

# China Tax Alert

Issue 5, February 2016

## New Version of Administrative Measures for Recognition of High and New Technology Enterprise (HNTe) Released

### Regulations discussed in this issue:

- Administrative Measures for Recognition of High and New Technology (Guokefahuo [2016] No.32), issued by Ministry Of Science and Technology (MOST), Ministry Of Finance (MOF) and State Administration of Taxation (SAT), effective from 1 January 2016

On 4th February, 2016, Ministry Of Science and Technology (MOST), Ministry Of Finance (MOF) and State Administration of Taxation (SAT) jointly issued a notice on revising Administrative Measures for Recognition of High and New Technology (Guokefahuo [2016] No.32).

Compared to Guokefahuo [2008] No.172 ("No. 172"), the broad principles behind of Guokefahuo [2016] No.32 remain the same, but it adjusts the HNTe recognition requirement, as well as the procedures and supervision of the policy. This will help achieve the policy objectives of the HNTe incentive for the benefit of in-charge tax authorities and prospective applicants.

### Key HNTe changes

Three main changes are clear when one compares the Guokefahuo [2016] No.32 to the old No.172:

#### 1. Recognition requirements

##### *R&D expense ratio requirement*

In terms of the R&D expense ratio, for companies with annual sales under RMB 50 million, the R&D expense ratio reduces from 6% to 5%. This reduction in the R&D expense ratio, to the benefit of small companies, clearly reflects the government's intention to give small sized companies a better treatment. For companies with annual sales between RMB 50 million to RMB 200 million and more than RMB 200 million, the R&D expense ratio remains the same, that is 4% and 3% respectively.

### *Personnel requirement*

In terms of the personnel requirement, the requirement that “the number of science and technology personnel with college degree or above should be more than 30% of the total employees of the company for the year” has been removed, and changed to “the number of science and technology personnel engaged in R&D and related technology innovation activities should be more than 10% of total employees of the company for the year”. This relaxation of the policy will benefit all companies and coincides with the actual mode of R&D management within corporate organisations. The Guokefahuo [2016] No.32 does not define “science and technology personnel engaged in R&D and related technology innovation activities”. At this stage, it will be up to companies to determine which staff should be included in the personnel percentage calculation. It does appear that part-time and support staff may be eligible for inclusion, but this is not confirmed.

### *Intellectual property requirement*

There are also changes in respect to the intellectual property (IP) requirement. The old regulation (No. 172) required that companies “shall own proprietary IP of core technologies of its main products/services gained through independent R&D activities, transfer, donation or acquisition in the past three years, or through global exclusive license for over five years”. The New Draft replaces the requirement as it now states: “companies shall own IP rights of key technologies which show core support to their main products (services) gained through independent research and development, transfer, donation or acquisition”. As such, under the old regulation, companies could obtain IP by “global exclusive license for over five years”. Under the Guokefahuo [2016] No.32 this is no longer applicable. This shows the government’s trend toward encouraging independent innovation and R&D. In addition, the previous criteria involving “IP granted in the past three years” and “proprietary IP” have also been removed. At present it seems that the IP may no longer need to be acquired or developed in the last three years. The specific implementation standards need to be further clarified.

### *Indicator requirement*

The indicator requirement has been changed to “company innovation ability assessment”, but the specific assessment standard has not yet been announced.

## **2.Change to the application documents for recognition**

There are several newly added application documents stipulated in the Guokefahuo [2016] No.32. This requires companies to provide “the key technology and technical indexes of the company’s high and new technology products (services)” and “certification approval and relevant qualification”. Other newly added documents include “certificate of the scientific research project approval, relevant documents on scientific and technological achievements transformation and R&D management”, “the annual Corporate Income Tax filing returns for the precedent three fiscal years” etc.

This essentially raises the compliance hurdle for HNTE companies and indicates that the authorities require comprehensive documents to prove that the technology meets the requisite standards.

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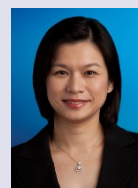
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## 3.Strengthened follow-up supervision of companies with HNTe status

- The Guokefahuo [2016] No.32 requires companies to file the annual development form by the end of May every year.
- The Guokefahuo [2016] No.32 emphasizes that the Ministry of Science and Technology, the Ministry of Finance, the State Administration of Taxation will establish mechanisms for 'random checks' and key inspections, in order to strengthen HNTe supervision and inspection protocols.
- The Guokefahuo [2016] No.32 stipulates the rules regarding penalties for non-compliance. Upon cancellation, the tax incentives previously enjoyed may be clawed back from the year of the misconduct.
- The new specific requirements and procedures for HNTe re-assessment are not yet released. As such, companies face some uncertainties concerning ongoing HNTe eligibility and compliance.

## Summary

The release of the Guokefahuo [2016] No.32 shows that the government will continue to encourage and support HNTe incentives. While the in-charge authorities have relaxed the HNTe recognition requirements in some respects, it is clear that HNTe audit protocols and documentary evidence thresholds have increased. As such, companies seeking HNTe status will need to actively plan and prepare in advance to manage the tightened audit procedures and certification/documentation requirements. In particular, companies are advised to consider the below two points:

- The changes in respect of the IP requirements, and application documentation, suggest that in-charge authorities may place more emphasis on (1) technology advancement, and (2) the connection between IP and R&D activities, core technology and the main products (services) of the applicant.
- The HNTe application documents are now more specific and rigid in respect of issues such as "certification approval and relevant qualification" and, when this is combined with tighter regulatory supervision of the HNTe program, it is apparent that companies must focus on contemporaneous record keeping and systematic management of R&D activities.

Guokefahuo [2016] No.32 points out that MOST, MOF and SAT will announce Guidance for Administration of Recognition of High and New Technology Enterprise in more details.

KPMG will continue to communicate with, and provide feedback to, the authorities to improve both the understanding and implementation of the Guokefahuo [2016] No.32.

For further information regarding the HNTe and other Chinese incentives for innovation, please contact your KPMG advisor and refer to the attached links for relevant KPMG R&D publications:

- [R&D Incentives: Adding value across ASPAC](#)
- [IP Tax Management in China - Navigating the thicket in a BEPS environment](#)
- [\[China Looking Ahead 4th Edition\] Created in China: The fast pace of innovation, R&D incentives and economic development](#)

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