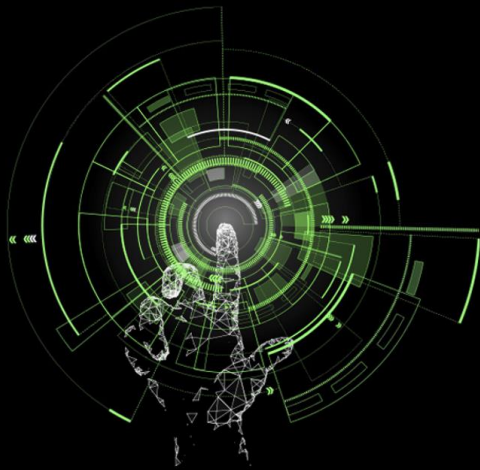


## ALERT ON INVESTMENT INCENTIVES IN HIGH TECHNOLOGY SECTOR

### Episode 2: Updating criteria to determine Hi-tech Application Project and Hi-tech Enterprise according to the latest regulations

May 2021



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## General information

### Newly issued regulations:

- Circular No. 04/2020/TT-BKHCHN (“Circular 04”) dated 28 September 2020 by the Ministry of Science and Technology (“MoST”), took effect from 15 November 2020, amending and supplementing Circular No. 32/2011/TT-BKHCHN dated 15 November 2011 on criteria determining **Hi-tech Application Project** (“HAP”).
- Decision No. 10/2021/QĐ-TTg (“Decision 10”) dated 16 March 2021 by the Prime Minister (“PM”) on criteria **determining Hi-tech Enterprise** (“HTE”) which replaced Decision No. 19/2015/QĐ-TTg dated 15 June 2015 and came into effect from 30 April 2021.

By this Alert, Deloitte Vietnam would like to update enterprises with the following:

1. Updating criteria to determine Hi-tech Application Project and Hi-tech Enterprise
2. The changes on the criteria of R&D expense and R&D labor
3. Deloitte Vietnam’s viewpoints
4. Deloitte Vietnam’s support services.



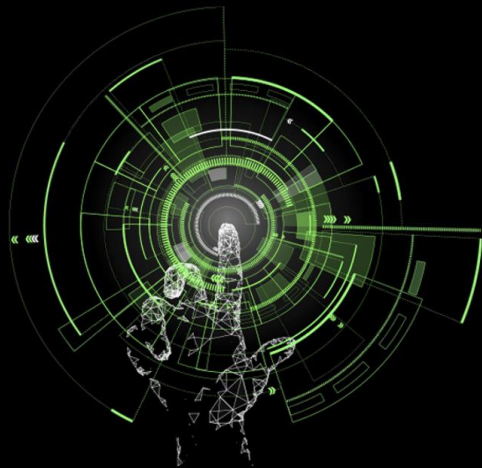
### The issuance of Circular 04 and Decision 10

- The application of former legal documents on investment in hi-tech industry has been affirmed to bring about positive results in recent years.
- Nonetheless, the number of enterprises and projects being certified during the last 10 years are still limited due to:
  - The criteria to apply for hi-tech certificates were quite demanding, thus limited the number of enterprises being certified. For example, the criteria of Research and Development (“R&D”) expenses and R&D labors were key challenges for major enterprises.
  - Especially, the previous set of criteria for R&D were quite difficult to meet for FDI enterprises with very large scale of capital and labor.
  - The implementation of certification procedures and use of application forms under the previous regulations have shown a lot of shortcomings.
- As a result, **Circular 04 and Decision 10 were officially issued** in order to improve the investment conditions in the high technology sector; eliminate obstacles for Hi-tech certified enterprises; and simultaneously attract very large corporations to enhance investment in Vietnamese hi-tech industries.

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## 1. Criteria to determine Hi-tech Application Project and Hi-Tech Enterprise

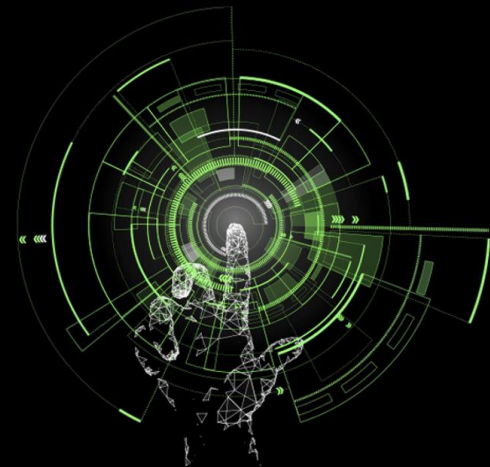
The following table summarizes the criteria to determine Hi-tech Application Project and Hi-tech Enterprise for purpose of applying Hi-tech Certifications as well as enjoying Corporate Income Tax (“CIT”) incentives:

Form of investment	Hi-tech Application Project	Hi-tech Enterprise
<b>Basis for incentive enjoyment</b>	Being certified as Hi-tech Application Activity by the MoST	Being certified as Hi-tech Enterprise by the MoST
<b>Main criteria</b>		
Legal documents	<ul style="list-style-type: none"> <li>Circular No. 32/2011/TT-BKH&amp;CN</li> <li>Circular No. 04/2020/TT-BKH&amp;CN</li> </ul>	<ul style="list-style-type: none"> <li>Article 75, Law on Investment No. 67/2014/QH13 and Clause 3, Article 76, Law on Investment No. 61/2020/QH14</li> <li>Decision No.10/2021/QĐ-TTg</li> </ul>
(1) Criteria of Product/Technology	Applying technology in the List of hi-tech prioritized for investment and development in Decision No. 38/2020/QĐ-TTg which must qualify one of the qualitative factors. <sup>1</sup>	Manufacturing hi-tech products on the List of hi-tech products prioritized for development in Decision No. 38/2020/QĐ-TTg
(2) Criteria of revenue ratio from Hi-tech products	Not required	Achieve at least 70% of the total annual net revenue of enterprises
(3) Criteria of the ratio of R&D labors to total headcount <sup>2</sup>	<ul style="list-style-type: none"> <li>Having capital of VND 6,000 billion and more and total headcount of 3,000 people and more: at least 1%</li> <li>Not being the above case and having capital of VND 100 billion and more and total headcount of 200 people and more: at least 2.5%</li> <li>Not being the above cases: at least 5%</li> </ul>	
(4) Criteria of the ratio of R&D expenses over the added value <sup>3</sup>	<ul style="list-style-type: none"> <li>Having capital of VND 6,000 billion and more and total headcount of 3,000 people and more: at least 0.5%</li> <li>Not being the above case and having capital of VND 100 billion and more and total headcount of 200 people and more: at least 1%</li> <li>Not being the above cases: at least 2%</li> </ul>	
(5) Criteria of Quality Management System	Qualifying national standards i.e. TCVN ISO 9001, HACCP, CMM, GMP or equivalent (depending on project status to apply national or international standards)	Not required specifically
(6) Criteria of Environment and Energy	Applying environmental-friendly and energy-saving measures in production and product quality control which are in accordance with Vietnamese or international standards and technical regulations	

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## 2. The changes on criteria of R&D expenses and R&D labors

- **Limitations under former regulations:**
  - Most of enterprises operating in hi-tech product manufacturing or hi-tech application in Vietnam are subsidiaries of foreign/multinational corporations with global networks. These corporations often establish R&D centers separated from manufacturing plants which serve for different market locations. Therefore, R&D activities (if conducted) in Vietnam usually involves small-scale research projects and/or to upgrade certain product features/functions only.
  - A survey showed that for ultra-large enterprises, the ratio of R&D expenses prescribed in former regulations was not suitable given that the annual turnover generated by such enterprises are often tens or hundreds of trillion dong and the revenue growth rate is approximately 10-20% per year, thus R&D expenses ratio of 0.5% - 1% over total net revenue is very difficult to achieve.
  - Qualifying for the R&D labor ratio (i.e. 2.5% over total headcount) is quite challenging for these enterprises. Particularly, due to specifications of R&D activities, employees working in manufacturing department may also participate in R&D activities to enhance applied technology and improve product quality. Those employees, may not necessarily holds bachelor degrees or higher, but associate degree only.
- **Amended criteria under Circular 04 and Decision 10**
  - **Classifying enterprises by scale:** By referring to regulations of the Law on supporting Small and Medium-sized Enterprises; Law on Investment; Law on Corporate Income Tax, the MoST proposed to classify enterprises into 03 levels to determine corresponding R&D criteria set out in the following table:

Level	Capital scale	Headcount scale	R&D expenses	R&D labors
<b>Ultra large</b>	VND 6,000 billion and above	3,000 employees and above	0.5%	1%
<b>Large</b>	VND 100 billion and above	200 employees and above	1%	2.5%
<b>Medium and Small</b>	Not being the 2 above cases		2%	5%

- **Calculation of the R&D expenses ratio:** is changed to calculate on **total revenue less input value** and apply uniformly to all levels of enterprises, particularly:

$$\text{Ratio of R\&D expenses} = \frac{\text{Total R\&D expenses}}{\text{Net revenue} - \text{Value of imported or domestically purchased raw materials and components}}$$

In which, total R&D expenses<sup>1</sup> include depreciation of infrastructure investment, fixed assets; regular expenses on R&D activities; training expenses; royalty, licensing fees related to technology or intelligent property transfer; etc.

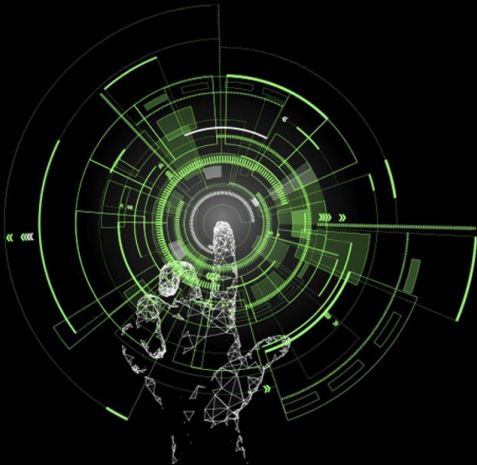
- **R&D labor ratio:** is calculated by the number of employees directly participating in R&D activities **having qualifications from college level and above**. R&D employees are those who sign labor contracts with definite terms from 01 year and above or indefinite term, in which, number of college-graduated employees does not exceed 30% of total employees.

<sup>1</sup>Specified in Clause 1d, Article 1, Circular No. 04/2020/TT-KH&CN and Clause 2, Article 3, Decision No. 10/2021/QĐ-TTg.

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### 3. Deloitte Vietnam’s viewpoints

- From our observations, the majority of enterprises applying hi-tech in production often does not involve a very large number of employee (often less than 3000 persons). Because of this, the criteria specified in Circular 04 and Decision 10 might be an opportunity but also a challenge for enterprises in satisfying the required incentives criteria. Particularly:



- For Hi-Tech Enterprises/ Hi-Tech Applied projects having been certified:** they must apply a new set of criteria specified under corresponding new/amended regulations from the effective date (i.e. 15 November 2020 for Hi-tech Application Project under Circular 04 and 30 April 2021 for Hi-tech Enterprise under Decision 10) to report annual operation results to the MoST, as well as assess the satisfaction of conditions for tax incentives on an annual basis. Thus, notable questions are given for hi-tech certified enterprises/projects as examples as below:
  - Would the current budgets and labor focus for R&D activities meet the new set of criteria as prescribed?
  - Which should be the solutions for hi-tech enterprises to ensure maintenance of those criteria within the continuance of revenue growth or technology renovation leading to labor force reduction?
  - How to prepare an application dossier for reissuance of Hi-tech Enterprise Certificate upon its expiration after 05 years?
- For Enterprises exploring investment and incentive policies to invest in the hi-tech sector of Vietnam:** Deloitte Vietnam would recommend the enterprises to:
  - Evaluate Technology and Products according to Decision No. 38/2020/QD-TTg (as introduced in the previous Alert)
  - Self-review to classify enterprise level and determine the corresponding criteria of R&D expenses and R&D labor ratio in order to ensure satisfaction of conditions for obtaining a certificate from the MoST
  - Make a strategic plan and prepare an appropriate budget for R&D activities to ensure that prescribed criteria are well maintained during incentive periods.

*Deloitte is pleased to support and accompany enterprises by providing advices, finding solutions and developing appropriate plans to assist the application of high-tech incentives (please refer to the support services provided by Deloitte Vietnam on the next page).*

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### 4. Deloitte Vietnam's support services

Deloitte Vietnam believes this Alert fairly provides a general view of policy mechanism by the Vietnamese Government in developing and encouraging investment in Hi-tech sector. In particular, the opportunity for Hi-tech incentives would definitely become one of the tax issues that need to be addressed by your business.

With our experiences from various practical projects, Deloitte Vietnam would be pleased to assist your business by introducing our support services provided by the Global Investment and Innovation Incentives (GI<sup>3</sup>) group in relation to high technology incentives as follows:



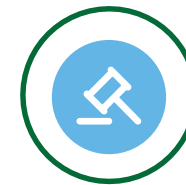
#### Strategy advisory and planning

- Review and identify investment incentive opportunities
- Calculate potential incentive savings
- Risk assessment and strategic planning



#### Certificate Application

- Assist in preparing and reviewing application dossiers
- Support to discuss and explain with the appraisal authority
- Support to obtain certificate



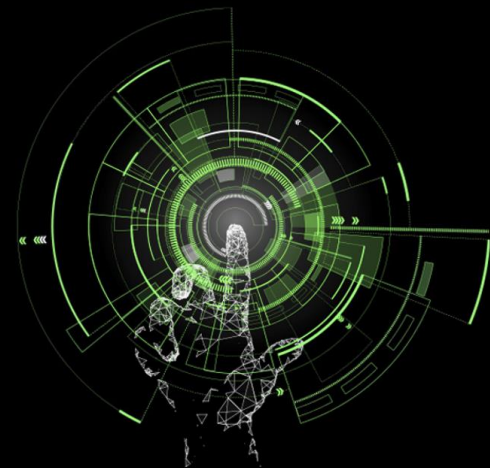
#### Maintenance and Reporting

- Training on the meaning of incentives maintenance
- Reporting compliance services
- Reviewing CIT incentive calculation



#### Certificate Application

- Support to work with appraisal authority upon a post-inspection
- Support to work with Tax authority upon tax audit





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