



Administrative Measures for Assessment of High/New Tech Enterprises

One of the most attractive tax incentives provided under the new Corporate Income Tax Law ("CIT Law") is for High/New Tech Enterprises ("HNTEs") specifically supported by the State. Such HNTEs are eligible to enjoy a reduced income tax of 15% as opposed to the standard tax rate of 25%. For newly set up HNTEs in the Special Economic Zones and Pudong in 2008, they may even enjoy a tax holiday.

The Detailed Implementation Regulations of the CIT Law ("DIR") issued in December 2007 only sets out the basic criteria and information for an enterprise to be qualified as HNTE, and defers the details to be formulated by the Ministry of Science and Technology ("MST"), Ministry of Finance ("MoF") and State Administration of Taxation ("SAT").

Finally, the three ministries have issued, after approval of the State Council, the "Administrative Measures for Assessment of High-New Tech Enterprises" ("Measures") and the "Catalogue of High/New Tech Domains Specifically Supported by the State" ("Catalogue") by way of a joint circular GuoKeFaHuo (2008) No. 172, with retrospective effect to 1 January 2008.

The Measures mainly sets forth the allocation of rights and responsibilities among the three ministries, the detailed criteria for the assessment and the application procedures, and penalty clauses resulting from withdrawal of the designation by the authorities.

We summarize below the key contents of the Measures as well as our observations for your reference.

How to qualify?

The enterprise has to a Chinese tax resident company and it has been set up for one year before the assessment for HNTE. Also it has to meet the following six criteria in order to qualify as an HNTE:

- (i). Proprietary intellectual property ("IP") right of core technology:
- the enterprise has obtained the IP right of the core technology in the last 3 years through self-R&D activities, transfer / purchase, donation, merger, etc; or
 - the enterprise should secure an exclusive right to use the IP right for a period of at least 5 years; and
 - the IP right should be associated with the main products (services) of the enterprise.
- (ii). Products /services of the enterprise within the scope of the Catalogue:
- The Catalogue contains 8 Domains. (see Table 1)
 - Under each Domain, the scopes of the activities are specified with very fine details. There are 51 types and 218 items detailed to the 8 Domains.

Table 1:

	Domains Supported by the State
1	electronic information technology
2	biological and medical technology
3	aviation and space technology
4	new materials technology
5	high-tech services
6	new energy and energy conservation technology
7	resources and environmental technology
8	transformation of traditional sectors through high-new tech

(iii). Headcount of scientific technology staff
Such staff with university degree and above should account for at least 30% of total headcount of the enterprise, amongst which at least 10% engaged in R&D activities.

(iv). R&D expenditure

- Such expenditure should reach a prescribed percentage of total revenue for the past 3 years (see Table 2);
- In addition, the amount of R&D expenditure incurred within China should not be less than 60% of the total R&D expenditure.

Table 2:

Total Revenue in Preceding Year	% of R&D Expenditure Over Total Revenue
below RMB50 million	not less than 6%
between RMB50 million and 200 million	not less than 4%
above RMB200 million	not less than 3%

(v). Income from high/new-tech products (services)
It should be more than 60% of the total annual income of the enterprise.

(vi). "Working Guidelines for Assessment of HNTes" ("Assessment Guidelines")

- The enterprise should meet the requirements of the Assessment Guidelines in respect of the rating in R&D management; capability for converting R&D outcome; number of IP rights; and growth of sales and total assets.
- The Assessment Guidelines will be issued later.

How to apply?

According to the Measures, an enterprise should log onto the "Assessment for High/New Enterprises website" to self-assess in accordance with the above criteria. If the result is positive, the enterprise should then submit a written application together with all required documents to the local assessment administrative institution ("Assessment Institution"). This Assessment Institution is comprised of officials from the local branches of MST (including technical expert pools), MoF and tax bureau at provincial or equivalent levels.

Upon approval by the Assessment Institution, the enterprise will be awarded an HTNE certificate which is valid for a period of 3 years from the issuance date. The names of qualified HNTes will be disclosed at the website to make the outcome transparent. The HNTe will have to apply for re-assessment with the Assessment Institution within 3 months before the expiry of the certificate in order to renew the HNTe qualification for another 3 years.

When to apply?

Enterprises may not be able to proceed with the application until the Assessment Guidelines are released, and the approval and supervision system is set up by the in-charge provincial authorities. However, we understand that some local authorities, such as Suzhou Industrial Park authorities, have provided a preliminary Assessment Guidelines and set up an online website to handle the applications for those existing HNTes.

PwC Observations

- The Measures and Catalogue project an impression that the criteria for qualifying as HNTes for the tax incentives are much higher than the same designation under the previous tax regime. In addition, the application procedure is not perfunctory in light of higher level of authorities' supervision and approval (provincial or equivalent), more standardised requirements (the Catalogue), more examination on technical qualifications (by technical expert pools), more transparency (disclosure of qualified HNTes), etc. Companies should get themselves more prepared in the application process.
- The current requirements of the proprietary IP right of core technology seems to suggest that it is now less stringent to fulfil such requirements than the expectation originally reflected in the DIR. However, it still has to wait and see whether the authorities would provide further clarifications or tighten up the requirements as the HNTe doctrine develops.

- Up to now, only the Measures and the Catalogue have been issued. Another very important document yet to be issued is the Assessment Guidelines which will make the whole HNTE doctrine closer to complete. The Assessment Guidelines will reflect many details to explain the unclear terms, definitions, jargons, and also add more steps, obligations and requirements for the applicants. It is advisable for companies to stay tune on this set of Assessment Guidelines.
- It can be seen from the criteria that the emphasis is on continuous, sustainable R&D activities by HNTE even though the original IP could be purchased or licensed from outside parties. In other words, enterprises which are just applying existing technologies to their manufactured products and services may no longer satisfy the new expectation of the State.
- The HNTE doctrine demonstrates the goals which the State wants to achieve. However, the whole system is still under development. Even if more clarifications are provided, there would still be some unclear and unanswered issues as this is a new system. Also, it is not surprising to see in future that different interpretations or applications may be taken by the local authorities, at least at provincial level (or equivalent), as they may have different agenda than the State.
- Under typical transfer pricing principles, companies owning technology should deserve to earn more profits. Hence, where a MNC is considering to having its Chinese subsidiaries to take advantage of the HNTE tax benefits by granting the IP rights of its technologies to China, then it may have to review their global profit alignment structure.
- Many MNC's group structures in China currently comprise a number of manufacturing companies with mere application of technologies and a small-size R&D centre. They may have to consider restructuring their China operations to take the full advantage of the HNTE's tax benefits.
- The CIT Law and its DIR provide other tax incentives in relation to technologies, such as, the "Super-deduction" for R&D expenses, exemption for transfer of technology income, and sharing of R&D costs between related parties. It is unclear how the HNTE criteria would interact with these other tax incentives.

We look forward to the Assessment Guidelines and, hopefully, further clarifications from the Chinese authorities. We will share with you in future issues of PwC News Flash as soon as new information is available.

In the context of this China Tax / Business News Flash, China or the PRC refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

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