NEXIA INTERNATIONAL

Intellectual property and R&D

A guide to European tax regimes

Contents

This report provides an overview of the tax regimes in Europe, together with an analysis of selected countries in the region, based on the views of Nexia International member firms.

About Nexia International

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With more than 500 offices in over 100 countries, we have a substantial presence in the world's major financial and economic centres. We are strategically placed to serve the diverse international requirements of our clients, ranging from globally listed entities and international subsidiaries, to owner-managed businesses and high-net-worth individuals.

Experts from around the Nexia International network work together to provide cohesive, customised services to solve cross-border business issues and advise individuals on wealth creation and preservation.

Providing a consistent quality of service, regardless of location, is fundamental to our work with anyone engaging professional advice across international borders. Through our tight knit global community, you can expect shared values, close and enduring relationships between member firms and the highest standard of professional advice – anywhere in the world.

Contributors

We are very grateful to the following Nexia International members for their contributions to this report:

Stefanie Bollinger - *ABT Treuhandgesellschaft Andreas Baumann & Co (Switzerland)*

Karl Cini - *Nexia BT (Malta)*

Kurt De Haen - *VMB (Belgium)*

Marc Derks - *HORLINGS Belastingadviseurs (The Netherlands)*

Pablo Gómez-Acebo Temes - *DE ANDRES Y ARTINANO (Spain)*

Gordon Hayden - *Smith & Williamson Freaney (Ireland)*

Lut Laget - *VGD (Luxembourg)*

Yves Sevestre - *Cabinet SEVESTRE (France)*

Rajesh Sharma - *Smith & Williamson (United Kingdom)*

Intellectual property and R&D – a guide to European tax regimes

The European Union (EU) announced its aim to become the most competitive economy in the world at the Lisbon Summit in 2000. The advancement of intellectual property (IP) and research and development (R&D) activities is widely believed to be an important element in achieving this aim.

At a subsequent EU Summit in Barcelona EU member states committed to spending 3% of gross domestic product on R&D investments by 2010.

Following these announcements, a number of EU jurisdictions have introduced favourable tax rules for IP and/or R&D activities, with a view to attracting and retaining investment in their countries. And despite falling tax revenues, governments are still keen to attract businesses engaged in these activities to their jurisdictions.

A significant challenge has been ensuring that the low effective tax rates created for IP and/or R&D activities successfully stand the EU compliance test, i.e. they aren't seen as "ring-fencing" or breaching the discriminatory rules.

The purpose of this report is to summarise the fiscal issues to consider when deciding where to locate IP and carry out R&D work for a group of companies.

The importance of IP

In recent years, businesses have become more focused on building and deriving value from creating and exploiting intangible assets. IP includes a range of intellectual and other properties held by businesses for the purpose of their business, such as know-how, brands, patents, trademarks, registered rights, drawings, designs and copyrights.

Developing or acquiring IP to improve business performance is an important objective of many businesses. But how the IP is taxed should also be a key consideration.

IP should be seen as a strategic asset of the business, rather than a bundle of legal documents. In fact, it may represent the single most valuable asset of the business – despite the information in financial statements. In many acquisitions, a significant part of the consideration is for the use of IP.

Businesses should identify all the IP used/owned by it, ensure that there is adequate legal protection, review the accounting policies for IP and obtain appropriate valuations before undertaking an analysis of the potential fiscal advantages of relocating it.

Advantages of an IP holding company

It is often preferable to locate all the IP within a group to a single company and license the relevant IP to group companies. This arrangement ensures the effective management of the group's resources, from a legal, fiscal and administration point of view. The holding company should be located in a tax-favourable jurisdiction in order to secure fiscal advantages.

Ideal location for an IP company

The attributes of an ideal IP location include:

- a low-tax, economically and politically stable jurisdiction in which the IP or the master licences can be centralised
- access to double taxation treaties
- the absence of or reduced withholding taxes on IP payments to the IP company
- for European companies, access to the EU Parent Subsidiaries Directives for the elimination of withholding taxes on dividend distributions
- the tax-free repatriation of profits from the IP company to shareholders
- the ability to deduct the royalty and licence fees in the operating countries
- a secure legal infrastructure to protect the IP and to deal with potential disputes and litigation
- the availability of the local workforce to deal with the day-to-day running of the IP company
- the absence of currency controls on the flow of income in and out of the IP company.

Test case scenario: BrainPower Inc.

This report looks at the tax rules relating to IP and R&D in various European countries. It is based on input from Nexia International member firms in the relevant countries, based on analysis of a fictional company.

The company, BrainPower Inc., is assumed to be a US multinational, that currently has its IP registered in the name of various affiliates based in different jurisdictions and its R&D activities spread all over the world. The group has made the strategic decision to concentrate all of its IP and R&D activities in one jurisdiction, although the IP location should not necessarily be the same as the R&D location.

Using this fictional scenario, each Nexia International member firm highlights the principal IP and/or R&D incentives available in their country.

Overview of findings

It is clear that various European jurisdictions have made efforts to introduce attractive tax rules for IP and/or R&D businesses. These tax rules provide tax-efficient treatment of either the corporation or the staff involved. In some countries both are eligible for local tax relief.

There is no one-size-fits-all tax solution, so each case needs to be analysed on its own merits and based on the underlying business circumstances.

The global tax ramifications at group level should also be thought through before implementing a specific IP and/or R&D structure. Indeed, issues such as controlled foreign company regulations in the country of the group's headquarters and applicable indirect tax rules may also have an impact on the overall effective tax rate.

In short, the tax structure used should be given due consideration to avoid adverse tax consequences in the relevant jurisdictions involved.

Belgium

Belgium tax law offers numerous tax incentives for income derived from R&D and IP activities. Special consideration should, however, be given to the "patent income deduction", where the gross income from patents up to 80% is tax-free. As a result the income derived from patents is subject to a maximum effective tax rate of 6.8%. The rules apply to both acquired and self-developed patents. However, capital gains realised on patents are ineligible for the tax benefits (but can be offset against tax losses or be taxed on a deferred basis if conditions are met). The 6.8% tax rate is the maximum tax rate as the Belgian taxpayer can also claim other tax reliefs.

R&D expenditure fully tax-deductible

R&D expenditure is fully tax-deductible while corresponding tax losses can be carried forward without limitation for offsetting other profits. There is also an increased "investment deduction" equal to approximately 120% of qualifying R&D investments. The excess investment deduction can be carried forward without limit. If the relevant conditions are satisfied, the investment deduction can be converted into a refundable R&D tax credit equal to 34% of the investment deduction. In addition, Belgian taxpayers are entitled to a further income; the notional interest deduction. This is a deduction for tax purposes only, equal to 3.8% of the taxpayer's qualifying prior-year Belgium GAAP net equity.

In addition to the well-known very attractive expatriate tax regime that has been in place for many years in Belgium, Belgium-based employers can retain 75% of the Belgium payroll withholding tax of qualifying R&D staff to reinvest in R&D projects.

Contributor:
Kurt De Haen
VMB

France

The French R&D tax credit aims to reduce the effective R&D cost and thus to increase the competitiveness of French entrepreneurs.

The R&D tax credit equals 30% of qualifying expenditure up to €100m and 5% of expenditure above that threshold. Furthermore, if a company is claiming the tax credit for the first time, the tax credit is 40% as regards the first financial year and is 35% as regards to the second financial year.

Stricter conditions for private research organisations

Examples of qualifying expenditure include depreciation of R&D assets, R&D payroll expenses, operating expenses and costs incurred for the protection of the payment. The French Finance Bill 2010 introduces stricter conditions where expenses are incurred for a private research organisation. Moreover, the tax credit also applies to R&D activities that are outsourced to locations within the EU.

Such tax credits can be offset against French corporate tax due for the financial year in which the R&D expenditure is incurred. If certain conditions are satisfied, a refund of tax is given for the relevant losses sustained by the business. Alternatively, the tax credits can be used as a part-prepayment of the company's French corporate tax liability for the three subsequent financial years.

Contributor:
Yves Sevestre
Cabinet SEVESTRE

Ireland

In addition to the attraction of having one of the lowest corporate tax rates in Europe of 12.5%, the Irish corporate tax regime includes a tax deduction for the acquisition cost of IP (broadly defined). The acquisition cost can be written off over 15 years (or, if shorter the accounting life of the asset) against income from related IP activities, including the sale of goods or services that derive the greater part of their value from the IP. The maximum annual deduction is limited to 80% of the IP profits, with any excess available for carry forward against future income but subject to the 80% ceiling.

The tax deduction can be withdrawn (clawed back) if the IP asset is disposed of within ten years.

The acquisition of IP should not trigger any stamp duty (transfer tax) liability, as a result of a broadly drawn exemption for transfers of IP.

Effective tax-break of 37.5%

A credit of 25% is available for qualifying R&D expenditure. This credit is in addition to the normal corporation tax deduction at 12.5%, therefore the effective tax-break on R&D is 37.5%. The tax credit applies to incremental expenditure or qualifying R&D incurred by trading companies or members of the trading group. Where a company/group have R&D credits in excess of its corporation tax liability then there is provision for realisation of the credit in the form of cash payment from the Revenue Commissioners.

While the incentive is aimed at domestic R&D activities, the R&D credit is not dependent on the location of the IP in Ireland and can be sub-contracted to unconnected parties (albeit with a low credit of 10%).

Contributor:
Gordon Hayden
Smith & Williamson Freaney

Luxembourg

The Luxembourg Government has created a very attractive set of tax rules for a broad scope of IP. Such income derived from, for example, copyrights on software, domain names, patents, trademarks and designs or models, is eligible for the reduced tax rate. Furthermore, it should be emphasised that both recurring income and realised capital gains are subject to the reduced tax rates.

Specifically, both income derived from self-developed IP which is included in the balance sheet as well as IP acquired from third parties is exempt at the rate of 80% for Luxembourg corporate tax purposes. It should be noted that only 80% of the net income is tax-free on the basis that the underlying expenses connected with the IP should be deductible. Based on the current tax rate of 28.59%, the net income would be subject to an effective tax rate of approximately 5.76%.

Furthermore, qualifying IP assets are exempt from wealth taxes in Luxembourg.

Contributor:
Lut Laget
VGD

Malta

Malta offers a favourable environment to incentivise and encourage R&D activities by Maltese companies. Income tax benefits granted to businesses that engage in R&D activities are mainly governed by the Malta Enterprise Corporation, which is an agency specifically set up in Malta to administer fiscal incentives to businesses at several stages of their life-cycle.

For example, tax credits may be given to companies on eligible costs incurred in running industrial research projects and experimental development projects if the project is completed within three consecutive years from the date of approval. Income derived from IP is subject to the standard 35% Maltese corporate tax rate, albeit that the Maltese credit/refund mechanism reduces the rate to a 5-10% effective tax rate when the Maltese IP company distributes a dividend.

Income tax advantages

With effect from 1 January 2010, any person (being an enterprise or an individual) in receipt of royalty or similar income derived from a qualifying patent may opt to have such income exempt from Maltese income tax.

In addition, Maltese companies can enjoy cash grants regarding costs that are directly related to the secondment of highly skilled personnel. The relevant employee may even opt to be taxed at a flat Maltese personal tax rate of 15% (as opposed to the standard progressive Maltese personal tax rates).

Contributor:
Karl Cini
Nexia BT

The Netherlands

The recently introduced Innovation Box tax regime taxes qualifying income derived from IP to a 5% effective tax rate in the Netherlands. The tax rate also applies to capital gains realised on qualifying IP assets as well as any other type of qualifying income. The scope of qualifying IP therefore is very broad. For instance, if there was any increase in sales attributable to product innovation, it should be possible to agree with the tax authorities that the additional profit should be taxed at the 5% rate.

Employment tax benefits

To qualify for the 5% regime, the Dutch company is required to own a patent or have a wage tax certificate allowing it to pay lower wage taxes for employees involved in R&D activities. There is therefore, a double benefit of being in the favourable wage tax regime.

The 5% effective tax rate only applies when the IP income exceeds the amount of tax-deductible R&D expenses that were incurred to create the IP in prior financial years.

Where employees are dedicated to R&D activities, Dutch tax law has the traditional 30% rule for expatriates and the wage tax facility as referred to above. The effect is that the Dutch Government is subsidising 46% of the Dutch payroll cost of such personnel.

Finally, so long as the IP is owned by a Dutch company, it should be possible to qualify for the regime even if the actual R&D activities are performed outside the Netherlands. Contract R&D activities and cost contribution arrangements therefore should qualify for the tax benefits.

Contributor:
Marc Derks
HORLINGS Belastingadviseurs

Spain

Spanish tax legislation provides for various tax incentives as regards R&D IP activities. In addition to an accelerated tax depreciation of IP assets, there is an R&D tax credit equal to 25% of underlying expenditure. Where expenditure increases from one year to the next, there is a 40% tax credit on the excess expenditure.

Spanish Patent Box

There is no specific tax relief for IP acquisition costs. However, income derived from IP, other than capital gains, is eligible for a 15% tax reduction, capped at six times of the total cost. This rule is generally referred to as the Spanish Patent Box. It should however be noted that its scope covers other IP assets rather than patents only.

As far as R&D/IP staff are concerned, there is a 40% subsidy of Spanish payroll withholding tax, whereas expatriates can enjoy a 24% flat individual income tax rate during their first five years of employment in Spain.

Contributor:
Pablo Gómez-Acebo Temes
DE ANDRES Y ARTINANO

Switzerland

Switzerland is not especially attractive for locating R&D and IP activities. However, some cantons offer some incentives.

Annual R&D costs are tax deductible at 100% for cantonal (including communal) and federal taxes. Accruals for future R&D assignments by third parties can be accounted for up to 10% of the taxable profit but are limited to a total amount of CHF 1m per year. On the other hand, all R&D income is taxable at the normal corporate tax rate of approximately 18 to 20% (federal and cantonal tax).

IP income is also taxable at the normal corporate tax rate of approximately 18 to 20%. There are some exemptions for holding companies. The main purpose of holding companies is the permanent administration of other companies. Holding companies that carry out no business in Switzerland, and two-thirds of whose assets or earnings consist of participating interests or earnings derived from participations, pay no cantonal income tax and a reduced cantonal capital tax. Most of the cantons accept the management of IP abroad as a business activity that does not affect the "holding privilege". As a result, this IP income is exempt from cantonal income tax but not from federal income tax. The federal corporate tax amounts to 7.8%. Income from Swiss IP is only tax-exempt if the management is a secondary activity of the holding company.

Nidwalden canton adopts "license box" rule

On 1 January 2011 the canton of Nidwalden was the first canton in Switzerland to adopt a "license box" rule. As a result, net licensing income resulting from the right to use IP will be taxed separately at a flat rate of 1.2% for Nidwalden cantonal and communal taxes. The basis for the tax calculation is the net income. This means that the costs that are directly linked to the IP are deductible. The license box rule is only applicable for companies having their domicile or branch in the canton of Nidwalden. The tax law excludes the application of the privileged holding or administrative company tax regime. It is necessary that the IP company should have economic substance, such as its own office space, qualifying personnel or management functions.

Contributor:
Stefanie Bollinger
ABT Treuhandgesellschaft Andreas Baumann & Co

United Kingdom

The United Kingdom provides for preferential corporation tax treatment for R&D-related expenditure. The relief come in the form of enhanced tax deductions or repayable tax credits, depending on the size of the enterprise.

The allowable costs are, in general, staff costs and consumables. Costs of hiring sub-contractors are subject to additional rules and will not necessarily be eligible for the enhanced relief.

SMEs

Small and medium-sized enterprises (SME) are defined as companies having less then 500 employees and either:

- turnover of less than €100m; or
- a balance sheet total of less than €86m.

These conditions have to be satisfied for two consecutive accounting periods.

If the company meets the qualifying conditions then it will be eligible for an additional tax deduction of 100% of the qualifying R&D expenditure incurred. The Government aims to increase this to an additional 125% deduction with effect from 1 April 2012.

Large company scheme

A large company will only be eligible for a maximum additional deduction of 30% of the qualifying R&D expenditure in the period.

It should be noted that there are certain restrictions on the availability and use of the losses arising from these additional deductions, which are outside the scope of this article.

Losses

SMEs with trading losses are entitled to an R&D tax credit for an accounting period. The R&D tax credit to which an SME is entitled to be the lower of:

- 200% of the "qualifying expenditure"; and,
- 14% of the qualifying surrender able loss for the period.

SMEs that are loss-making for tax purposes can therefore claim an effective cash repayment equal to 28% of the eligible qualifying expenditure (being 200% x 14%).

Patent box

The UK Government has proposed to introduce a patent box from April 2013. This will reduce the rate of corporation tax of 10% levied on the profits derived from patents, although rules for calculating the relevant profits from patents have not been finalised yet. The scheme is designed to encourage businesses to establish and retain innovative industries in the UK rather than relocate to low tax jurisdictions.

Contributor:
Rajesh Sharma
Smith & Williamson

Nexia International member firms in the relevant jurisdictions:

BELGIUM

VGD
Greenland - Burg. E. Demunterlaan 5
Brussels
B - 1090
Primary contact:
Peter Bruggeman
Tel: + 32 2 735 09 43
peter.bruggeman@vgd.eu

VMB
Koning Albert-I laan 64
1780 Wemmel
Brussels
Primary contact:
Kurt De Haen
Tel: + 32 (0)2 460 09 60
kurt.dehaen@vmb.be

FRANCE

ACA
31 rue Henri Rochefort
75017 Paris
Primary contact:
François Mahé
Tel: 0033 1 47 66 77 88
f.mahe@aca.nexia.fr

Cabinet SEVESTRE
71 Avenue Marceau
75016 Paris
Primary contact:
Yves Sevestre
Tel: + 33 (0) 1 53 57 90 10
y.sevestre@cabinet-sevestre.com

COREVISE
3-5 rue Scheffer
75016 Paris
Primary contact:
Stéphane Marie
Tel: + 33 (0)1 53 70 19 70
smarie@corevise.com

GROUPE SEFICO
65 Avenue Kléber
75116 Paris
Primary contact:
Yves Sonier
Tel: +33 1 44 34 08 00
y.sonier@groupesefico.com

GROUPE NOVANCES
Parc de Crécy, 13 rue Claude Chappe
Saint Didier au Mont D'Or
Lyon 69370
Primary contact:
Christian Dechant
Tel: + 33 472 822 200
cdechant@novances.fr

IRELAND

Hayden Brown
Grafton Buildings
34 Grafton Street
Dublin 2
Primary contact:
Stephen Brown
Tel: +353 1 6771951
stephen.brown@haydenbrown.ie

Smith & Williamson Freaney Limited
Paramount Court
Corrig Road
Sandyford Business Park
Dublin 18
Primary contact:
Paul Wyse
Tel: +353 (1) 614 2500
paul.wyse@swf.ie

LUXEMBOURG

A3T S.A.
44, boulevard Grande Duchesse Charlotte
Luxembourg
Primary contact:
Andréas Tartoras
Tel: + 352 27 44 00
atartoras@a3t.lu

VGD
6, Rue Jean-Pierre Brasseur
Luxembourg
L-1258
Primary contact:
Lut Laget
Tel: + 352 263 84 81
lut.laget@vgd.eu

MALTA

Nexia BT
72, "Pebbles"
Triq il-Mahsel
St. Thomas Bay
Marsascala MSK3649
Primary contact:
Karl Cini
Tel: + 356 21637778
karl.cini@nexiabt.com

NETHERLANDS

FACET Audit B.V.
Fascinatio Boulevard 768-772
PO Box 4079
Rotterdam
3006 AB
Primary contact:
Cor van Marle
Tel: + 31 10 4526 144
c.vanmarle@facet-accountants.nl

FSV Accountants + Adviseurs B.V.
Hogeweg 43
P.O. Box 128
Zaltbommel
5300 AC
Primary contact:
Bas Opmeer
Tel: + 31 418 579679
b.opmeer@fsv.nl

Nexia Nederland
Jozef Israëlskade 46
Amsterdam
1072 SB
Primary contact:
Nico Kuipers
Tel: +31 (0)20 570 0200
NKuipers@horlings.nl

SPAIN

De Andres Y Artinano -
Nexia Spanish Desk Member
C/ Velázquez, 90
Madrid 28006
Primary contact:
Pablo Gómez-Acebo Temes
Tel: + 34 914 359 757
p.gomez-acebo@daya.es

Laes Nexia
José Ortega y Gasset 22-24
Madrid 28006
Primary contact:
Javier Estellés
Tel: +34 91 576 8432
j.estelles@laesnexia.com

Laudis Consultor -
Nexia Spanish Desk Member
Legal and tax office
Passeig de Gràcia, 101, 5
Barcelona 08008
Primary contact:
Xavier Echeverria
Tel: + 34 932 387 387
xe@laudis.es

Lavinia Auditoria -
Nexia Spanish Desk Member
Audit Office
Pl. Francesc Macià, 5. 1r. 1a
Barcelona 8021
Primary contact:
Jaume Pigem
Tel: + 34 932 417 240
jpigem@laviniaudit.com

SWITZERLAND

ABT Treuhandgesellschaft Andreas
Baumann & Co.
Zurichstrasse 27 B
Adliswil
Zurich CH- 8134
Primary contact:
Andreas Baumann
Tel: + 41 44 711 90 90
andreas.baumann@abt.ch

Controlgest SA
Boulevard de Pérolles 7
P.O. Box 839
Fribourg CH-1701
Primary contact:
Olivier Curty
Tel: + 41 26 322 02 50
controlgest@bluewin.ch

FIDI BC SA
Via Pioda 12
P.O. Box 5635
Lugano CH-6901
Primary contact:
Fabrizio Biaggi
Tel: + 41 91 910 63 63
fabrizio.biaggi@fidibc.com

Fiduciaire Patrick TRITTEN
Rue de la Fontenette 23
Carouge/Geneva CH-1227
Primary contact:
Patrick Tritten
Tel: + 41 22 342 27 01
trittenfid@bluewin.ch

Firex Audit & Consulting SA
Rue du Mont-Blanc 14
P.O. Box 1468
Geneva CH-1211
Primary contact:
René Kurth
Tel: + 41 22 908 01 50
rkurth@firexaudit.ch

ReviTrust Revision + Treuhand AG
Bahnhofstrasse 7
P.O. Box 947
Buchs CH-9471
Primary contact:
Roger Beggiato
Tel: + 41 81 750 68 68
roger.beggiato@revitrust.ch

Saffery Champness (Suisse) S.A.
Avenue Pictet-de-Rochemont 7
Geneva 1207
Primary contact:
Andrew Cleeton
Tel: +41(0) 22 319 0970
andrew.cleeton@saffery.ch

T & R AG
Saegeweg 11
P. O. Box 237
Gümligen
Bern CH-3073
Primary contact:
Ariste Baumberger
Tel: + 41 31 950 09 09
Ariste.baumberger@tr-bern.ch

UNITED KINGDOM

Jones Peters
Hughes House
6 Church Street
Banbridge BT32 4AA
Primary contact:
Ken Jones
Tel: + 44 (0) 28 4062 5427
ken.jones@jonespeters.co.uk

Meston Reid & Co.
12 Carden Place
Aberdeen AB10 1UR
Primary contact:
William Anderson
Tel: + 44 (0) 1224 625 554
andersonw@mestonreid.com

Saffery Champness
Lion House
Red Lion Street
London WC1R 4GB
Primary contact:
Clive Nicholson
Tel: +44 20 7841 4000
clive.nicholson@saffery.com

Scrutton Bland
820 The Crescent
Colchester Business Park
Colchester CO4 9YQ
Primary contact:
Andrew Strickland
Tel: + 44 (0) 1206 838400
andrew.strickland@scruttonbland.co.uk

Smith & Williamson
25 Moorgate
London EC2R 6AY
Primary contact:
Rajesh Sharma
Tel: + 44 (0) 20 7131 4000
rajesh.sharma@smith.williamson.co.uk

Nexia International Secretariat
4 Harley Street
London
W1G 9PB
Telephone: +44 (0)20 7487 4648
Primary contact: Donal Watkin
Email: dwatkin@nexia.com