DOI: 10.54254/2754-1169/93/20241087

Research on Tax Planning Strategies for Chinese Service Outsourcing Enterprises

Yanbing He[1,2,a], Dr. Razif Bin Rosli[2,b,*]

[1]*Pharmaron Beijing Co., Ltd. , Beijing Economic and Technological Development Zone, China.*
[2]*SEGi University & Colleges, No.9, Jalan Teknologi, Taman Sains Selangor, Kota Damansara, PJU 5, 47810 Petaling Jaya, Selangor.*
a. 758282229@qq.com, b. razifrosli@segi.edu.my
**corresponding author*

Abstract: Amid escalating trade disputes, increasing trade barriers, and instability in financial markets, the Chinese economy faces numerous challenges and uncertainties. In such a complex economic environment, the service outsourcing industry encounters various urgent development and operational issues. This paper aims to deeply study the unique characteristics of the service outsourcing industry, its development status in China, and a series of supportive measures and tax incentives implemented by the government in this field. By combining the practical challenges and development issues faced by the industry with the research on tax planning by domestic and foreign scholars, this paper particularly focuses on the feasibility analysis of tax planning in the service outsourcing industry. This exploration aims to provide theoretical support and practical guidance for enhancing the international competitiveness of the service outsourcing industry, thereby contributing positively to the high-quality development of enterprises, promoting corporate innovation, and supporting the national strategy of science and technology.

Keywords: Service Outsourcing, Tax Planning, Zero Tax Rate

1. Introduction

Service outsourcing refers to the practice of outsourcing non-core business activities or tasks that do not possess professional advantages within the enterprise to specialized institutions. This aims to fully utilize the professional advantages of external institutions, improve enterprise efficiency, and enhance overall competitiveness.

China's service outsourcing industry is developing rapidly, with a growing number of enterprises, total service outsourcing contract amounts, and personnel involved. However, due to recent geopolitical rises, trade frictions, and increased uncertainties in the global economic situation, coupled with the fact that the main clients of the service outsourcing industry are developed countries such as the US, Europe, and Japan, and with the slowing growth of the Chinese economy and rising labor costs, the challenges faced by the service outsourcing industry in China have drawn the government's attention. To support the healthy development of the industry and address various problems encountered by enterprises during development, the Chinese government has successively implemented a series of policies and measures in finance, talent, finance, and taxation to support the development of service outsourcing enterprises. These policies aim to promote the development of

DOI: 10.54254/2754-1169/93/20241087

the service outsourcing industry and enhance the position and capability of service outsourcing enterprises in international competition. How to reasonably and legally utilize these policies, especially tax incentives, to contribute to enterprise development is a crucial issue that enterprise employees, especially financial personnel, need to consider carefully. Therefore, this paper studies the preferential policies introduced by the state and the literature published by experts and scholars, exploring the feasibility of tax planning in this industry.

2. Introduction to the Service Outsourcing Industry

2.1. Development of the Service Outsourcing Industry in China

Since the 21st century, the service outsourcing industry in China has rapidly developed. The number of service outsourcing employees increased from 6.072 million in 2014 to 16.047 million by the end of February 2024. The number of service outsourcing enterprises grew from 28,100 in 2014 to a total of 73,962 nationwide by the end of 2022. The execution amount of service outsourcing contracts rose from USD 81.34 billion in 2015 to USD 284.9 billion by 2023.

Due to the high-tech, high value-added, and knowledge-intensive nature of the service outsourcing industry, it has attracted a large number of highly educated talents. As of the end of February 2024, the industry had cumulatively absorbed 16.047 million employees, of which 10.476 million had a college degree or higher, accounting for 65.3%. Between January and February 2024, the industry added 176,000 new employees, 166,000 of whom had a college degree or higher, accounting for 94.3%. To further promote the robust development of the service outsourcing industry, by February 2024, China had established 37 service outsourcing demonstration cities, including Shanghai, Beijing, and Dalian, where enterprises can fully utilize human resources and other hardware facilities to maintain smooth communication with major contracting parties from the US, Japan, and Europe.

2.2. Supporting Policies for the Service Outsourcing Industry

The Chinese government has introduced a series of policies on funding, talent, and taxation to promote the development of the service outsourcing industry and enhance the international competitiveness of service outsourcing enterprises. Additionally, each service outsourcing demonstration city has implemented a series of support policies to foster the industry's growth. These policies include providing related funding, talent training, and tax incentives. The main tax incentives involve tariffs, import value-added tax (VAT), export VAT, corporate income tax, and personal income tax. For instance, in the 37 service outsourcing demonstration cities, export VAT is exempted, VAT zero rates are applied to cross-border taxable services and cross-border logistics, and VAT is exempted on imported equipment for foreign-funded R&D centers. Furthermore, advanced technology enterprises and high-tech enterprises are offered preferential income tax policies, and eligible enterprises can deduct R&D expenses from taxable income.

2.3. Challenges Faced by the Service Outsourcing Industry

Although service outsourcing enterprises have rapidly developed under the strong support of the state, they face competition from countries like the US, Europe, and India, which developed their service outsourcing industries earlier and have significant development advantages and support facilities. In recent years, China has faced rising labor and housing costs, and a severe shortage of high-end talent within enterprises. This situation has led to insufficient investment in R&D, thus affecting their innovation capabilities. These issues have seriously impacted the development of China's service outsourcing industry. Therefore, the state, enterprises, and internal employees should pay great attention to the development of the service outsourcing industry. Under the premise that the state

DOI: 10.54254/2754-1169/93/20241087

introduces relevant preferential policies and provides supporting funding, better utilization of national preferential policies for enterprise development, analysis and research of preferential policies for service outsourcing enterprises, and the study of suitable tax planning schemes for enterprises can streamline internal processes and optimize enterprise operations, providing a basis for financial management and tax planning. As a knowledge and technology-intensive industry, the service outsourcing sector is a crucial participant in the national strategy of technological development and is a key industry supported by the state.

2.4. Current Research on the Service Outsourcing Industry

The service outsourcing industry involves multiple fields, including information technology, finance, healthcare, customer service, and human resources management. Each industry has its unique tax policies, regulations, and corresponding preferential policies aimed at encouraging investment and industry development.

However, due to the complexity and diversity of the service outsourcing industry, tax planning may face various challenges and obstacles. For example, differences in tax regulations between different countries or regions can lead to tax risks and uncertainties in cross-border transactions. Moreover, with the continuous changes and updates in international tax standards, service outsourcing enterprises need to continuously adjust their tax planning strategies to ensure compliance and maintain a competitive advantage.

Therefore, it is crucial to strengthen research on tax planning in the service outsourcing industry. This not only helps enterprises better understand and respond to changes in tax policies but also provides theoretical and practical support for government departments to formulate more accurate and effective tax policies. Additionally, academic circles, industry, and the government should enhance cooperation and exchange to jointly promote in-depth research on tax planning in the service outsourcing industry, thereby facilitating sustainable industry development and economic prosperity. Based on the collection of relevant preferential policies and literature, this paper explores the policies and tax incentives of relevant countries in the service outsourcing industry and, according to the industry's characteristics, assesses the feasibility of tax planning to play a positive role in the development of the service outsourcing industry.

3. Literature Review on Tax Planning

Tax planning primarily explores the relationship between tax burden (TB) and tax rate (t), tax base (B), deductions (d), and tax incentives (I). This relationship can be expressed as $TB=f(B; t; 1/d; 1/I)$. In other words, the tax burden (TB) is directly proportional to changes in the tax base (B) and tax rate (t), and inversely proportional to deductions (d) and tax incentives (I). Therefore, a broader tax base and higher tax rate result in a heavier tax burden, while more pre-tax deductible items lighten the tax burden. This section aims to understand various aspects of tax planning based on the research of domestic and foreign scholars, providing a solid theoretical foundation for tax planning practices in service outsourcing enterprises.

3.1. Review of Foreign Literature

Foreign literature investigates tax planning issues from perspectives such as business activities, financing methods, and policy environments. LBFD defines tax planning as "the act of taxpayers reasonably arranging to reduce their tax payments." [1] Indian expert Yasasvi shares a similar view with LBFD, stating that "the purpose of tax planning is to fully utilize tax incentives to obtain the maximum tax benefits." [2] Italian-American economist Franco Modigliani and his student Merton Miller analyzed tax planning from the perspective of financing methods, arguing that "under the premise of ensuring taxation, enterprises can achieve higher tax benefits through debt financing." Myron Hughes proposed that "tax planning should be carried out by considering the economic environment and specific preferential policies" from macro and micro perspectives. Maekarin Sharon believes that tax planning should also take into account the enterprise lifecycle based on economic and tax policies. Scholes and others used modern contract theory to analyze tax planning issues, suggesting that tax planning should focus not only on pre-tax returns but more importantly on post-tax benefits, with the goal of tax planning being tax revenue [3]. Mayshar explored tax planning from the perspective of taxpayer tax costs and government tax costs to determine optimal tax conditions. Clausing and other scholars studied how multinational groups use transfer pricing strategies for tax planning. Kenneth analyzed the relationship between tax incentives and exports, while Michael R. Diamond examined tax planning from the perspective of reasonably arranging corporate organizational structures. These comprehensive foreign studies on tax planning provide theoretical support for analyzing and studying tax planning in the service outsourcing industry.

3.2. Review of Domestic Literature

Chinese scholars and tax experts have studied corporate tax planning issues based on foreign tax planning theories and practices, combined with China's tax environment. Professor Huang Ning believes that "tax planning refers to enterprises achieving tax revenue goals through prior arrangements under legal and compliant requirements." [4] Professor Gai Di stated that "tax planning means that enterprises use national incentives to reduce tax payments and how to reasonably avoid taxes." [5] Domestic tax expert Professor Gao Jinping also believes that "tax planning is to achieve tax revenue and fund financing by planning and arranging various activities of enterprises in accordance with regulations." These experts analyzed tax planning from the perspective of business activities or utilizing national incentives. Teacher Tian Xia and others explored the importance of tax planning from the perspective of tax planning and financial management. Teacher Cai Chang suggested that "tax planning should consider reducing tax risks." Teacher Liu Tao comprehensively analyzed tax planning costs, risks, and returns based on investment theory. Teacher Zhou Yufei included the examination of risk factors in studying tax planning schemes. Professor Yue Shumin used game theory to explore how to optimize China's tax system to balance the interests of tax authorities and taxpayers, allowing enterprises to fully utilize tax incentives while enabling the state to regulate the economy through tax laws [6].

Experts at home and abroad have analyzed tax planning from various angles, and it can be summarized that the general principle of any tax planning is to reduce the tax burden and minimize risks. The implementation methods of tax planning are as follows:

a) Avoiding the realization of taxable income;
b) Avoiding the application of higher tax rates;
c) Delaying the occurrence of tax liabilities;
d) Fully utilizing pre-tax expense deductions;
e) Utilizing tax incentives;
f) Using various differential provisions of tax laws for tax planning.

4. Overall Approach to Tax Planning

To conduct tax planning for enterprises, first of all, we should be familiar with the national tax law provisions for the industry, summarize the tax incentives related to the industry, on this basis, sort out the company's business process, and find the space for tax planning in the value chain; Secondly, we should discuss with the top management to determine the goals to be achieved in tax planning, establish several tax planning schemes and choose planning schemes according to the income or tax planning risks after planning, and then we can put them into practice and see the effect of tax planning.

Step 1: Familiarize with Tax Incentive Policies

To engage in tax planning, it is essential to be well-versed with the tax laws and regulations pertinent to the industry, especially the tax incentives provided by the government. This involves collecting relevant national regulatory policies related to the industry and analyzing each tax incentive's required industry characteristics and enterprise features. Through this analysis, potential areas for tax planning within the company's specific business activities can be identified.

Step 2: Define Tax Planning Goals

Tax planning goals can either focus on reducing the tax burden of a single tax type or maximizing the overall enterprise value. After discussing these goals with senior management, several alternative plans should be established based on the enterprise's actual situation.

Step 3: Discuss and Decide on the Best Plan

After fully considering the tax benefits, costs, and risks, the best tax planning plan for the enterprise should be determined, adhering to the principle of minimal cost and maximal benefit.

Step 4: Implement and Feedback on Tax Planning Results

With a detailed tax planning scheme in place, the next step is to implement the plan and verify if the results align with initial estimates. If the tax planning process does not meet expectations or if other issues arise, an analysis should be conducted to adjust the plan accordingly. Finally, the results and effectiveness of the tax planning should be reported and evaluated.

5. Tax Planning Strategies for Chinese Service Outsourcing Enterprises

Service outsourcing enterprises are a burgeoning industry heavily supported by the state, enjoying substantial tax incentives. These incentives encompass reductions in income tax rates and pre-tax deductions, and the application of zero VAT rates for qualifying cross-border taxable services. The primary tax incentives involve regulations related to corporate income tax and VAT.

VAT Incentives:

VAT incentives mainly address the output VAT and input VAT. For output VAT, incentives include zero VAT rates and VAT exemptions for cross-border taxable services in the service outsourcing industry. Zero VAT rates mean that cross-border taxable services are exempt from export VAT. The input VAT on raw materials, fixed assets, and services purchased for cross-border business can be deducted from domestic VAT payable. If input VAT exceeds output VAT, a tax refund can be requested. For input VAT, incentives include exemptions from VAT and tariffs on imported goods, applicable to foreign-funded R&D centers and foreign-invested enterprises meeting certain conditions for self-use equipment, as well as bonded area imports.

The VAT rate can be calculated using the following formula:

VAT Rate= (Output VAT−Input VAT/Output VAT)×100%

Corporate Income Tax Deductions: Corporate income tax deductions for the service outsourcing industry include full deductions for social insurance and housing fund contributions paid by enterprises according to employee wage ratios. Full deductions are also allowed for commercial insurance premiums paid for employees in special positions, and for wages, bonuses, and allowances for disabled employees, which can be deducted at 200% of the actual amount. Additional pre-tax deductions include accelerated depreciation of fixed assets, depreciation of capital assets for production use, interest expenses not exceeding similar bank loan rates, and service fees paid to affiliated enterprises that comply with the arm's length principle.

Starting January 1, 2023, the additional deduction ratio for R&D expenses for all eligible industry enterprises has been increased to 100%, becoming a long-term institutional arrangement. These additional deductible expenses primarily include salaries, bonuses, social insurance, and housing funds for R&D personnel and their assistants, raw materials and auxiliary materials used for research, and depreciation of fixed assets and intangible assets used for R&D. For venture capital enterprises investing in other enterprises through equity investments, up to 70% of the investment amount can be deducted before paying corporate income tax.

6. Research Conclusions

By analyzing the development status and operational issues of the Chinese service outsourcing industry, combined with tax theories and the tax incentives introduced by the state, it is concluded that the service outsourcing industry can engage in tax planning through VAT and corporate income tax. Additionally, tax planning can be applied to the daily operations and investments of enterprises.

References

[1] *Su, Q. (2005). Analysis of misconceptions and prevention in corporate tax planning. Financial Economy, (20), 69.*
[2] *Chen, G. Q., Zhu, R. X., & Yao, W. S. (2011). Corporate Tax Planning. Economic Science Press.*
[3] *Wang, M., & Zhou, M. (2012). Analysis of tax planning strategies from the perspective of contract theory. In Annual Meeting of the China Tax Planning Research Association and Symposium on Corporate Lawful Tax Payment and Safe Operation and University Tax Professional Social Practice and Teaching (Conference Proceedings).*
[4] *Huang, N. (2009). Legal issues of income tax planning for state-owned enterprises in China (Master's thesis). Guizhou University.*
[5] *Gai, D. (2011). Tax Accounting and Tax Planning. Dongbei University of Finance and Economics Press.*
[6] *Yue, S. M. (2003). Theoretical Analysis of the Optimization of China's Tax System. Renmin University of China Press.*