The Research & Development Tax Incentives

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“If you get up early, work late, and pay your taxes, you will get ahead–if you strike oil.”

J. Paul Getty

- **Innovation** is generally considered a cornerstone of sustainable economic growth and prosperity, as well as a key to business success and to the development of emerging economies.

- Classical economic theory: markets tend to underinvest in R&D and will not generate the social optimal level of R&D

- State policies of subsidizing scientific and entrepreneurial activities leading to innovation and to the accumulation of valuable intangible assets (know-how, patents, trademarks, copyrights etc.)

- The quest for internationally mobile capital that might be attracted by extraordinary tax incentives → harmful tax competition?

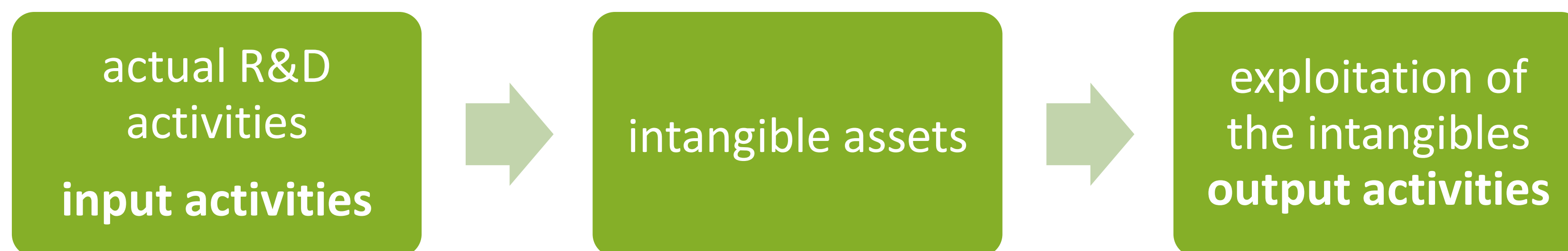
- Wilson with regard to the effects of R&D tax (credit) incentives within the United States, found that state R&D tax incentives were effective at increasing R&D within the relevant US state, but, at the same time, nearly all of the resulting increases came at the expense of reduced R&D spending in other state[1]

- Start of the crisis in 2007 → many states (in particular within the European Union) introduced the policy of providing tax incentives to R&D activities and the result thereof (i.e. valuable intangible assets)

- **1998: OECD: The Report Harmful Tax Competition: An Emerging Global Issue**
- Soft law instrument – recommendations to Member States
- targeting harmful preferential tax regimes

- **2013: BEPS Action Plan**
- preferential regimes continue to be a key pressure area
- nowadays harmful preferential tax regimes have often the form of across the board corporate tax rate reductions on particular types of income
- Action 5 of the BEPS: „Revamp the work on harmful tax practises with a priority on improving the transparency incl. compulsory spontaneous exchange of rulings related to preferential tax regimes and requiring substantial activity for any preferential regime.
- Action 5 of the BEPS Action Plan: „requiring substantial activity for any preferential regime“

- **OECD Frascati Manual** distinguishes among 3 subsequent stages:
- (1) basic research →the experimental or theoretical work undertaken without any particular application or use in view;
- (2) applied research → original investigation undertaken in order to acquire new knowledge and primarily directed towards a specific practical aim or objective;
- (3) experimental development → represents the systematic work, which is directed to producing new materials, products or devices, to installing new processes, systems and services, or to improving substantially those already produced or installed.



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Comparative Overview of R&D Tax Incentives within Europe

- to be published on GGI website
- most of the EU member states covered & Switzerland
- initial information based on IBFD Tax Reasearch Platform
- subsequently subject to review & eventual comments by GGI members in corresponding jurisdictions
- tax incentives on input activities (R&D) included only
- output activities (IP exploitation) topic of the next presentation
- factors of investment allocation decision process

The most common types of R&D tax incentives:

1. Charge to expense of R&D costs capitalized for accounting purposes
   Some tax systems allow for costs sustained for the creation of intangible assets to be charged to expense when incurred, notwithstanding that the applicable accounting principles require the capitalization of such costs
   Ireland → 100% tax depreciation in case of capital expenditure on scientific research

2. Extra-allowances for R&D costs
   Some tax systems provide for special allowances for R&D costs incurred. They lead to the deduction of amounts higher than the actual costs incurred.
   Lithuania, Latvia → 200%
   UK (SME's) → 230%
   Slovenia, Czech Republic → 100%
   Romania, Poland → 50%
   Hungary → 300% if partnership with the qualified research facility

The most common types of R&D tax incentives:

3. Accelerated depreciation/amortization
   Some tax systems allow accelerated depreciation/amortization of the cost of acquisition of capital assets employed in the R&D input activities
   Finland, Lithuania

4. R&D investment-based tax credits
   Certain tax systems provide for a tax credit to be granted to companies carrying on R&D activities. Most commonly, the tax credit is computed in proportion to the R&D costs incurred by the company
   Austria → tax credit equal to 10% of the R&D expenses

The most common types of R&D tax incentives:

5. Education/training extra allowances
   Some tax systems provide for special allowances for education/training costs incurred in connection with R&D activities.
   Austria → 20% of qualifying expenses
   Slovakia → 25% of qualifying personnel costs
   Croatia → up to 80% of education costs

- The incentives quite frequently capped
- Various R&D incentives often combined

"The hardest thing in the world to understand is the income tax."

Albert Einstein

References:

1 D.J. Wilson, *Beggar thy neighbor? The in-state, out-of-state, and aggregate effects of R&D tax credits*, The Review of Economics and Statistics, May 2009, 91(2), p. 431 et seq., at p. 435.

Source:

- IBFD Tax Research Platform
- Paolo Arginelli, *Innovation through R&D Tax Incentives: Some Ideas for a Fair and Transparent Tax Policy*, World Tax Journal, 2015 (Volume 7), No. 1
- GGI Member Firms:
  Contax Wirtschaftstreuhandgesellschaft mbH, DGST Reviséurs d'entreprises, ACTIV Ltd., Vukmir & Associates, M.Eliades & Partners LLC, Rantalainen Accounting Services Ltd., FIDAG, FACT GmbH Wirtschaftsprüfungsgesellschaft, Kovács Réti Szegheõ Attorneys-at-Law, Byrne & McCall Accountants & Tax Advisors, Studio Baldi, GT Fiduciaires SA, CREDAL Advisory Ltd., LIMES International B.V., EFS Group Sp. z o.o., AVM Advogados, Mirus Consultantá Fiscalá SRL, AT Partners, k.s., SKUPIMA SIMIČ & PARTNERJI d.o.o., Dr. Frühbeck Abogados, S.L.P., Stromson Revisionsbyra KB, Fiduciaire FIDAG SA, Citroen Wells Chartered Accountants

Thank you for your attention!

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