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Tax Incentives for High and New Technology Enterprises

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Tax Incentives for High and New Technology Enterprises

China's new Enterprise Income Tax (EIT) Law, which took effect on 1 January 2008, includes a principal tax incentive in the form of a reduced EIT rate of 15 per cent applicable to high/new technology enterprises (HNTEs). Correspondingly, the Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation have jointly formulated the Administrative Measures governing the Recognition of HNTE (the Measures) in order to clarify the new recognition criteria and procedures for HNTEs.

The Measures strongly indicate that the Government is serious about granting the 15 per cent incentive tax rate in 2008 and future years only to companies that will meet relatively stringent criteria on the continuous research and development (R&D) of high and new technology.

Qualification of HNTEs

Under the Measures, in order to meet the definition of an HNTE, an enterprise must have the following characteristics:

- Be established within China (excluding Hong Kong, Macau and Taiwan)
- Have existed for more than one year
- Continuously conduct R&D activities and transform intellectual property (IP) developed into products and/or services
- Have its own IP rights
- Carry out business within the scope of the Catalogue of High and New Technology Domains Specifically Supported by the State (the Catalogue)

Following the definition, the Measures further provide certain objective requirements for the qualification of HNTEs.

Proprietary IP Right of Core Technology

The enterprise must have obtained the IP right of the core technology in the last three years through R&D activities, transfer/purchase, donation, merger, *etc.*, or it must secure an exclusive right to use the IP right for a period of at least five years. Please note, the IP right should be associated with the main products or services of the enterprise.

Products/Services Within the Scope of the Catalogue

Products and services within the scope of the Catalogue include the following:

- Electronic information technology
- Biological and medical technology
- Aviation and space technology
- New materials technology
- High-tech services
- New energy and energy conservation technology
- Resources and environmental technology
- Transformation of traditional sectors through high/new technology

Under each domain, the scopes of the activities are specified in detail. There are 51 types and 218 items detailed to the eight domains.

Number of Scientific Technology Staff

Staff that have university degrees should account for at least 30 per cent of the enterprise's total employees, among which at least 10 per cent must be engaged in R&D activities.

R&D Expenditure

R&D expenditure should reach a prescribed percentage of total revenue for the past three years.

Total revenue in preceding year	Percentage of R&D expenditure over total revenue
Less than RMB50 million	Not less than 6 per cent
Between RMB50 million and RMB200 million	Not less than 4 per cent
More than RMB200 million	Not less than 3 per cent

In addition, the amount of R&D expenditure incurred within China should not be less than 60 per cent of the total R&D expenditure.

Income from High/New-Tech Products or Services

Income from high/new-tech products or services should be more than 60 per cent of the total annual income of the enterprise.

Application for HNTE Recognition

According to the Measures, enterprises should visit the "Assessment for HNTEs Website" to self-assess in accordance with the above criteria. If the result is positive, an enterprise should then submit a written application together with all required documents to the local Assessment Administrative Institution (the Assessment Institution). The Assessment Institution is composed of officials from the local branches of Ministry of Science and Technology (including technical expert pools), Ministry of Finance and tax authorities at provincial or equivalent levels.

Upon approval by the Assessment Institution, the enterprise will be awarded an HNTE certificate that is valid for three years from the issue date. The name of qualified HNTE will be disclosed on the website to make the outcome transparent. Furthermore, The HNTE will have to apply for re-assessment with the Assessment Institution three months before the expiry of the certificate in order to renew the HNTE qualification for another three years.

Quarterly Filing Before Approval as an HNTE

The HNTE status application process is complicated and likely will be a prolonged process for most enterprises. Because all rules are not yet issued and the procedures of relevant governmental bodies are not yet in place, it is likely that HNTE Status Certificates will not be possible until the end of 2008 or the first half of 2009. In the meantime, enterprises hoping to obtain such certificates must compute their quarterly or monthly tax obligations using the prevailing 25 per cent enterprise income tax rate (unless some other transitional rule applies to allow a lower rate).

Under the guidance to promote the development of high and new technology of a substantive nature, the review of IP right of core technology will be critical for the qualification of HTNEs. Therefore, multinational companies should (i) reconsider their IP arrangements with their Chinese subsidiaries and (ii) carefully review the clauses in the IP license agreement in order to obtain the qualification of HNTEs to take full advantage of the tax benefits for HNTEs.