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Tax Incentives related to R&D

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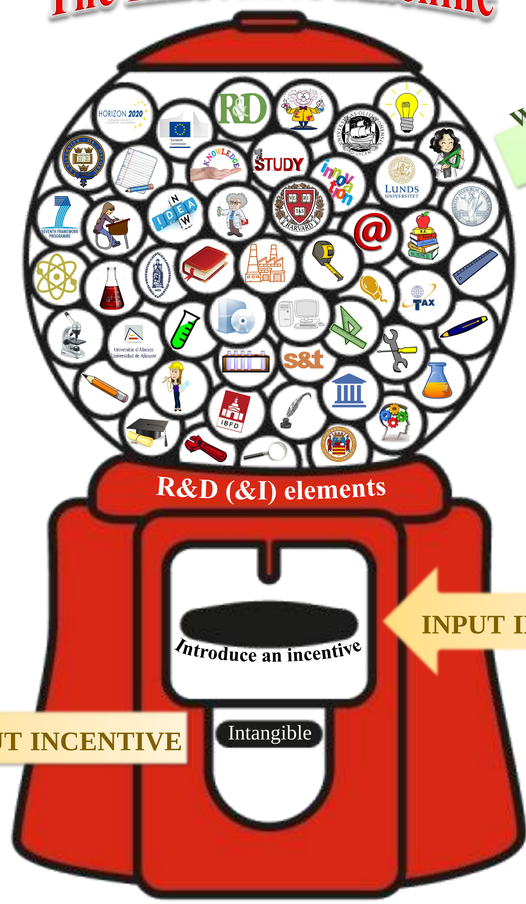
CONCISE TABLE OF CONTENTS

HYPOTHESES & OBJECTIVES OF THE RESEARCH

This doctoral thesis puts forward legal arguments in support of the development of tax measures to foster R&D (&I) structures in order to make innovation more attractive and profitable for firms. Therefore, the current research focuses on tax incentives and it explores several design issues in light of tax law relevant principles as well as international and European standards.

The Innovative Machine



WHAT IS R&D FOR TAX PURPOSES?

INPUT INCENTIVE

OUTPUT INCENTIVE

OBJECTIVE SCOPE

International references:
- R&D activities: Frascati Manual
- Technological innovation: Oslo Manual
- Knowledge-based capital: new benchmark?

Domestic definitions:
- Regulated by Corporate Income Tax Law
- References to Accounting and Business Law
- Lack of clarity
- Legal uncertainty for firms

SUBJECTIVE SCOPE

Research operators
- Public/Private sector
- Business/non for profit
- MNEs/SMEs
- Subcontractors
- Other (start-up, business angels)

Collaboration actions
- European Research Infrastructure Consortium
- Public-private partnerships
- Transfer of technology (patent license, know how contract)

INPUT TAX INCENTIVES: DESIGN ISSUES

Purpose: to make firms more innovative and productive

Tax incentives versus direct subsidies: effective combination?

Impact on R&D expenditure: financial support to R&D investments carried out by firms.

Input incentives can be targeted to different expenditure categories: i) R&D costs (machinery, equipment, buildings, overhead costs); ii) R&D wages; iii) IP expenditure (i.e. the costs and expenditure for acquiring patents)

Cost side incentives may be granted to particular groups: SMEs and specially start-up companies, i.e. French tax credit for young innovative enterprises; they may also be tied to certain types of technologies, i.e. environmentally friendly technologies in Belgium.

Tax incentives: direct or indirect means?
i) direct: incremental-, mixed- or volume-based tax credits, i.e. France, Italy; enhanced or super deductions, i.e. Ecuador, Turkey;
ii) indirect: tax deferrals, i.e. Australia, the United States.

OUTPUT TAX INCENTIVES: DESIGN ISSUES

Output tax incentives apply to the income from R&D activities. That is, privilege fiscal measures (BEPS Action 5) to the results of the R&D process: (eligible) IP rights and intangibles:
i) under a "narrow approach", the incentives are typically limited to patents, designs and models. It is also frequently that software and copyrights are included in the scope of application of the regime; few regimes also cover know-how, secret formulas and processes;
ii) under a "broad approach" the benefits of the incentives are extended to cover also marketing intangibles, particularly trademarks, i.e. Luxembourg.

What types of incomes may benefit from such incentive?
i) royalties from the license of IP;
ii) capital gains from the sale of the IP;
iii) profits from the direct use of the IP.

Output incentives may take different forms in order to promote IP rights exploitation:
i) notional deductions from the taxable base, i.e. Belgium, Spain;
ii) partial exemptions of the eligible income, i.e. Portugal;
iii) separate (nominal) tax rate, i.e. the Netherlands, the United Kingdom

Providing a preferential tax treatment for certain income arising from IP rights: goal of enhancing R&D activities: requirement of substantial economic activity ➔ modified nexus approach: compliant IP boxes, i.e. Italy.

Developing countries could badly suffered the profit shifting in the case where they cannot tax the royalty income this one benefits from an IP box in the State of residence; hence, the possibility to include a subject to tax clause during the DTC negotiation could be an issue from this perspective and would avoid potential double non (or low) taxation.

LEGAL CONSTRAINTS

International standards: International Public Law Principles, Tax Treaties

European perspective:
- EU State aid rules: may aid for R&D be considered compatible with the internal market? Article 107(3)(c) TFEU ("State aid to facilitate the development of certain economic activities")
- EU Code of conduct for business taxation: R&D incentives as harmful tax measures?
- EU fundamental freedoms: restriction, by favouring national research and investments, as compared to research and investments in other EU Member States

Domestic level:
Tax justice criteria (ability to pay, equality, effectiveness, proportionality):
- General prohibition of fiscal privileges.
- Extra fiscal goals may be legitimated by constitutional values or other priorities.

CONCLUSIONS (*so far*)

Clarity and precision are required in the definition of R&D for tax purposes. It is necessary to consider just those activities and intangibles close to the R&D (&I) process.

R&D tax incentives provided are compatible to tax justice criteria when they are addressed to get extra fiscal goals legitimated by constitutional values or other priorities, i.e. innovation.

In terms of effectiveness, either input and output incentives should be able to create positive externalities based on a behavioural response. That is, if taxpayer benefits via tax incentives for his activity, he may be expected to grant and improve innovative structures and activities.

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