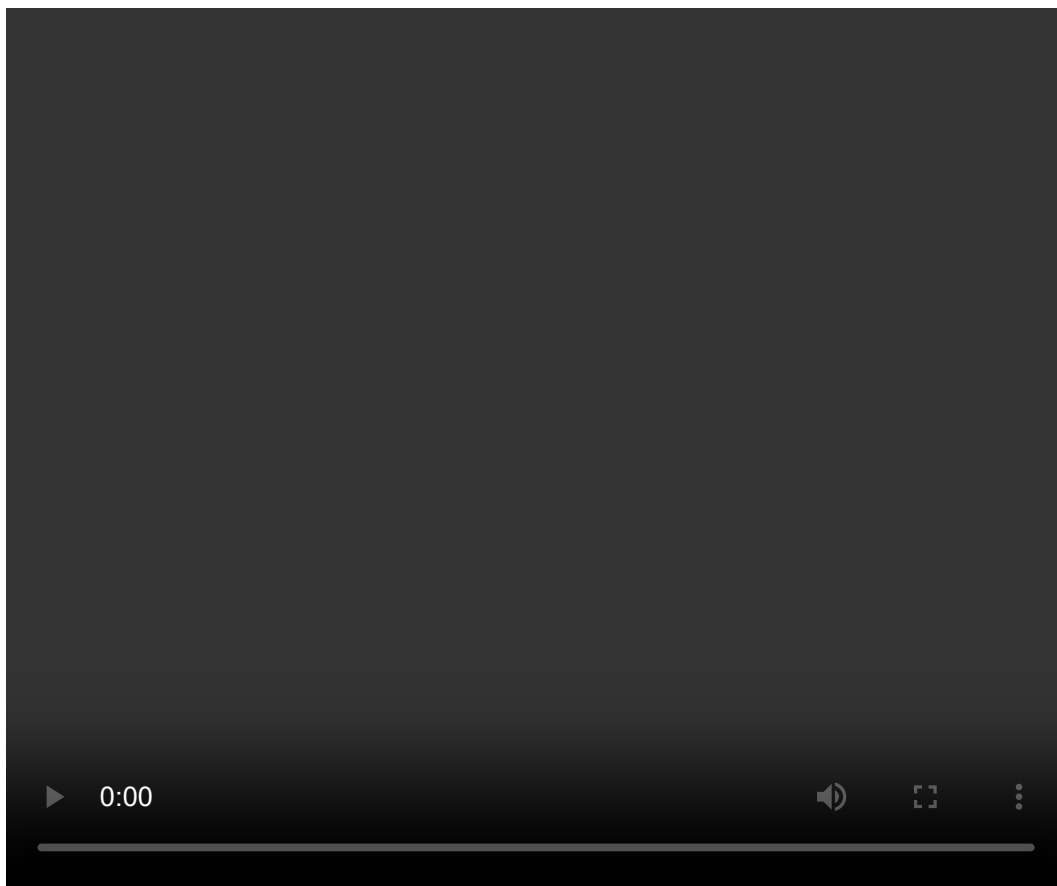
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Interpretation of the new policy on pre-tax deduction of R&D expenses in 2023

Hello everyone, I am Yang Min, Deputy Director of the Income Tax Department of the State Taxation Administration.

The report of the 20th National Congress of the Communist Party of China emphasized upholding innovation as the core of my country's modernization drive. The R&D expense deduction policy is a crucial policy tool for encouraging scientific and technological innovation. In recent years, the government has repeatedly optimized and improved the R&D expense deduction policy, increasing support and playing a positive role in encouraging R&D, which has been widely welcomed by enterprises.

On March 24, the State Council executive meeting decided to implement the policy of increasing the pre-tax deduction ratio for R&D expenses of eligible enterprises from 75% to 100% as a long-term institutional arrangement. This important measure will further stabilize enterprise expectations, encourage independent innovation, and boost enterprise confidence and vitality. To implement the spirit of the State Council executive meeting, our bureau, together with the Ministry of Finance, jointly issued the "Announcement on Further Improving the Policy of Pre-tax Deduction for R&D Expenses" (No. 7 of 2023), which clarifies the specific policies. To facilitate a comprehensive and accurate understanding of this policy by both taxpayers and tax authorities and to unify the interpretation of policy implementation, I will provide some interpretation of this policy today:

I. On the historical evolution of the policy

In recent years, the government has repeatedly increased the R&D expense deduction ratio, iteratively upgrading the preferential policies, which has played a significant policy guiding role in supporting enterprises to increase R&D investment. In 2008, the government legally confirmed the R&D expense deduction policy. In 2015, the government significantly broadened the scope of R&D activities and expenses eligible for preferential treatment and, for the first time, clarified the negative list system. In 2017, the government increased the deduction ratio for technology-based SMEs from 50% to 75%. In 2018, the government increased the

deduction ratio for all eligible industries from 50% to 75% and allowed enterprises to deduct R&D expenses entrusted to overseas entities before tax, as stipulated. In 2021, the government increased the deduction ratio for manufacturing enterprises from 75% to 100%, optimized and simplified the auxiliary account format, and for the first time allowed enterprises to deduct R&D expenses for the first three quarters in advance during the October pre-tax payment. In 2022, the state increased the additional deduction ratio for technology-based SMEs from 75% to 100%, increased the additional deduction ratio for other enterprises in the fourth quarter from 75% to 100%, and allowed enterprises to apply in advance during the application period in October each year to enjoy the preferential treatment of additional deduction for R&D expenses in the first three quarters.

Building on this foundation, Announcement No. 7 in 2023 further increased the preferential policies, raising the additional deduction ratio for R&D expenses for all eligible industries from 75% to 100% as a long-term institutional arrangement. This policy has two main highlights: First, it stabilizes enterprises' policy expectations. The State Council executive meeting on March 24th clarified that raising the additional deduction ratio for R&D expenses for eligible industries would be a long-term institutional arrangement, providing enterprises with clearer expectations and encouraging them to more scientifically and rationally allocate R&D activities and funding, thereby improving the efficiency of technological innovation. Second, it unifies the policy for all enterprises. Before Announcement No. 7, different policies applied to manufacturing enterprises, technology-based SMEs, and other enterprises. After the release of Announcement No. 7, all enterprises are subject to the same policy, eliminating the need to determine the enterprise's "identity." This not only simplifies the policy interpretation but also facilitates its precise implementation.

II. Regarding the policy content and specific wording

(I) Policy Content

According to Announcement No. 7, if an enterprise's actual R&D expenses incurred in its R&D activities do not form intangible assets and are included in the current period's profit and loss, in addition to the deduction based on actual expenses as stipulated, starting from January

1, 2023, an additional 100% of the actual expenses incurred can be deducted before tax; if they form intangible assets, starting from January 1, 2023, 200% of the intangible asset cost can be amortized before tax.

Consistent with the existing policy on additional deductions for R&D expenses, Announcement No. 7 divides R&D expenses into two categories: expensed and capitalized, and clarifies the specific policies for each: First, expensed R&D expenses. Expensed R&D expenses refer to R&D expenses actually incurred that have not formed intangible assets and are included in current profit and loss. For expensed R&D expenses, in addition to the deduction based on actual expenses as stipulated, starting from January 1, 2023, an additional 100% of the actual amount can be deducted before tax. For example, if a company incurs 1 million yuan in R&D expenses in 2023, in addition to the 1 million yuan deduction based on actual expenses, it can also deduct an additional 1 million yuan, meaning the company can deduct 2 million yuan in R&D expenses in 2023, correspondingly reducing the company's taxable income, thereby achieving the goal of paying less tax and saving cash flow. Second, capitalized R&D expenses. Capitalized R&D expenses refer to R&D expenses that have formed intangible assets. For R&D expenses that have formed intangible assets, starting from January 1, 2023, they are amortized before tax at 200% of the intangible asset cost. It's important to note that for capitalized R&D expenses, regardless of whether the intangible assets are formed before or after 2023, they can be amortized before tax at 200% of the intangible asset cost after January 1, 2023. For example, if a company develops an intangible asset in September 2022, and its allowable deduction for the intangible asset cost is 15 million yuan, amortized over 10 years, then in 2023, it can amortize 3 million yuan before tax at 200% of the intangible asset cost. As you can see, compared to not enjoying the additional deduction policy, enjoying the additional deduction policy will double the pre-tax amortization amount, effectively achieving the goal of paying less tax and saving cash flow, thus encouraging companies to increase their R&D investment.

(ii) Other policy interpretations

Other policy interpretations and management requirements for enterprises to enjoy the R&D expense super-deduction policy shall still be implemented in accordance with the relevant provisions of the "Notice of the Ministry of Finance, the State Administration of Taxation, and the Ministry of Science and Technology on Improving the Policy of Pre-tax Super-deduction for Research and Development Expenses" (Cai Shui [2015] No. 119) and the "Notice of the Ministry of Finance, the State Administration of Taxation, and the Ministry of Science and Technology on Relevant Policy Issues Concerning the Pre-tax Super-deduction of Expenses for Enterprises Entrusting Overseas Research and Development" (Cai Shui [2018] No. 64). The main policy interpretations include the following aspects, which are introduced here:

First, there are enterprises eligible for the additional deduction. Specifically, enterprises eligible for the additional deduction must simultaneously meet the following two conditions: First, they must be resident enterprises with sound accounting practices, subject to tax assessment based on audited records, and capable of accurately collecting R&D expenses; second, they must not belong to any of the industries listed in the negative list, namely, tobacco manufacturing, accommodation and catering, wholesale and retail, real estate, leasing and business services, and entertainment. As long as an enterprise meets these two conditions, it can apply for the additional deduction policy for R&D expenses regardless of whether it is profitable or loss-making in the current year. If an enterprise is operating at a loss, enjoying the additional deduction policy for R&D expenses will further increase its losses. These increased losses can be carried forward to subsequent years for offsetting purposes according to tax regulations, thus reducing the taxable income in the offsetting year and achieving the goal of paying less tax and saving cash flow.

Second, R&D activities eligible for additional deduction. R&D activities refer to systematic activities with clear objectives that enterprises continuously undertake to acquire new scientific and technological knowledge, creatively apply new scientific and technological knowledge, or substantially improve technologies, products (services), and processes. To facilitate judgment, Document No. 119, based on the above definition, lists activities that are not eligible for the additional deduction policy, and also establishes a mechanism for referring disputed R&D

projects to the science and technology department for verification. Enterprises that conduct R&D activities in the form of independent, commissioned, cooperative, or centralized R&D can enjoy the additional deduction policy for their R&D expenses in accordance with relevant regulations. In other words, apart from independent R&D, R&D expenses incurred through commissioned, cooperative, or centralized R&D have corresponding regulations clarifying how to enjoy the additional deduction policy.

Third, R&D expenses eligible for additional deduction. These include personnel costs, direct input costs, depreciation, amortization of intangible assets, new product design fees, new process specification development fees, clinical trial fees for new drug development, field trial fees for exploration and development technologies, and other related expenses. Among these, other related expenses are subject to a deduction limit. Document No. 119 uses a positive enumeration format to clarify the specific expenses eligible for additional deduction among the aforementioned costs. For example, personnel costs include wages and salaries, basic pension insurance premiums, basic medical insurance premiums, unemployment insurance premiums, work injury insurance premiums, maternity insurance premiums, and housing provident fund contributions for personnel directly engaged in R&D activities, as well as labor costs for externally hired R&D personnel. It should be noted that employee welfare expenses, supplementary pension insurance, and supplementary medical insurance are not considered personnel costs and should be included in other related expenses according to the "Announcement of the State Taxation Administration on Issues Concerning the Scope of Collection for Pre-tax Deduction of R&D Expenses" (Announcement No. 40 of 2017), and are subject to a deduction limit.

III. Management Requirements

(a) Accounting Requirements

Document No. 119 stipulates that auxiliary accounts should be set up for R&D expenses eligible for additional deduction, based on R&D projects, to accurately collect and calculate the actual amount of various R&D expenses eligible for additional deduction in the current year. The tax authorities issued two versions of auxiliary account templates in 2015 and 2021,

respectively. Enterprises can set up auxiliary accounts by referring to the applicable auxiliary account templates according to their own actual situation, or they can design their own R&D expenditure auxiliary account templates.

(II) Application Method

The additional deduction for R&D expenses adopts the method of "actual occurrence, self-judgment, declaration and enjoyment, and retention of relevant materials for future reference". Enterprises can calculate the additional deduction amount based on the actual R&D expenses incurred, fill in the preferential enjoyment information in the corresponding line of the tax return, and retain relevant materials for future reference. No prior filing or approval is required.

(III) Timing of Entitlement and Application

According to current policy regulations, when enterprises pre-pay their corporate income tax for the third quarter (quarterly pre-payment) in October or September (monthly pre-payment), they can choose whether to enjoy the additional deduction policy for R&D expenses in the first three quarters of the year. Those who do not choose to enjoy the additional deduction policy for R&D expenses during the October pre-payment period can enjoy it uniformly when handling the annual corporate income tax settlement (i.e., between January and the end of May of the following year).

For taxpayers who enjoy the policy during the enterprise's pre-payment declaration, if they file manually, they can fill in the relevant preferential item name and preferential amount in the detailed line under "Deduction: Tax-exempt income, Reduced income, Additional deduction" on line 7 of the "People's Republic of China Enterprise Income Tax Monthly (Quarterly) Pre-payment Tax Declaration Form (Type A)" (A200000). If taxpayers file through the electronic tax bureau, they can directly select the corresponding preferential item name from the drop-down menu and fill in the preferential amount. It should be noted that since there are many preferential items in the drop-down menu, enterprises should consult the "Enterprise Income Tax Declaration Item Catalog" in the "Taxpayer Services" section of the State Taxation Administration's official website when filing, and select the correct preferential item to accurately

enjoy the preferential policy. In addition, when enjoying the preferential policy, enterprises also need to fill in the "Detailed Statement of Additional Deduction for R&D Expenses" (A107012) based on the relevant information for the first three quarters. The "Detailed Statement of Additional Deduction for R&D Expenses" (A107012) is a form in the annual enterprise income tax declaration form, which can be found by searching for the number A107012. When filling out the form, please carefully read the instructions first, and then fill in the relevant data as required. For enterprises using the "2021 R&D Expenditure Auxiliary Ledger Template" or designing their own auxiliary ledger template, some detailed rows can be omitted according to the instructions, making the process simpler. It is particularly important to note that line 51, "Total Amount of R&D Expenses Deducted This Year," represents the amount of preferential treatment claimed in the pre-payment declaration. Please ensure this information is accurate and consistent with the data entered in the pre-payment declaration form. After completing the "Detailed Statement of R&D Expenses Deduction Preferential Treatment" (A107012), simply keep it for future reference; it does not need to be submitted to the tax authorities.

For those enjoying preferential treatment during the annual tax return, fill in the relevant lines of the "Detailed List of Tax-Exempt, Reduced Income and Additional Deductions" (A107010) and the "Detailed List of Additional Deductions for R&D Expenses" (A107012) of the "Annual Corporate Income Tax Return of the People's Republic of China (Type A, 2017 Edition)". The method for completing the "Detailed List of Additional Deductions for R&D Expenses" (A107012) is similar to that for the pre-payment declaration, and this form will be submitted to the tax authorities as part of the annual tax return.

To facilitate understanding of the policy, we have compiled a Q&A guide to the additional deduction of R&D expenses and revised the new policy guidelines. Taxpayers who need this information can visit the State Taxation Administration's official website and WeChat account to view and understand the specific policy details. Next, we will also leverage big data to accurately deliver policies, ensuring that eligible taxpayers are fully aware of the preferential policies and can fully enjoy their benefits.

That concludes my explanation. Thank you everyone.

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