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High-tech = high risk?

Contacts

China

Martin Ng
Managing Partner
Martin.ng@worldtaxservice.cn
+ 86 21 5047 8665 ext.202

Ened Du
Manager
Ened.du@worldtaxservice.cn
+ 86 21 5047 8665 ext.215

In brief

» 1,723 high-tech enterprises were audited, by a joint-departmental check taking place nationwide in Beijing, Liaoning, Zhejiang, Anhui, Shandong, Hubei and Shaanxi provinces, and Shenzhen.

» The audit has resulted in a staggering punishment: 168 enterprises failed the test (42 high-tech qualifications are revoked and 124 enterprises are warned).

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In detail

Tax abuse based on high-tech status is on Chinese authority's radar nowadays. On 6 September 2015, three Chinese ministries (MST, MOF and SAT)[1] have jointly announced the result of a national audit against high-tech enterprises starting for some time since late 2012.

The audit was carried out in two phases:

- Phase 1: Self-examination by local authorities on high-tech qualification recognition
- Phase 2: Key inspection by state authority in charge of high-tech qualification recognition

The audit has focused not only on the recognition process, but also the application procedures and penalty on the advisory agents. The key inspection areas are:

1) Ownership of intellectual property (IP) rights
2) Booking of R&D expenses
3) High-tech products/services and its related revenues
4) Number of high-tech employees
5) Tax benefits status

Eight joint inspection units from MST, MOF and SAT have inspected 1,723 enterprises in 8 provinces and regions. As a result, 168 enterprises are found to be non-compliant, and ranked by 3 categories (A, B and C). Among them, 42 enterprises have their high-tech qualification revoked and 124 enterprises are instructed to rectify the non-compliant issues.

The audit result is summarized below:

Rank	Enterprises inspected	Main issue identified	Treatment after inspection
A	6	Found to have made fraudulent declaration.	Their high-tech qualifications are revoked and tax benefit has to be withdrawn.
B	36	Found not satisfied due to new status.	Their high-tech qualifications are cancelled.
C	124	Found to have minor defects in application procedure or formality, but the qualification is not affected.	They are instructed to rectify the non-compliant issues.

WTS observation

A Chinese high-tech qualification equates not only to tax benefit (to enjoy a low income tax rate at 15% versus the normal 25%), but also a commitment to IP development and consistency in the group's transfer pricing policy in the case of multinational corporations.

It is not rare to see high-tech qualification holders being audited in recent years. However, it is a precedent that a nationwide audit is exercised jointly by three ministries, with 168 non-compliant companies publicly condemned. It sends a clear message that tax benefits are only for those who deserve them, and the Chinese authorities are sparing no efforts to strip away loopholes in tax benefit abuse cases. High-tech qualification holders are advised to review their operation status annually to ensure they can stand against such an audit.

Note 1:

MST: Ministry of Science and Technology
MOF: Ministry of Finance
SAT: State Administration of Taxation

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Author

WTS China Co., Ltd.

WTS Shanghai
Unit 031, 29F, Hang Seng Bank Tower
1000 Lujiazui Ring Road
Pudong New Area,
Shanghai 200120 PRC
Tel: +86 21 5047 8665
Fax: +86 21 3882 1211
www.wts.cn
info@worldtaxservice.cn

WTS Beijing

Unit 601, Landmark Tower1,
8 North Dongsanhuan Road,
Chaoyang District, Beijing, 100004 PRC
Tel: +86 10 6590 6338
Fax: +86 10 6590 7903

Contact

Martin Ng
Managing Partner
Martin.ng@worldtaxservice.cn
+ 86 21 5047 8665 ext. 202

Ened Du
Manager
Ened.du@worldtaxservice.cn
+ 86 21 5047 8665 ext. 215

Xiaolun Heijenga
Partner
xiaolun.heijenga@wts.de
+ 49-69-1338 456 340

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