



# Tax Newsflash

China

Deloitte Tohmatsu Tax Co.

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## New Rules Issued for HNTE Status Recognition

Rules issued by China's Ministry of Finance, the State Administration of Taxation and the Ministry of Science and Technology on 29 January 2016 amend the requirements to qualify for High-New Technology Enterprise ("HNTE") status (Guo Ke Fa Huo [2016] No. 32, see [full text in Chinese](#) (hereinafter, "New Measures")). Specifically, the New Measures lower certain thresholds for a company to be recognized as an HNTE, streamline the application process and update the list of state-encouraged high-new technologies, but they also enhance the post-recognition audits of HNTEs. The New Measures apply retroactively as from 1 January 2016.

### (1) Background

HNTE status is beneficial because such companies are subject to a 15% enterprise income tax rate, rather than the standard 25% rate.

The previous rules governing HNTEs (Guo Ke Fa Huo [2008] No. 172, see [full text in Chinese](#)) were issued in 2008. As a result of the rapid pace of technological developments over the past eight years, these rules have become somewhat out of step with the realities of the global economy. During an executive meeting held on 13 January 2016, the State Council agreed it was time to revise the 2008 rules to eliminate certain impediments to qualify for HNTE status, such as the requirement relating to R&D expenses for small and medium sized enterprises (SMEs).

### (2) Key Changes

#### 1) HNTE Requirements

The New Measures make the following changes to the requirements for a company to qualify for HNTE status:

	2008 Measures	New Measures	Comments
Intellectual property (IP)	The company must have owned the core proprietary IP rights used in its main products and services for the past three years. The proprietary IP rights had to be obtained through the company's own R&D efforts or through a transfer, purchase, donation, merger and acquisition transaction, or an exclusive license to use the IP for at least five years.	The company must have owned the IP that has a core function in supporting the main products and/or services of the company from a technology perspective. The proprietary IP rights still must be obtained through the company's own R&D efforts or through a transfer, purchase, donation, merger and acquisition.	The New Measures remove the restriction that the company must have held the IP for the past three years, as well as the requirement for a five-year exclusive license right.
	The products and/or services must fall within the scope of State-Encouraged High-New Technologies.	Technologies that have a core function in supporting the main products and/or services of the company must fall within the scope of State-Encouraged High-New Technologies.	The New Measures emphasize the "core function" of the IP rights in supporting the company's business.
Technical personnel	On an annual basis, at least 30% of the total number of employees of the company had to be technical personnel that held a college diploma or a higher degree; included in the 30% technical personnel requirement was that personnel dedicated to R&D activities must represent 10% of the total number of employees of the company.	Technical personnel engaged in R&D and relevant technological innovation activities must represent at least 10% of the total number of employees annually.	The New Measures acknowledge the rise in R&D outsourcing and relax the requirement relating to technical personnel.
R&D expenses	Qualifying R&D expenses had to exceed the following as a percentage of the company's sales revenue for the last three fiscal years: <ol style="list-style-type: none"> <li>At least 6% if the revenue was less than RMB 50 million in the most recent fiscal year;</li> <li>At least 4% if the revenue was between RMB 50 million and RMB 200 million in the most recent fiscal year; and</li> <li>At least 3% if the revenue was more than RMB 200 million.</li> </ol>	Qualifying R&D expenses must exceed the following as a percentage of the company's sales revenue for the last three fiscal years: <ol style="list-style-type: none"> <li>At least 5% if the revenue is less than RMB 50 million in the most recent fiscal year;</li> <li>At least 4% if the revenue is between RMB 50 million and RMB 200 million in the most recent fiscal year; and</li> <li>At least 3% if the revenue is more than RMB 200 million.</li> </ol>	The New Measures lower the percentage of revenue criteria for companies whose sales revenue is less than RMB 50 million, which should enable more SMEs to enjoy the preferential policies for HNTes.

Other requirements	The company had to meet the requirements in the "Operating Guidelines for Recognition of HNTes" (Operating Guidelines) in areas such as organization and management of the R&D activities, the ability to convert the results of research into commercial production, the number of independent IP rights owned and the growth of sales and the total assets.	The company's innovation ability must meet the requirements.	More details are expected to be discussed in the upcoming revisions to the Operating Guidelines.
Violation/accident records	Not mentioned in the requirements to be reviewed during the application process (however, the 2008 rules listed significant accidents relating to the safety or quality of products and/or services or environmental breaches as one of the post-recognition events that would result in the revocation of HNTe status).	The company must not have had any significant accidents relating to the safety or quality of its products and/or services or violations of environmental laws during the year before HNTe status is granted.	The New Measures require a company to meet certain safety, quality and environment protection standards.

## 2) Application and administration

The New Measures make the following adjustments and/or clarifications to the application and administrative procedure:

- When applying for HNTe status, a company must submit copies of its enterprise income tax returns for the last three years to the relevant authorities.
- The public notice period, during which objections can be raised to a company that has favorably passed through relevant HNTe review process, is reduced from 15 to 10 business days.
- An HNTe must submit an annual report ("HNTe status report") to the relevant authorities that contains details on the IP, technical personnel, R&D expenses, business revenue, etc. for each fiscal year during the validity period of the HNTe status. The report for a fiscal year must be submitted by the end of May of the following year.
- The record filing requirement where an HNTe changes its company name is revoked, but the HNTe still must notify the relevant authorities to confirm that its HNTe status continues to be valid.
- The validity of HNTe status will not be negatively impacted if an HNTe relocates to another province.
- The simplified procedure to renew HNTe status is revoked. Under the 2008 rules, a company was allowed to apply for a simplified "renewal" procedure so that HNTe status could be extended for an additional three-year period after the expiration of the original HNTe status. Under the New Measures, once HNTe status expires, the company must re-apply under the normal procedure if it wishes to continue to enjoy the tax incentives available for HNTes.

### 3) State-Encouraged High-New Technologies

The New Measures revise the scope of state-encouraged high-new technologies by adding various emerging technologies and removing some outdated ones. The New Measures also refine the language by focusing more on technical descriptions of technologies rather than the products supported by the technologies.

#### Examples of Newly Added Industries/Technologies

<ul style="list-style-type: none"> <li>➤ Technology for cloud computing services</li> <li>➤ Inspection, testing and certification services</li> <li>➤ Technology for e-business and modern logistics</li> <li>➤ City management and social-related services</li> <li>➤ Supporting technology for the creative cultural industry</li> </ul>	<ul style="list-style-type: none"> <li>➤ Additive manufacturing (i.e. 3D printing)</li> <li>➤ Manufacturing and application of graphene materials</li> <li>➤ Natural disaster monitoring</li> <li>➤ Warning and emergency disposals</li> <li>➤ New energy automotive testing and infrastructure</li> </ul>
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### 4) Post-recognition audits

#### i. Audit mechanism

The New Measures require the relevant national and provincial government authorities to set up a formal post-recognition audit mechanism.

If the relevant government department discovers that an HNTE company no longer meets the HNTE requirements due to changed circumstances, the department can request the competent authorities to conduct a review. If the review confirms the company's failure, HNTE status will be revoked and the tax authorities will be notified to recapture the tax benefits relating to the year in which the company became ineligible for HNTE status.

An HNTE must report any significant changes relating to HNTE status to the competent authorities within three months (extended from 15 days).

#### ii. Revocation of HNTE status

The competent authorities must revoke HNTE status in the following cases:

2008 Measures	New Measures	Comments
<ol style="list-style-type: none"> <li>1. The company provided false information when applying for HNTE status;</li> <li>2. The company committed tax evasion or fraud;</li> <li>3. The company had a significant safety or quality accident; or</li> <li>4. The company committed illegal acts or violations of environmental protection laws and regulations and was penalized by the relevant authorities.</li> </ol>	<ol style="list-style-type: none"> <li>1. The company provided significant false information when applying for HNTE status;</li> <li>2. The company had a significant safety or quality incident, or committed significant illegal acts or violations of environmental protection laws and regulations; or</li> <li>3. The company did not report significant changes relating to the HNTE requirements or failed to submit the annual HNTE status report for more than two years.</li> </ol>	<p>Under the New Measures, the violation must be "significant"; insignificant violations will not result in revocation of HNTE status. The New Measures do not provide further guidance on what will be deemed to be significant for these purposes.</p>

The New Measures eliminate the rule that prevented a company from re-applying for HNTE status for five years following the revocation of HNTE status.

The New Measures confirm that relevant tax benefits must be recaptured according to the tax administration laws and regulations from the year in which the disqualifying event took place.

### **(3) Deloitte's comments and recommendations**

The New Measures broaden the scope of State-Encouraged High-New Technologies, relax certain requirements and streamline the application process for HNTEs. Therefore, it is expected that more companies (SMEs, in particular) will be able to obtain HNTE status and enjoy the relevant tax benefits. However, companies still need to carefully consider whether to apply for HNTE status since HNTE status results in various ongoing compliance obligations and the company must ensure that the associated IP arrangement is aligned with the group strategy. It also is worth noting that post-recognition scrutiny and audits will be enhanced following the issuance of the New Measures.

Companies that wish to enjoy the tax benefits of HNTE status should start to assess whether they would qualify under the New Measures and prepare the application materials accordingly. More details relating to the application process likely will be provided in the upcoming revisions to the Operating Guidelines. Therefore, it is important to closely monitor future developments and seek professional assistance if necessary to ensure that an HNTE application is accurate and submitted in a timely manner.

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