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# *Tax incentives on Research and Development (R&D)*

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Belgian Branch reporters

Marc De Mil
International Tax Expert, Federal Public Service Finance

Tom Wallyn
Tax Director, PwC

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## *Agenda*

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1.2 Brief overview of business income taxation
1.3 Tax policy considerations relating to R&D incentives
1.4 R&D input incentives
1.5 Output R&D fiscal incentives (patent box or similar incentive)
1.6 Procedural requirements

**Part 2: R&D incentives in an international context**

2.1 Introduction
2.2. Eligible taxpayers and territorial scope of R&D incentives
2.3. Patent box regimes and harmful tax competition
2.4 Intangibles and BEPS situations

## *Part 1: R&D incentives under domestic tax taw*

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## *Part 1: R&D incentives under domestic tax taw*

1.1 Introduction

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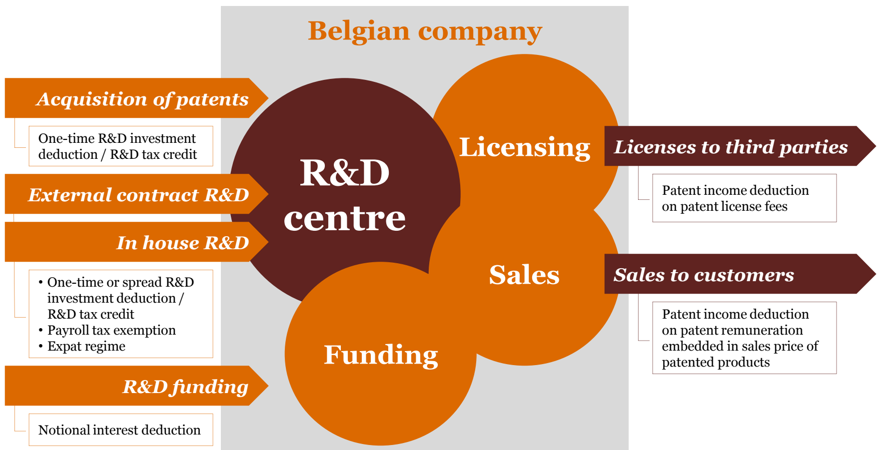
## *Introduction*

EU 2020 Strategy – 3% GDP spent on R&D incentives (currently 2%)






## *Part 1: R&D incentives under domestic tax taw*

1.2 Brief overview of business income taxation

## *1.2 Brief overview of business income taxation*

P.M.



## *Part 1: R&D incentives under domestic tax taw*

1.3 Tax policy considerations relating to R&D incentives

# 1.3 Tax policy considerations relating to R&D incentives

1.3.1 "General tax climate" for R&D

1.3.2 Reasons for introducing R&D incentives

1.3.3 R&D incentives, equality of treatment and ability to pay

1.3.4 Subjective scope

1.3.5 R&D incentives: MNEs versus SMEs?

1.3.6 Definition of R&D for tax purposes



## *Part 1: R&D incentives under domestic tax taw*

1.3 Tax policy considerations relating to R&D incentives

### 1.3.1 "General tax climate" for R&D

- Profit centre >< cost centre
- Competitive location
- Cost centre
  - Investment deduction
  - Personnel
    - Expat
    - Reduction of withholding tax
    - Upfront certainty

## *Part 1: R&D incentives under domestic tax taw*

1.3 Tax policy considerations relating to R&D incentives

### 1.3.2 Reasons for introducing R&D incentives

- European pressure
- National policy
  - Regional policy
  - Stimulating research and manufacturing
  - Extension of all companies



## *Part 1: R&D incentives under domestic tax taw*

1.3 Tax policy considerations relating to R&D incentives

### 1.3.3 R&D incentives, equality of treatment and ability to pay

- Almost absence of discussion
- Belgian >< foreign

## *Part 1: R&D incentives under domestic tax taw*

1.3 Tax policy considerations relating to R&D incentives

### 1.3.4 Subjective scope

- Incentives
  - Limited to companies
    - Patent income deduction
    - Tax exoneration for regional grants)
  - Limited to non-resident personal taxation
    - Expat status for foreign researchers
  - Applicable in corporate taxation and in personal income taxation but applicable in a different way
    - Investment deduction, tax credit for R&D

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## *Part 1: R&D incentives under domestic tax taw*

1.3 Tax policy considerations relating to R&D incentives

### 1.3.4 Subjective scope

- Applicable in corporate taxation and in personal income taxation and applicable in the same way
  - Wage withholding tax exemption for researchers, tax allowance for additional employees, innovation premiums

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## *Part 1: R&D incentives under domestic tax taw*
1.3 Tax policy considerations relating to R&D incentives

### 1.3.5 R&D incentives: MNEs versus SMEs?

- In general, no specific R&D incentives tailored to SME's
- Discussion PID
  - Policy
  - Practice
  - Change in tax legislation



## *Part 1: R&D incentives under domestic tax taw*
1.3 Tax policy considerations relating to R&D incentives

### 1.3.6 Definition of R&D for tax purposes

- OECD 2002 Frascati Manual
- European Regulation N° 800/2008
- R&D: "Creative work undertaken on a systematic basis in order to increase the stock of knowledge and the use of this stock of knowledge to devise new application"
- Fundamental, industrial and experimental research

## *Part 1: R&D incentives under domestic tax taw*

1.4 R&D input incentives



## *1.4 R&D input incentives*

1.4.1 General overview of R&D input incentives

1.4.2 Privileged R&D expenditures

1.4.3 Tax credit versus allowance

1.4.4 Territorial scope

1.4.5 Anti-avoidance provisions

## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.1 General overview of R&D input incentives

- R&D investment deduction
  - Deduction from the taxable basis (after losses and before the "stock" of excess NID stemming from previous years, i.e. tax years 2012 and before)
  - Available for investments made in:
    - Patents
    - Fixed <u>assets</u> <u>used in Belgium</u> in the research and development of <u>new</u> products and forward-looking technologies <u>not harming the environment</u> or the purpose of which is to reduce environmental damage as much as possible
  - *Alternative*: tax credit



## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.1 General overview of R&D input incentives

- Payroll withholding tax exemption
  - 80% of the payroll tax on salaries of researchers should not be remitted to the Belgian Treasury

    => Employment cost of a researcher is reduced

    => No impact for the employee
  - Accounting treatment: exempted amounts are recorded as a profits of the year

    => Net benefit for the company = (WHT exemption * (100% - 33,99%))
  - Qualifying researchers working in qualifying projects / programs
- P.M.: exemption of certain regional grants

## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.2 Privileged R&D expenditures

- R&D investment deduction / tax credit
  - New amortizable assets
    - Tangible fixed assets: buildings, equipment, etc.
    - Intangible fixed assets: capitalized R&D expenses, etc.
    - Amortizable assets (under Belgian GAAP)
    - Minimum 3 year depreciation period
    - See also CAS advice, nr. 2012/13
    - Quid contract R&D?
  - Exclusively used for professional purposes



## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.2 Privileged R&D expenditures

- R&D investment deduction / tax credit
  - R&D investments need to be environment friendly
  - Used in an R&D centre
    - Separate branch of activity (cf. article 46 RD BITC)
    - With separate accounts
    - Universality of goods that is able to operate autonomously
    - Assets are only eligible to the extent that they do not exceed the normal limit necessary for the operation of the R&D centre
    - Should also apply to companies as a whole

## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.3 Tax credit versus allowance

- R&D tax credit = R&D investment deduction * 33,99% (always!)
  - Same conditions as for the investment deduction, but irrevocable option
  - Rationale: guaranteed **cash reimbursement**
  - Existing stock of ID of three previous assessment years is converted to R&D tax credit - Not refundable
- ID can be carried-forward indefinitely to future profitable years, but limitations
- TC can be carried-forward to future profitable years, but limitations
- If not deducted for 5 subsequent tax years (including the investment year) – reimbursement of the tax credit



## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.3 Tax credit versus allowance

One-shot
- Patents and R&D
- 13,5 % of the acquisition value (ID)
- Tax benefit (TC): 4,59 %

Spread
- R&D
- 20,5 % of the yearly amortization (ID)
- Tax benefit (TC): 6,97%

Example
- Acquisition equipment in 2014
- Price: 1.000.000 EUR
- ID: 135.000 EUR
- Tax benefit: 45.887 EUR

Example
- R&D expenses in 2014
- Capitalization of EUR 1.000.000
- Depreciation over 3 years:
  3 X 333.333 EUR
- ID: 3 x 68.333 EUR
- Tax advantage: 3 x 23.226 EUR
- Tax benefit: 69.678 EUR

## *Part 1: R&D incentives under domestic tax taw*

1.4 R&D input incentives

### 1.4.3 Tax credit versus allowance

| Parameters | | Tax benefit | |
|---|---|---|---|
| Discount factor | 7% | **Nominal tax benefit spread R&D ID /tax credit** | **69.679,50** |
| Total capitalised R&D (EUR) | 1.000.000,00 | As % of capitalized R&D | 6,97% |
| Tax depreciation period | 3 | **NPV tax benefit spread R&D ID/tax credit** | **65.220,43** |
| Belgian corporate tax rate | 33,99% | As % of capitalized R&D | 6,52% |
| Spread increased R&D investment deduction rate* | 20,50% | **NPV total tax benefit spread R&D ID/tax credit (taken into account spread of P&L cost)** | **43.468,89** |
| | | As % of capitalized R&D | 4,35% |

**Option 1: Immediately expensed**

| Amounts in EUR | Year 1 | Year 2 | Year 3 | Total |
|---|---|---|---|---|
| **Capitalised R&D** | 1.000.000,00 | | | 1.000.000,00 |
| **Net tax effect** | 339.900,00 | | | **339.900,00** |

**Option 2: Spread R&D investment deduction ("ID") /tax credit**

| Amounts in EUR | Year 1 | Year 2 | Year 3 | Total |
|---|---|---|---|---|
| **Depreciation on capitalised R&D** | 333.333,33 | 333.333,33 | 333.333,33 | 1.000.000,00 |
| **Tax benefit spread R&D ID/tax credit **** | 23.226,50 | 23.226,50 | 23.226,50 | 69.679,50 |
| **NPV Tax benefit spread R&D ID/tax credit** | 23.226,50 | 21.707,01 | 20.286,92 | **65.220,43** |
| **Tax benefit cost in P&L ***** | 113.300,00 | 113.300,00 | 113.300,00 | 339.900,00 |
| **NPV Tax benefit cost in P&L** | 113.300,00 | 105.887,85 | 98.960,61 | **318.148,46** |
| | | | | |
| **Difference net tax effect Option 1 versus Option 2 (NPV)** | **-203.373,50** | **127.594,86** | **119.247,53** | **43.468,89** |

* Rate for tax year 2015

** Tax benefit = Depreciation on capitalised R&D x spread increased R&D investment deduction rate x Belgian corporate tax rate

*** Tax benefit = capitalised R&D x Belgian corporate tax rate

## *Part 1: R&D incentives under domestic tax taw*

1.4 R&D input incentives

### 1.4.3 Tax credit versus allowance

| Parameters | | Tax benefit | |
|---|---|---|---|
| Discount factor | 7% | **Nominal tax benefit one-shot R&D ID/tax credit** | **45.886,50** |
| Total capitalised R&D (EUR) | 1.000.000,00 | As % of capitalized R&D | 4,59% |
| Tax depreciation period | 3 | **NPV tax benefit one-shot R&D ID/tax credit** | **45.886,50** |
| Belgian corporate tax rate | 33,99% | As % of capitalized R&D | 4,59% |
| Spread increased R&D investment deduction rate* | 13,50% | **NPV total tax benefit one-shot R&D ID/tax credit (taken into account spread of P&L cost)** | 24.134,96 |
| | | As % of capitalized R&D | 2,41% |

**Option 1: Immediately expensed**

| Amounts in EUR | Year 1 | Year 2 | Year 3 | Total |
|---|---|---|---|---|
| **Capitalised R&D** | 1.000.000,00 | | | 1.000.000,00 |
| **Net tax effect** | 339.900,00 | | | 339.900,00 |

**Option 2: One-shot R&D investment deduction/tax credit**

| Amounts in EUR | Year 1 | Year 2 | Year 3 | Total |
|---|---|---|---|---|
| **Depreciation on capitalised R&D** | 333.333,33 | 333.333,33 | 333.333,33 | 1.000.000,00 |
| **Tax benefit one-shot R&D investment deduction/tax credit**** | 45.886,50 | 0,00 | 0,00 | 45.886,50 |
| **NPV Tax benefit one-shot R&D investment deduction/tax credit** | 45.886,50 | 0,00 | 0,00 | **45.886,50** |
| **Tax benefit cost in P&L ***** | 113.300,00 | 113.300,00 | 113.300,00 | 339.900,00 |
| **NPV Tax benefit cost in P&L** | 113.300,00 | 105.887,85 | 98.960,61 | **318.148,46** |
| | | | | |
| **Difference net tax effect Option 1 versus Option 2 (NPV)** | **-180.713,50** | **105.887,85** | **98.960,61** | **24.134,96** |

* Rate for tax year 2015

** Tax benefit = Acquisition value (Capitalised R&D) x one-shot increased R&D investment deduction rate x Belgian corporate tax rate

*** Tax benefit = capitalised R&D x Belgian corporate tax rate

## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.4 Territorial scope

- R&D investment deduction / tax credit
  - Used in Belgium (at least partly)
  - This requirement is likely incompatible with EU law (ECJ Laboratoires Fournier, C-039/04, 10 March 2005)
  - But new Comm.ITC 68/18



## *Part 1: R&D incentives under domestic tax taw*
1.4 R&D input incentives

### 1.4.5 Anti-avoidance provisions

- List of assets that do not qualify
- R&D tangible and acquired intangible assets (other than patents) to be used during entire depreciation period
  - If used for another purpose: recapture rule comes into play
  - Not in case of spread regime
  - ≠ Situation in which assets are sold or put out of use – in this case even additional investment deduction or tax credit is possible

## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)



## *1.5 Output R&D fiscal incentives (patent box or similar incentive)*

1.5.1 General overview of output incentives

1.5.2 Definition of privileged IP rights

1.5.3 Acquired IP

1.5.4 Pre-existing IP

1.5.5 Development condition

1.5.6 Privileged IP income

1.5.7 Anti-avoidance provisions

1.5.8 Credit for foreign withholding taxes

## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.1 General overview of output incentives

- After the NID the PID
  - Corporate taxpayers, irrespective of their size or industry, are entitled to an 80 per cent deduction of their gross patent income from their taxable base



## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.2 Definition of privileged IP rights

- Patents and supplementary protection certificates
- PID is not restricted to Belgian patents
- Applies to variable income streams, fixed income streams, as well as upfront fees, milestones, etc.
- PID is also not restricted to the so-called "research centres – laboratories
- The tax deduction is only applicable when a patent is granted by the competent organism

## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.2 Definition of privileged IP rights

For reasons of manageability (the budgetary point of view > BITC) :

- Patents fully or partly self-developed by Belgian companies (or branches of foreign companies), either in R&D centres in Belgium or abroad, constituting a separate branch of activity of the company
- Patents acquired by a Belgian company or branch provided they are being further developed in R&D centres in Belgium or abroad, constituting a separate branch of activity of the company
- Patents licensed to the Belgian company or branch provided they further develop in R&D centres in Belgium or abroad, constituting a separate branch of activity of the company

As of January 1st 2013, SME's are not required to fulfil the R &D centre requirement.



## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.3 Acquired IP

- PID is not limited to self-developed patents, but also acquired IP
  - By acquisition or
  - By licensing
- The additional condition to benefit from the PID is to further improve the patent.
- Ratio legis
- No obligation that this "further improvement" of the patent should lead to a new patent.

### *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

**1.5.4 Pre-existing IP**

- PID is applicable starting in the tax year 2008 (income year 2007)
- To avoid abuse and to limit the scope of the incentive, the tax incentive is only applicable to "new" income from patents
  - "New" means income from patents that have not been used by the Belgian company, a licensee or a related company, for the purpose of the supply of goods or services to third parties before 1 January 2007

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### *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

**1.5.5 Development condition**

- This condition is paraphrased in a different way
  - For new patents the law mentioned the wording "completely or partially developed"
  - For patents that are acquired or licensed to a Belgian company the wording is "further improved"
- "Improvement" = "leading to an added value for instance if the value of the patented product or procedure was raised
- Income from know-how, related to this improvement, should therefore also classify as patent income that can benefit from the PID"

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## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.6 Privileged IP income

- income received by the owner, the usufructuary and the licence holder

- The BITC  gives a definition of the privileged IP income.
  - Income streams, from whatever nature, for licensees granted by the company on patents insofar the income is included in the Belgian taxable result of the company or branch. Only the income related to the patent can be considered as privileged IP income (f.i. know-how not directly related to the patent can not benefit from PID)
  - The so-called embedded royalty (what income would have been received from a third party by the company having exploited patents on his own behalf)



## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.6 Privileged IP income

- The PID can only be granted for income received during the period that the company has a patent
  - Before
  - After
- Multiple patents
- Opposition > revocation of the patent >  PID is no longer granted
- Only applicable if the income is taxable in Belgium

## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.7 Anti-avoidance provisions

- Anti-abuse provisions apply to acquired patents to avoid
  - A double deduction of the costs and
  - A double dip because of successive licences and sublicenses
- Acquirement
  - Property, co property, usufruct or a licence agreement
- The income from these acquired patents must be reduced by
  - Compensations paid to third parties for obtaining the ownership of the patent and
  - The amortizations applied to the acquisition value of the patents. The cost related to research and development (activated or not), however, need not to be deducted from the patent income



## *Part 1: R&D incentives under domestic tax taw*

1.5 Output R&D fiscal incentives (patent box or similar incentive)

### 1.5.8 Credit for foreign withholding taxes

- If royalties are subject to a foreign withholding tax, Belgium will grant a lump-sum tax credit limited to the foreign tax rate, with a maximum of 15 per cent
- The foreign tax credit can only be set off against the tax on the patent income and is not refundable

## *Part 1: R&D incentives under domestic tax taw*

1.6 Procedural requirements



## *Part 1: R&D incentives under domestic tax taw*

1.6 Procedural requirements

- R&D investment deduction / tax credit
  - Form to added to the corporate tax return (275U – 275W)
  - Certificate Flemish Region
  - Defence file
- Payroll withholding tax exemption
  - Notification requirement (department of Scientific Policy)
  - Simplified registration procedure
  - Possibility to ask for a binding opinion
- Patent income deduction
  - Form to added to the corporate tax return (275P)
  - Defence file

## *Part 2: R&D incentives in an international context*



## *Part 2: R&D incentives in an international context*

### 2.1 Introduction

## *Part 2: R&D incentives in an international context*
2.1 Introduction

- Discrimination
- BITC
  - The word “Belgium” is not mentioned, or
  - It is clearly stipulated “Belgian and foreign”



## *Part 2: R&D incentives in an international context*

2.2 Eligible taxpayers and territorial scope of R&D incentives

***Part 2: R&D incentives in an international context***

## 2.2 Eligible taxpayers and territorial scope of R&D incentives

2.2.1 Compatibility with the non-discrimination provision of DTCs

2.2.2 Compatibility with EU fundamental freedoms

2.2.3 Compatibility with EU State aid rules



***Part 2: R&D incentives in an international context***

## 2.2 Eligible taxpayers and territorial scope of R&D incentives

### 2.2.1 Compatibility with the non-discrimination provision of DTCs

- Belgium extended the benefit of R&D incentives to permanent establishments of foreign companies

## *Part 2: R&D incentives in an international context*

2.2 Eligible taxpayers and territorial scope of R&D incentives

### 2.2.2 Compatibility with EU fundamental freedoms

- No limitation of the application of the R&D incentives to the Belgian territory
- Administrative practice elucidates
  - Administrative commentary on the deduction for investment where, in this new commentary, is clearly explained that the assets used by a taxpayer must be linked to the professional activity in Belgium, but where it is of no importance in which country, Belgium or abroad, the asset is bought and where it is of no importance whether the asset is effectually used in Belgium or abroad

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## *Part 2: R&D incentives in an international context*

2.2 Eligible taxpayers and territorial scope of R&D incentives

### 2.2.3 Compatibility with EU State aid rules

- Policy of the legislator in harmony with the target group
- However, 'Young Innovative Companies'
  - Not paying a part of the payroll taxes of the remuneration paid to their scientific personnel
  - 2006 : Commission approved this support scheme
  - 2011 : screening by the Commission found that Belgian had not introduced the definitions of the types of research eligible for this break in its legislation
  - 2013 : EU decision to investigate
  - 2014 : a formal investigation is taking place

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## *Part 2: R&D incentives in an international context*

2.3 Patent box regimes and harmful tax competition



## *Part 2: R&D incentives in an international context*

2.3 Patent box regimes and harmful tax competition

### 2.3.1 Under the OECD BEPS Action Plan

- 1998 OECD Report "Harmful Tax Competition: An Emerging Global Issue"
- Action n°5 of the OECD BEPS action plan
  - Improving transparency
  - 'Substantial activity' test for preferential regimes (so as to counter purely tax-driven transaction)
- Quid application to the Belgian patent income deduction?

## *Part 2: R&D incentives in an international context*

2.3 Patent box regimes and harmful tax competition

### 2.3.2 Under EU State aid rules and the Code of Conduct for business taxation

*2.3.2.1 Under the Code of Conduct for business taxation*

- 1998 Code of conduct for business taxation
- Activity test which seems to be even more stringent
- Cfr. EU investigation of UK patent box (test requires real and substantial activities <u>in</u> the UK)
- Is this in line with EU fundamentel freedoms?
- Quid application to the Belgian patent income deduction?



## *Part 2: R&D incentives in an international context*

2.3 Patent box regimes and harmful tax competition

### 2.3.2 Under EU State aid rules and the Code of Conduct for business taxation

*2.3.2.2 Under State aid rules*

- Belgian patent income deduction aims at stimulating R&D activities
- Not selective
- Should be considered as in line with EU State aid rules

**_Part 2: R&D incentives in an international context_**

2.3 Patent box regimes and harmful tax competition

### 2.3.2 Under EU State aid rules and the Code of Conduct for business taxation

*2.3.2.3 Harmful tax competition and fundamental freedoms*

- In order to benefit from Belgian patent income deduction, patent should be developed or improved in an R&D centre, *in Belgium or abroad*
- This seems to be in line with EU fundamental freedoms



## *Part 2: R&D incentives in an international context*

2.4 Intangibles and BEPS situations

## *Part 2: R&D incentives in an international context*

2.4 Intangibles and BEPS situations

### 2.4.1 Transfer of intangible to low tax jurisdictions

- Transfer implies taxation
- Quid application of article 344 § 2 BITC?
  - Company
  - Branch structure
- Legitimate transfer to a branch
- Exit taxation



## *Part 2: R&D incentives in an international context*

2.4 Intangibles and BEPS situations

### 2.4.2 Royalty payments to intermediary IP companies

- Beneficial ownership concept:
  - Legal versus economic approach
  - Belgian position
  - Tax treaties
  - EU interest and royalty directive
- GAAR
- Sham doctrine

# *Thank you !*