



2009 EDITION

GLOBAL GUIDE TO R&D TAX INCENTIVES

 YOUR GLOBAL NETWORK OF LEADING TAX ADVISORS



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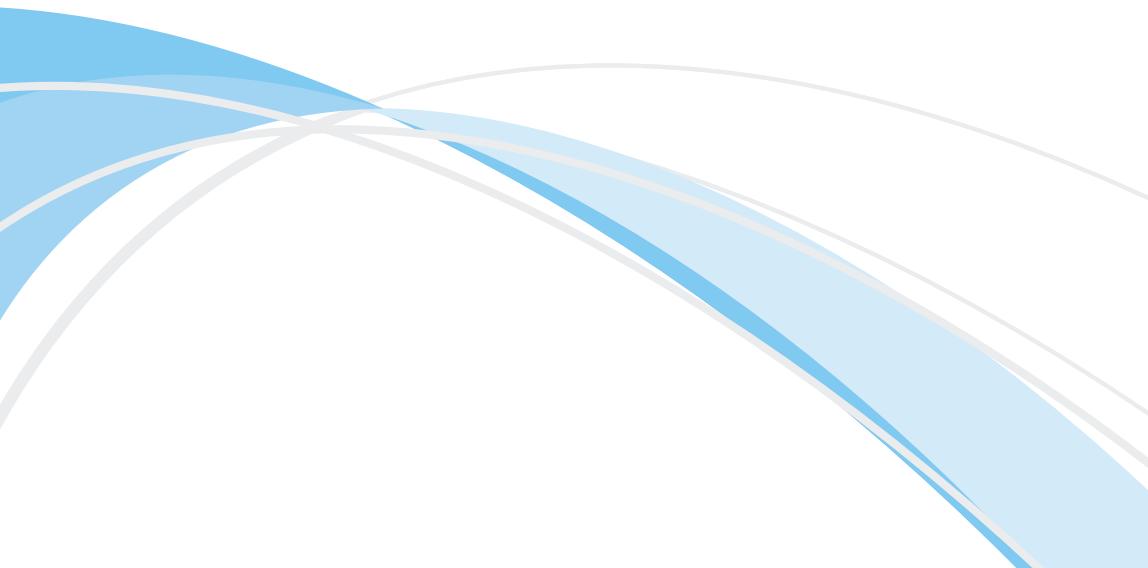


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Political leaders in many countries around the globe may find it difficult to agree on a variety of topics. This book, however, is about one area that many countries find a place for common ground: the need to provide business enterprises with income tax incentives to perform Research and Development (R&D) activities for the health of the host country's economic stability. But these incentives take on bewildering forms. There are deduction incentives. There are credit incentives. The nature of qualifying research activities is defined in a variety of different ways. And there are often times additional, state, provincial or other local incentives as well. Some countries incentivize research in limited industries, or perhaps even more targeted incentives for areas such as vaccine research.

We created this book to be an essential desk top “ready reference” for tax executives, principally, when called upon to inform their colleagues of the impact of locating a research activity in a particular country. Or when it is necessary to consider moving research projects to a jurisdiction that rewards the enterprise more handsomely than a present arrangement provides. Or, as a result of a merger, when it is necessary to close a redundant facility, a decision needs to be made as to which facility to close. These individual country incentive regimes may play an important, perhaps even a pivotal role in the final determination to locate, expand or to close an R&D facility.

Although as we go to publication we find the world's major economies in recessions of historic proportions, most companies understand that cutting R&D spending is not a wise move. *The Wall Street Journal* reported recently that “Big R&D spenders say they've learned from past downturns that they must invest through tough times if they hope to compete when the economy improves.” Indeed, even as dozens of major corporations announce projected reductions in sales and profits, and they announce significant lay-offs, plant closings and sales of unprofitable lines, most also say that their spending on R&D will hold steady. To be sure, there might be a refocus on what R&D

is deemed vital, but unless the economy takes a turn for the worse, most companies are resisting any temptation to scale back R&D spending to any sizable degree.

We predict that companies will continue to place R&D under a microscope to make sure that the expenditures have the ability to result in products in the near term. Few organizations have the luxury of spending on “blue sky” R&D. And as companies focus on managing their R&D spend, undoubtedly these companies will also evaluate closely the jurisdiction where the R&D will take place. With the permission of the OECD, we have included in its entirety, a recent Policy Brief entitled, “**Research and Development: Going Global.**” This sweeping study explains some of the driving forces that result in “going global.” Costs are one such factor, and we suspect that most sophisticated organizations factor in tax incentives when costs become a driving force for locating R&D facilities in one jurisdiction over another. We hope that this publication helps guide some of the evaluations in that regard. It must be stated that the guidance provided in the pages that follow does not replace the need for professional tax advice in contemplating—and acting on—your company’s individual needs and circumstances.

Finally, a book such as this one happens only with the help of many individuals. We gratefully acknowledge the assistance that we received from our fellow Taxand member firms as well as our Associates who helped research the ever-changing landscape of tax incentives. We also acknowledge the help and oversight that we received from our Publisher and our internal Marketing personnel.

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RESEARCH AND DEVELOPMENT: GOING GLOBAL

(Policy Brief, July 2008, © OECD 2008)

Introduction

The unprecedented pace and scale of today's globalisation process has attracted much attention in recent years. Globalisation is having a particularly large impact on innovation. The scope for global collaboration is increasing as more of the world's regions possess important research and innovation capabilities. So while the United States, the European Union and Japan have so far been the leaders in this respect, countries such as China and India have a growing research and innovation capacity.

This has become a major reason for companies to locate research and development (R&D) outside the home country. While corporate R&D activities are still carried out predominately in the home country, companies are changing how they innovate and building globally distributed R&D (and innovation) networks. Innovation strategies of companies increasingly depend on global sourcing to sense new market and technology trends worldwide, as global competition has forced companies to innovate and to develop commercially viable products and services faster. The knowledge needed to do so has become more multidisciplinary and more broadly located, making innovation more expensive and riskier.

The internationalisation of R&D is not entirely new: in the 1980s, R&D investments mainly took place between developed countries, often through mergers and acquisitions (M&As). The current internationalisation of R&D has three distinguishing characteristics: it is gathering pace because of the often greenfield investments of multinational enterprises (MNEs), it is spreading to more countries, including developing countries, and it goes beyond adapting

technology to local conditions. The internationalisation of R&D and the redistribution of R&D capabilities are in many cases part of firms' broader strategic decisions on production, marketing and M&As. This *Policy Brief* looks at the changing R&D landscape and its implications for business and government policy.

How is globalisation affecting R&D?

R&D has long been one of the least mobile activities of MNEs, largely because of the complex and "tacit" nature of much technological knowledge – a person's knowledge and experience are personal to them, and are therefore not easy to transfer to someone else. So some knowledge is not easily transferable; it remains linked to a specific location. Because of economies of scale and scope in R&D, the dispersion of R&D across various locations also prevented R&D laboratories from reaching critical mass and reduced synergies among a company's various R&D projects. Finally, a company's competitive advantage is often directly related to that of its home country and as such is strongly shaped by that country's industrial specialisations and national innovation systems, including its accumulated research and labour force skills.

These centripetal forces seem to be increasingly counterbalanced by centrifugal forces favouring the geographical decentralisation of R&D. The rising cost and risk of R&D (because of its increasingly multidisciplinary character and growing complexity) and the growing global competition in innovation have led firms to aim at reducing R&D costs while speeding up the development process. This has led companies to source technology and knowledge from abroad and rely more on external sources of innovation. The increasing globalisation of science and technology capabilities and the larger number of locations with attractive science and technology bases have widened the opportunities for R&D-investment abroad.

New technological opportunities, notably ICT, are among the main drivers of the internationalisation process as these have enabled new ways of collaboration and have led to greater specialisation in the global innovation system. Advances in ICT have also facilitated the management of dispersed innovative activities and enabled the outsourcing of R&D. For instance, developments in the codification and standardization of R&D processes have increased the possibilities to segment R&D activities and disperse R&D stages over different locations.

What is the role of multinationals?

Foreign Direct Investment (FDI) plays a major role in the internationalisation of R&D, and MNEs are the main actors. More than 95% of the 700 firms worldwide with the largest R&D expenditure are MNEs; they account for close to half of the world's total R&D expenditure and more than two-thirds of the world's business R&D. The top R&D-performing MNEs often spend more on R&D than many nation states and their presence is felt not only through activities in their home countries but also increasingly abroad.

Recent evidence shows that the top spenders on R&D have increasingly invested in R&D outside their home country. Following the fragmentation of the value chain and the resulting internationalisation of manufacturing, MNEs now increasingly establish R&D facilities at many locations worldwide. A survey by the UN Conference on Trade and Development (UNCTAD) of the largest investors in R&D suggests that the pace of internationalisation in R&D is accelerating. As many as 69% of the responding firms stated that their share of foreign R&D is set to increase (only 2% indicated a decline and the remaining 29% expected the level of internationalisation to remain unchanged).

These survey results are confirmed by more systematically gathered data on outward R&D investment of MNEs. For countries for which data are available, R&D performed abroad has increased since 1995 relative to R&D performed at home (Figure 1). The only exception is Switzerland which has seen a slight

decrease, but Swiss affiliates abroad still do as much research as all companies inside Switzerland. The share of R&D investments abroad is smaller in other countries but still over 20% in Germany, Finland and Sweden. However, some authors have pointed out that R&D establishments abroad may be acquired “incidentally” through mergers and acquisitions whose main objective was not access to R&D. Assessing the importance of such “incidental” internationalisation of R&D is difficult as data on R&D facilities abroad that distinguish between M&As and greenfield investment are not readily available.

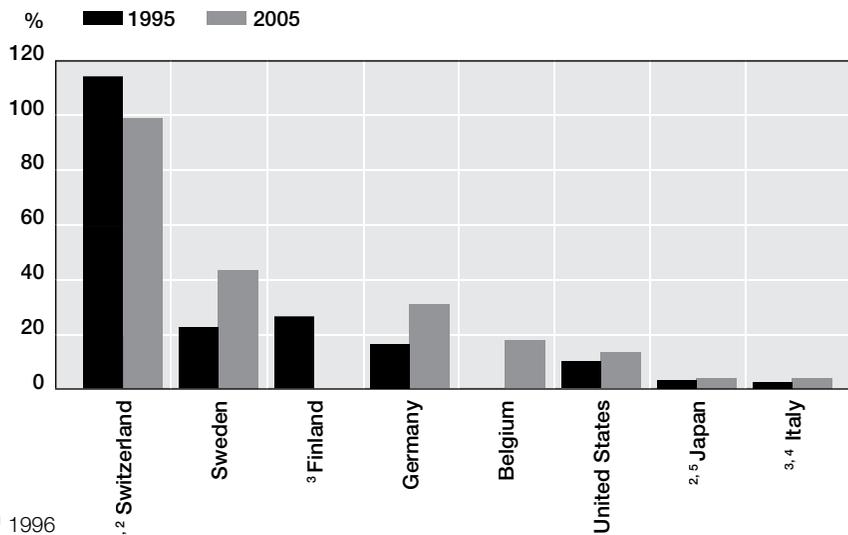
Which countries are attracting R&D investment?

Most R&D investment still goes to OECD countries, and the United States is the most important receiving country. In the OECD area, the largest cross-border flows of R&D take place between the three main regions: the United States, the European Union and Japan. US multinationals placed over USD 17 billion of their foreign investment in R&D in the European Union and USD 1.7 billion in Japan in 2005. The European Union invested USD 19.1 billion in the United States and USD 3.9 billion in Japan. The United States was a net exporter of R&D to the EU in the late 1990s, but in the early 2000s European firms established more foreign R&D affiliates in the United States. Japan invested only USD 1.1 billion in the United States and USD 0.7 billion in the EU.

While most internationalisation of R&D by MNEs still takes place within the main OECD regions, emerging countries increasingly attract R&D investments although these remain relatively small in a global perspective. A 2007 study by the Economist Intelligence Unit of more than 300 senior executives identified India (26% of respondents), the United States (22%) and China (14%) as the most attractive overseas locations for R&D. The Asia-Pacific region, in particular, is expected to attract more offshore R&D over the next three years: 30% of respondents planned a substantial increase in their investment there.

Figure 1

BUSINESS R&D EXPENDITURE BY AFFILIATES ABROAD AS % OF DOMESTIC R&D



¹ 1996

² 2004

³ 1998

⁴ 2003

⁵ 1997

Source: OECD, AFA database, January 2008.

The large increases in foreign R&D investment in developing Asia and particularly in China and India have attracted much attention in recent years. According to official Chinese statistics, 1160 foreign R&D centres had been established in China by the end of 2007, most of them after 2001. Other surveys and studies, including by the OECD, present lower figures. Japanese-

based manufacturing companies increasingly base their foreign R&D centres in China, with an increase of over 400% from 2000 to 2004, compared to a 36% increase in EU15 and 23% in North America. In absolute terms, China had 67 Japanese R&D centres in 2004 and the EU15 had 60. This shift towards emerging countries is expected to continue, as demonstrated by the findings on future R&D investments in a survey by the UN Conference on Trade and Development (UNCTAD). China was the location mentioned most often, followed by the United States. India was in third place, and Russia was also among the top ten target locations. Other emerging economies named were Singapore, Chinese Taipei and Thailand. But the investment trend is not only from the developed to the developing world. MNEs with headquarters in the developing world have recently started to set up foreign R&D affiliates. For Chinese firms alone, 37 R&D units were located abroad in 2006, of which 26 were in developed countries (11 in the United States and 11 in Europe). Companies from developing countries have recently also purchased western companies, often to gain access to intellectual property or markets.

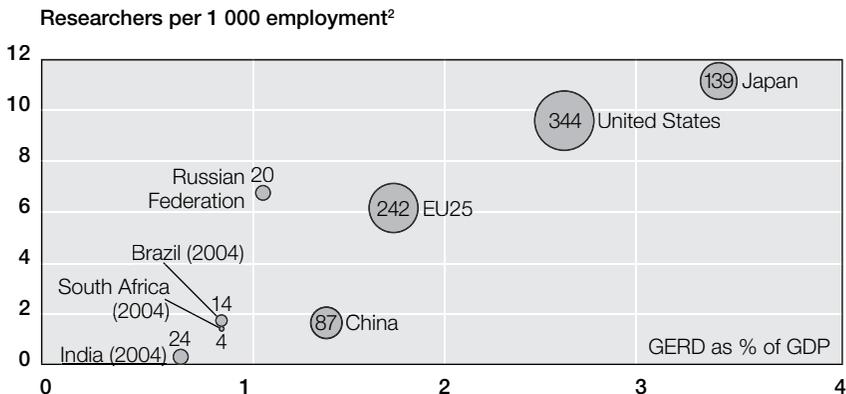
Are there new reasons for taking R&D abroad?

The traditional motive of FDI in R&D is to serve as a conduit for exploiting intellectual assets developed in the MNE's home country. Accordingly, R&D in affiliates abroad is adaptive, designed to customise technologies developed in the home country to fit local conditions. Motives for decentralising this type of R&D are primarily demand-oriented and related to market proximity. Technological knowledge tends to flow from the parent firm's laboratory to the foreign-based facility so that the affiliate's technological advantages primarily reflect those of the home country (where core innovation activities continue to be concentrated) while foreign R&D units tend to exploit the parent company's technologies.

Figure 2

GLOBAL SUPPLY OF S&T CAPABILITIES

Global investments in R&D, 2006¹



¹ The size of the bubble represents R&D expenditure in billions of current USD in PPP;

² For researchers per 1 000 persons employed: India 2000, Brazil, United States and South Africa: 2005

In recent years, owing to changes in the competitive, international and technological environment, MNEs have complemented this decentralised, adaptive R&D with more innovative R&D abroad. Innovation strategies increasingly use global sourcing to tap into new market and technology trends worldwide and to develop new ideas which they then implement worldwide. Knowledge is more likely to flow from foreign units to the parent company if the foreign affiliates undertake asset-augmenting R&D activities that generate knowledge that is valuable for the rest of the organisation. To absorb local sources of knowledge, foreign subsidiaries need to be embedded in the host country's innovation system but also in the firm's organisational network.

The shift towards subsidiaries that are actively engaged not simply in incremental, adaptive R&D but also in radical innovation reflects the increasing importance of supply-related location factors and the presence of scientific and technological skills. Location decisions for these kinds of R&D facilities are related to the host country's technological infrastructure, the presence of other firms and institutions that may create benefits which investing firms can absorb, access to trained personnel, established links with universities or government institutions, the existence of an appropriate infrastructure for specific kinds of research, etc.

The distinction between adaptive and innovative R&D centres seems clear in theory, but may be less so in the real world. A wide range of empirical studies indicate that both demand and supply motivations are behind the location of R&D activities in host countries, but that technology-sourcing motivations are on the rise.

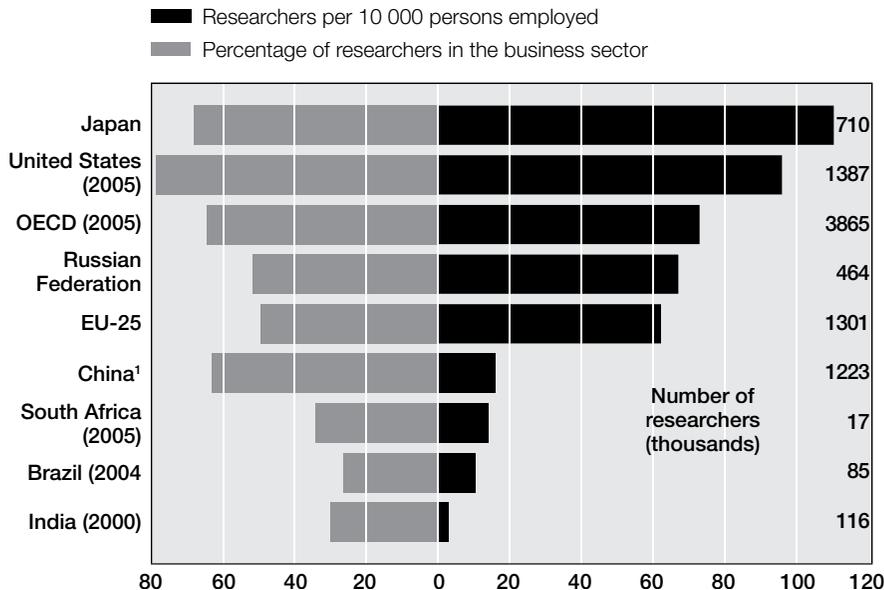
Why locate R&D in emerging countries?

Surveys indicate that China and India, among others, are now considered very attractive locations for future investment because of their large and rapidly growing markets and their large pools of qualified workers with relatively low labour costs (although they are rising). They combine low wages and a good education system with a large mass of well-trained researchers. Typically, while the number of R&D personnel as well as R&D investments in emerging countries may look small in relative terms, the absolute numbers give a different picture (Figure 2). In China, for example, only a small proportion of the population has a tertiary degree, but in absolute numbers enrolments and graduates from tertiary education in China match those in the United States and the EU. Nevertheless, enrolments in and graduations from advanced research programmes such as the PhD are still low in China

Figure 2 (cont.)

GLOBAL SUPPLY OF S&T CAPABILITIES

Researchers, 2006¹



¹ Data for scientists and engineers rather than researchers; overestimation possible.

compared to other countries. Recent evidence on the suitability of new graduates from China and India for work in internationally active MNEs, based on interviews with human resource managers, indicates that on average only 13% of the potential talent supply in low-wage countries is suitable for employment by MNEs.

The attractive cost and availability of researchers in emerging countries are clearly important new drivers for the internationalisation of R&D. Just as the internationalisation of manufacturing had important cost advantages, the internationalisation of R&D is also motivated to some extent by cost-cutting and the outsourcing of activities and location of R&D in countries with low costs. However, the reason seems less to be lower wages per se than an available pool of skilled scientists and engineers. A survey on the reasons for locating MNEs' R&D in developed and emerging countries (*Thursby and Thursby, 2006*) confirms the complexity of R&D location decisions in both. The results generally indicate that growth potential, quality of R&D talent and collaboration with universities were crucial factors for locating R&D in developed countries. The same three factors, not low costs, were also important for locating R&D in emerging countries.

Emerging countries also display some important drawbacks, such as inadequate enforcement of intellectual property rights (IPR). Although China has strengthened its IPR regime through stricter laws and regulations, enforcement remains a problem (*OECD Reviews of Innovation Policy: China*, forthcoming 2008). While India has improved its IPR regime, the protection of intellectual property remains weak in some areas owing to inadequate laws and ineffective enforcement. Previous OECD work has shown that stronger IPR helps attract foreign multinationals, which can strengthen domestic capabilities. In trying to explain why MNEs set up foreign R&D affiliates in emerging countries with weak IPR regimes, UNCTAD and OECD studies have found that these R&D activities often focus on technologies that are typically used in combination with complementary technologies. In the absence of the latter, local technology leakage does not pose a major threat.

Where do we go from here?

Changes in the investment behaviour of MNEs reflect the changing landscape of innovation and the increasingly global supply of science and technology resources and capabilities. The internationalisation of business R&D is part of the broader process of internationalisation of innovation and science, human resources and technology co-operation. Complex policy issues therefore arise, since innovation policy instruments such as R&D support, education and training policies, and infrastructure policies are predominantly national in scope. The challenge for governments is to adjust national policies in light of increasingly international innovation networks.

Overall, the internationalisation of innovative activities can bring substantial benefits, e.g. greater cost efficiency in the innovation process, greater ability to learn about innovation conducted by other companies/institutions, a reduced time length before commercialisation and a positive impact on the innovation capacity of the own firm. At the same time, concerns are raised in many countries, notably the possible erosion of home based innovative activities by off-shoring and outsourcing abroad that could result in a reduced capacity to absorb knowledge and technologies developed abroad. This concern is particularly strong for smaller countries that may not have the critical mass for research and too small a market. Some OECD countries, as well as many developing countries fear being marginalised in this process.

The policy responses are typically aimed at transforming the national innovation system so as to embrace the global division of labour in R&D and to specialise in local strengths. This can be achieved by strengthening the local innovation system and by supporting capabilities to acquire and assimilate knowledge and technologies developed elsewhere in the world.

The policy response to these challenges needs to take account of the current nature of the globalisation process and to build on individual countries' strengths. The key elements for action include:

- ❖ **Excellent framework conditions.** Political stability, public infrastructure, market size and development, tax rates and labour market conditions are key factors in locating R&D.
- ❖ **An excellent innovation system based on local strengths.** A strong and vibrant research base, effective protection of IPR and a well-trained workforce are major determinants of MNEs' investment in R&D and promoting the growth of domestic enterprises.
- ❖ **Stronger international linkages.** This involves supporting the internationalisation of public research organisations, fostering the international mobility of researchers, and linking domestic firms to foreign sources of innovation. It may also require opening R&D funding and programmes in OECD countries to foreign firms and research institutes.
- ❖ **Policy coherence.** This involves co-ordination across various policy areas (education, science and innovation, but also macroeconomic, trade, fiscal, competition, development and employment policies) as well as vertical co-ordination at regional, national and inter national levels of governance.

Effective policies should respond not only to national concerns in terms of attractiveness and competitiveness, but also to global challenges. Turning the internationalisation of R&D into a global win-win situation will require a stronger policy focus on:

- ❖ Encouraging “brain circulation” and “brain connection” to make researchers more mobile and working together more.
- ❖ Embedding inward and outward foreign direct investment in R&D in the local environment and thus fostering inward and outward spillovers.

- ❖ Enhancing the exploitation of home-based knowledge in developing countries in response to global challenges and development objectives.
 - ❖ Strengthening the relevance of international collaboration by focusing on thematic priorities in fields of worldwide importance.
-

For further information

For more information on the OECD's work on the internationalisation of R&D, please contact:

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For further reading

OECD (2006), **Science, Technology and Industry Outlook**, Chapter 4 "The internationalisation of R&D", ISBN 978-92-64-02848-7, € 80, 250 pages

OECD (2007), **Science, Technology and Industry Scoreboard 2007**, available at www.oecd.org/sti/scoreboard.

OECD (2007), **Staying Competitive in the Global Economy: Moving up the Value Chain**, ISBN 978-92-64-03365-8, € 35, 126 pages.

OECD (2008), **The Internationalisation of Business R&D: Evidence, Impacts and Implications**, ISBN 978-92-64-04404-3, € 35, 108 pages.

Or visit: www.oecd.org/sti/stpolicy.

Thursby, J. and M. Thursby (2006). "**Here or There? A Survey of Factors in Multinational R&D Location and IP Protection**", Marion Ewing Kauffman Foundation, Washington, DC.

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I. OVERVIEW

For over 50 years, the United States (“U.S.”) tax code has recognized the importance of encouraging research expenditures. Beginning in 1954, taxpayers were allowed the flexibility of either currently deducting research expenditures or deferring the research costs and amortizing them over a period to be elected by the taxpayer, but not shorter than 60 months. This statute was enacted to encourage research, but also to reduce uncertainty and the associated controversy that some taxpayers encountered during Internal Revenue Service (“IRS”) exams.

At the outset of the Reagan Administration, U.S. tax policy was significantly modified in order to reduce tax burdens, and from this change sprang the creation of the tax credit for increasing research activities. In 1981, a 25 percent tax credit was added to the U.S. tax code. This credit enabled taxpayers to both currently deduct their research expenditures and claim a 25 percent credit on that portion of its expenditures that were in excess of a rolling three-year average.

The justification for the improved credit was described by the Reagan Administration as a means to help U.S. companies regain their former competitive edge, which was then viewed as eroding in the face of mounting global competition. It was believed that some research was not being conducted by U.S. firms, at least domestically, and therefore product innovation was suppressed due to economic realities of the 1970s, which saw some of the highest interest rates in U.S. history.

The U.S. research credit continues to this day to enjoy bipartisan political support. But at the same time, it also continues to be a particular area of concern for the IRS. Year after year, the research credit regime is extended in length, and even enriched. But also, year after year, the IRS views the research credit as a potential source of noncompliance by taxpayers. Currently, the IRS

classifies research credit claims as a “Tier I” issue. Such issues are of the “highest strategic importance” to the IRS. The IRS has also published a number of audit technique guides, which is useful to the taxpayer.

Taxpayers find that their claims for the research credit are met with ever increasing skepticism from the IRS.

Unfortunately, no real change appears imminent, so for the foreseeable future, taxpayers can expect a continuation of past IRS resistance to the credit.

The good news is that most taxpayers continue to “settle” their disputes with the tax authorities at levels that still equate to valuable amounts of this credit.

However, the U.S. tax rules are not as clear as one might like. Also, given that the original deduction statute has been “on the books” since 1954, and many associated regulations are themselves 10, 20 and even 50 years old, the reality of the current state of technology and business practices have evolved to what could not have even been imagined when these rules and regulations were first published. There also seems to be a disconnect between political intentions and administrative responses.

Taxpayers find that their claims for the research credit are met with ever increasing skepticism from the IRS. Taxpayers sometimes spend thousands of hours, and also many multiples of that in terms of dollars, while pursuing their claims. Unfortunately, no real change appears imminent, so for the foreseeable future, taxpayers can expect a continuation of past IRS resistance to the credit.

However, the good news is that most taxpayers continue to “settle” their disputes with the tax authorities at levels that still equate to valuable amounts of this credit. Audits are very time consuming, but taxpayers who document their claims before the audit, and better yet, those who submit their “claim” with their current annual tax return, receive the best consideration from the IRS. Additional good news comes from the fact that Congress continues to show its support for innovative endeavors by updating tax laws benefitting companies engaging in R&D. In 2008, the House and Senate voted overwhelmingly to extend expiring tax laws, including a two-year extension of the R&D tax credit. This Tax Extenders Package was passed as an addition to the Emergency Economic Stabilization Act, and recognized that a crucial step to restoring the nation’s economic health would be to include “must-have” provisions such as the R&D tax credit. By implementing this extension and making enhancements to the credit, the U.S. government demonstrates the continued importance of domestic R&D efforts.

II. DEDUCTION INCENTIVES

Prior to 1954, taxpayers deducted research expenses if they believed them to be “ordinary and necessary,” incurred in conducting a trade or business, and resulted in no assets of lasting value. All three of these conditions posed problems for taxpayers when attempting to sustain the deduction that it claimed. If the taxpayer satisfied these conditions, then it claimed an Internal Revenue Code (“IRC”) §162 business deduction for the expenditure.

Many taxpayers were particularly tripped up by the “in *conducting* a trade or business” requirement, as the expenditure was often incurred by a new entity that had not yet begun its intended trade or business. The expenditure usually related to some invention or product development that was not yet able to be commercialized.

The 1954 statute intentionally liberalized this condition by substituting “in *connection* with a trade or business” for “in *conducting* a trade or business.” Perhaps as a signal of skepticism to come on the part of the tax authorities, the meaning of this phrase was elevated to the U.S. Supreme Court to decide by the IRS. The resulting **Snow**¹ decision acknowledged and upheld this congressional liberalization of the “in connection with a trade or business” rule.

As it stands today, taxpayers are entitled to deduct all expenditures relating to their research activities. Alternatively, and solely at the election of the taxpayer and which requires no condition nor reason², taxpayers have two different deferral methods that they may utilize. The first is referred to as an IRC §174(b) election whereby a taxpayer may elect to defer and amortize these expenses over a period of not less than 60 months. The amortization period begins with the month that the taxpayer first realizes benefits of the research expenditures. If taxpayers make this election, they are required to continue to use this method for all expenditures of those projects for which they make the election and cannot change to the deduction method unless they are granted permission to do so by the IRS. The deduction or the §174(b) deferral method must be selected by the taxpayer in the initial year that research expenses are incurred. This means that if a taxpayer initially deducts its research expenses, it has established that method of accounting, and any deviation from the deduction method must conform to an accounting method change. Likewise, if a taxpayer elects to defer and amortize research expenses, this too is an accounting method and the taxpayer must also request permission to change its method of accounting if it later chooses to deduct these costs as incurred.

The second deferral and amortization option is referred to as an IRC §59(e) election. This election is more liberal than the §174(b) method in that it does not require a taxpayer to apply the method to all expenses or projects. Taxpayers can merely designate the dollar amounts of expenditures that it wishes to defer

and amortize. A second distinction is that this election is an annual election so taxpayers can make use of it in one year without regard to its preference in future years. The amortization period cannot be less than 10 years, and also must begin immediately within the year of deferral.

Periodically, the IRS publishes Revenue Procedures that govern the requirements and conditions for various accounting method changes. Currently (at the time this document is published), the controlling IRS Revenue Procedure³ allows a number of “automatic” changes, meaning that if the taxpayer’s facts fit the requirements of the Rev. Proc. 2008-52, then the change is deemed granted. See the discussion in Section V for certain issues frequently encountered by taxpayers that arguably fall outside of the Revenue Procedure.

Interestingly, IRC Section 174, which governs the deductibility of “research and experimental expenditures,” does not attempt to define these terms, except to say what they are not. Section 174 does not apply to any expenditure for “the acquisition or improvement for land or for the acquisition or improvement of property which is to be used in connection with the research or experimentation and of a character which is subject to the allowance” for depreciation or depletion. It also does not apply to any expenditure that is incurred for the purpose of the exploration for natural resources. Finally, only an amount that is “reasonable under the circumstances” shall be treated as a research expenditure.

The IRS has published regulations that attempt to provide a definition of the term “research and experimental expenditures.” The regulations provide that this term means “expenditures incurred in connection with the taxpayer’s trade or business, which represent research and development costs in the experimental or laboratory sense.” In order for an activity to be considered in an

¹ *Snow v. Commissioner*, 416 US 500, (1974)

² The election must be made however in accordance with the requirements of §1.174-4

³ Rev. Proc 2008-52

“experimental or laboratory sense,” the costs must be “for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product.”

A “product” is broadly defined in these regulations to include items to be held for sale, lease or license, and also includes items to be used in a taxpayer’s business. Therefore, the term “product” includes any process, formula, pilot model, invention, technique or other similar property.

Also of note, neither the nature of the product or improvement, nor the level of technological advancement shall have any bearing on whether an activity constitutes a research and experimental activity. The sole determinant is the “nature of the activity” and not whether it relates to major or minor improvements.

The regulations list several items which are not considered research or experimental costs. These include ordinary testing or inspection of products for quality control purposes, efficiency surveys, management studies, consumer surveys, advertising or promotional costs, research that requires historical or literary analysis, and finally the cost of acquiring another’s patent, model, production or process.

In keeping with the statute, the regulations also provide that the cost of land or property that is subject to the allowance for depletion or depreciation is not a research expenditure. However, the regulations⁴ provide that in certain instances, the design costs associated with the development of a depreciable asset are considered a research cost. The extent to which this regulatory exception applies is currently the focus of intense taxpayer-IRS debate.

The country or locale where the research activities are conducted is of no importance to the deduction incentive. The nature of the costs eligible for this treatment is all costs associated with the research activity. Therefore, all direct

and indirect costs associated with or allocated to the research activity are to be considered research costs.

III. CREDIT INCENTIVES

The U.S. research and experimental credit is an additional incentive provided to taxpayers to encourage them to perform research in the U.S. It was first promoted in 1981 and as originally constructed it provided an incentive only to taxpayers that *increased* their research spending over a moving three year average. Since its inception, the credit regime has continuously evolved and changed, but at its core, it continues to entitle taxpayers only to a credit to the extent that they increase their rate of spending on research activities.

There are currently three different credit regimes from which taxpayers can choose in order to compute their research credit: the Regular Credit, the Alternative Incremental Research Credit (“AIRC”) and the Alternative Simplified Credit (“ASC”). The principal distinctions among these three regimes relate to credit calculation mechanics, whereas the basic rules of credit qualification and definitions are constant across all three regimes. The AIRC method was made largely irrelevant with the passage of the ASC and is no longer available for tax years beginning after December 31, 2008.

Common Definitions and Other Rules

Under all three credit regimes, several common rules apply. The definition of research activities eligible for the credit is more complex than the definition set forth above for the deduction incentive. In order for an activity to be eligible for the credit, it must satisfy the additional criteria:

- ❖ First, the activity must be one that can be treated for deduction purposes as a research expenditure.

⁴ IRC Reg. Sec. 1.174-2(b)(1)-(4)

- ❖ Second, it must be an activity undertaken for the purpose of discovering information which is technological in nature, and the application of the information is intended to be useful in the development or improvement of a business component of the taxpayer.
- ❖ Last, substantially all of the activities must constitute elements of a process of experimentation for a qualified purpose. There are three such qualified purposes: (1) new or improved function, (2) performance and (3) reliability or quality.

There are certain activities that are excluded from credit eligibility, even if the basic rules set forth above indicate otherwise. Excluded from credit eligibility are the following specific types of research: any research that is funded by another person, research after commercial production, research to adapt an existing business component to suit a particular customer's requirement, and the costs associated with the duplication of an existing business component.⁵ The statute provides that software that is developed by (or for the benefit of) the taxpayer for internal use (such as payroll or accounting software) can qualify, but only to the extent provided in the regulations.

Unlike the research deduction incentive, which includes all costs of a research activity, the research credit is only available to the extent that certain types of costs are incurred. There are generally three categories of eligible expenses: (1) wages⁶ paid to persons performing the research and to persons directly supporting or directly supervising the research; (2) supplies used in the conduct of the research; and (3) contract research expenditures.

If a taxpayer decides to outsource some or all of its research, then the contract research costs are eligible, but only to the extent of 65 percent of the contract price relating to the research activity.⁷ In certain instances, 75 percent, and not 65 percent, is the appropriate qualifying percentage where the research is performed by a qualified research consortium. In other instances, 100

percent, and not 65 percent, is the appropriate qualified percentage if the research payments are paid for “energy research” (production, development or conservation), and if the energy research is performed by a small business (500 or fewer employees), a federal laboratory or an institute of higher education.

Just as the deduction incentive broadly defines “product,” the credit incentive uses a similar concept, but uses the term “business component.” A business component is any product, process, computer software, technique, formula or invention to be held for sale, lease or license; components are also those items to be used by the taxpayer in a trade or business. In *Union Carbide Corp. v. Commissioner*, T.C. Memo 2009-50, the U.S. Tax Court analyzed the Business Component Test and reiterated the holding in *Norwest Corp. v. Comr.*, 110 T.C. 454 (1998) stating, “To be useful within the meaning of this test, the research need only provide some level of functional improvement to the taxpayer.”

The research credit incentive is calculated at a modified controlled group level. Basically, whether consolidated for tax purposes or not, any “more than 50 percent owned” entities are treated as though they are wholly owned for purposes of credit calculations. The resulting credit is allocated to each

⁵ But there are important “exceptions to the exception,” or other nuances that one needs to consider before determining if an activity is ineligible for the credit.

⁶ Wages included for this purpose are only those that are currently taxable to the employee. Accruals for vacations, deferred compensation or unexercised stock options are not considered wages until paid or otherwise treated as taxable to the employee, and non-taxable fringe costs are never treated as wages for this purpose.

⁷ In order to qualify, the contract must not shift the economic risk to the contractor, otherwise the contractor, and not the customer, is generally entitled to claim a research credit for the contracted activities. For example, if the contract specified that the contractor was only to be paid in the event that it successfully performed and met the technical challenges of the contract, then the contractor is said to bear the economic risk, and the customer would therefore be precluded from claiming 65 percent of the contract price as a qualified research expenditure.

member of the group. This rule requires that all members of the group participate in a credit *computation exercise* that utilizes one, and only one, of the credit regimes. It is a rule that requires the group to select the one method that produces the best credit answer for the group as a whole, even though it may not be the optimal method for any particular member.

Once the credit is computed, it must then be allocated. The regulations allow for an *allocation methodology* that requires each member to compute its *proforma* individual credit on a “stand alone” basis, and utilize the regime that best suits its purpose. The aggregate of these “stand alone” *proforma* credits then becomes the basis of an allocation of the actual credit computed per the preceding paragraph.

Because the research credit is billed as an “incremental” credit, providing incentives to increase research, the statute and the regulations emphasize that consistency of treatment is important. Taxpayers that determine that a current year activity qualifies as a research activity must determine if it incurred amounts in prior years for the same type of activity. If it did, then it must consider these amounts in the prior years as research costs as well, even if the statute of limitations precludes the taxpayer from amending the prior year to claim a benefit for the earlier expenditure.

However, in *Union Carbide* the Tax Court made it clear that a taxpayer does not have to possess the exact same type of records from the base years to the current years in order to prove consistency. The Court stated that it would accept the taxpayer’s evidence and oral testimony “as a close approximation of all the qualified research activities” and expenses that occurred during the credit years and the base period. The Court indicated that it was “more appropriate to accept” the taxpayer’s computation of qualified costs rather than “to reject the [taxpayer’s] efforts as a whole.” The Court also accepted oral testimony and corroborating documentary evidence to establish that

qualified research activities themselves occurred without specific supporting contemporaneous project reports.

Similarly, taxpayers that acquire or dispose of businesses must make adjustments to their historical expenditures; otherwise distortions could result. Therefore, in the case of an acquisition, taxpayers must include in their historical spending the research spending of the entity that it acquired. If it disposes of an entity, it should exclude the research spending of the disposed entity, provided it supplies the buyer of the entity with the information relating to this adjustment.

The actual credits computed by each of the credit regimes are, in effect, taxable to mitigate the double-dip benefit of the credit and the deduction. Taxpayers are required to reduce their deduction for research expenses by the amount of the credit claimed. This reduction has the effect of increasing taxable income. However, taxpayers can avoid this adjustment if they elect to use a tax-effected credit amount, which reduces the credit percentage and subsequently takes into account the maximum corporate tax rate (currently 35 percent) under IRC §280C(c)(3). For example, the regular credit rate of 20 percent discussed below would be reduced by 35 percent, resulting in an effective credit rate of 13 percent.

Regular Credit Regime

Under this regime, taxpayers are entitled to claim a nominal credit of 20 percent of the excess of current year research expenses over a base amount. The base amount is computed by applying a historical research spending level ratio to recent gross receipts. The ratio is a fraction; the numerator is the historical research spending level, while the denominator is the historical gross receipts. This ratio is known as the “fixed base percentage.” For many companies, the historical period for which this fixed base percentage is calculated is the taxpayer’s 1984-1988 taxable years (1985-1989 for fiscal year companies).

According to IRC §41(c)(6), taxpayers are required to consistently treat expenses and gross receipts in the fixed base percentage years, with the treatment applied to similar expenses and gross receipts in the credit determination year. This means that if a taxpayer determines that a certain pool of expenditures are eligible for the credit in the determination year, say 2009, and also assuming that these same types of expenses existed during the base years, it must treat these same types of expenses as qualified research in the calculation of the fixed base percentage and include them in the calculation. This is regardless of whether or not the expenditures were originally claimed in any of the fixed base percentage years.

This regime has been the mainstay of the U.S. research credit incentive since 1990. The regular credit calculation's complexity has contributed to significant taxpayer-IRS controversies.

This regime is generally attractive to companies with current research spending significantly greater than their fixed base percentage years, with stable gross receipts that have not "sky-rocketed," and with the ability to prove their fixed base percentage via strong documentary evidence.

There are special rules contained in IRC §41(c)(3)(B) for "start-up companies" that did not exist during the base year period (i.e., from 1984 through 1988). These rules provide taxpayers that did not exist during the base years a way to utilize the regular credit regime by establishing a three percent fixed base percentage for the first five years, and then applying a formula approach for years thereafter taking into account recent qualifying expenditures and recent gross receipts.

Alternative Incremental Research Credit Regime ("AIRC")

This credit regime was added for tax years beginning after June 30, 1996. At the time the AIRC was adopted, Congress recognized that many taxpayers that incurred substantial research expenditures were none the less ineligible to claim

a credit because their historical spending, as a percent of their gross receipts, was quite high. Many in the aerospace and defense industries found themselves in this situation as the 1980s coincided with the high defense spending and the use of fixed price procurement contracts by the Reagan Administration which placed the economic risk on the contractor. This situation reversed in the 1990s, and many in the industry found that they no longer were eligible to claim research credits since they were not increasing current spending as compared to the base period.

This elective regime rewards taxpayers to the extent that they incur qualified research expenses that exceed at least one percent of their most recent four-year average of gross receipts. The regime consists of three bands of credit eligibility, each band with its own unique credit percentage. The first band is for qualified research expenses that exceed one percent, but not 1.5 percent of gross receipts. The second band is for expenses that exceed 1.5 percent, but not two percent of gross receipts. The final band is for expenses that exceed two percent of gross receipts. The credit percentages for each band however is quite low, and are currently set at three, four and five percent respectively.

This regime is generally attractive to taxpayers that have experienced declines in research spending as compared to the fixed base percentage years and those that have not experienced large increases in their gross receipts. This credit was marginalized by enactment of the Alternative Simplified Credit Regime (discussed below), and as noted above, this credit was eliminated for tax years beginning after December 31, 2008.

Alternative Simplified Credit Regime (“ASC”)

This regime was effective beginning with the 2007 tax year. As its name implies, this regime presents taxpayers with a research incentive that is simpler to calculate than either of the two methods discussed above. This elective regime

provides for a 12 percent credit applied to those qualified research expenses that exceed 50 percent of a three year moving average of such expenses. Additionally, the Tax Extenders Act increased the ASC credit percentage from 12 to 14 percent for 2009.

This regime is attractive to taxpayers that have somewhat flatter research spending patterns and also to taxpayers who have very significant levels of gross receipts, including those who have experienced a recent surge in gross receipts.

An elected regime cannot be changed for that year. It can however be changed for subsequent years. The election of either the AIRC or the ASC must be made on a timely filed return and cannot be made on an amended return.

IV. OPPORTUNITIES

Most taxpayers deduct currently all of the research expenditures that they incur. However, the deferral elections are used by some taxpayers that find it helpful to manage the level of research deductions as these expenses are required to be allocated between U.S. and non-U.S. income, thereby affecting the amounts of foreign tax credits that a company can claim. Other taxpayers find it helpful to manage overall taxable income in order to avoid limitations of other deductions, particularly ones that derive a permanent book / tax difference, such as the deduction for domestic manufacturers.

Many taxpayers find that they inadvertently capitalize some research costs into the basis of self-constructed property or internally developed software. Capital intensive taxpayers should determine the book treatment for such expenses and develop a methodology that isolates these costs so that they can be deducted as incurred. Depending on a taxpayer's situation, they may be entitled to an accounting method change or a tax return amendment if they find that they have inadvertently capitalized these costs.

Companies that are in start-up mode are required to capitalize many costs. However, research costs are not costs that are required to be capitalized. Companies that utilize a long-term contract accounting method often require research in order to meet their obligations for an initial contract. These incurred research costs are usually direct costs of such a contract and are therefore “allocated” to this initial contract. Subsequent contracts for the same or similar items may utilize the benefits of this research, but such use does not imply that any of the research costs need to be “allocated” to these subsequent contracts. Again, taxpayers should determine the book treatment of these initial contract research costs since these costs are “spread” to expected future contracts.

Opportunities for research credit enhancement are numerous, starting with the fact that there are different calculation regimes which afford taxpayers with significant options. If taxpayers find that they are unable to adequately document their historical base period expenses and gross receipts, they will find the new ASC an attractive alternative. While the ASC credit rate is lower than the regular credit rate, some taxpayers may find that avoiding controversy with the IRS is justification enough to make this election.

A number of research activities are frequently overlooked by taxpayers, including:

- ❖ Contract research that conditions payment upon success,
- ❖ Research support by manufacturing engineers,
- ❖ The cost of supplies related to prototypes,
- ❖ The need to conduct large scale research to account for environmental factors that are not easily replicated in a laboratory,
- ❖ Research costs capitalized into fixed assets,
- ❖ Research support activities,

- ❖ Contracted supplies subjected to the 35 percent subcontract research reduction,
- ❖ The elimination of inter-company research charges,
- ❖ Process improvement initiatives, and
- ❖ Payments to consortiums and institutions of higher education treated as contributions and not as research.

V. COMMENTARY

The biggest pitfall that many taxpayers encounter is the lack of adequate documentation to support credit amounts claimed. Accounting records by themselves usually lack the necessary information to support the various research credit code and regulatory tests and conditions. This is particularly so with regard to the fixed base percentage years. Recall that the most common fixed base percentage years are from 1984 through 1988 years. Many taxpayers have not retained adequate business documentation that provide evidence which supports activities that took place and costs that were incurred during these years.

A second trap for the unwary is the failure of many companies to make a timely IRC 280C election to adjust the credit rate to an after tax rate. If taxpayers file their return claiming no credit at all and later amend their return to claim a credit, the taxpayer must use the full credit rate and reduce their research deductions by the amount of the credit. This usually has the effect of increasing state taxable income, as well as federal income. The tax on the increase in income can be due currently even if the credit is not currently utilized and becomes a carry-forward of the taxpayer.

If a taxpayer utilizes the regular credit regime and encounters heavy resistance from the IRS for an uncertain position concerning the definition of gross receipts or a challenge to its fixed base percentage calculation, the taxpayer

cannot later switch to another regime that does not utilize those concepts. Taxpayers should assess their IRS audit expectations and determine beforehand the best credit regime.

Supply costs also continue to be an area of controversy between many taxpayers and the IRS. IRC §41 provides that “supplies used in the conduct of research” qualify for the credit. The IRS continues to argue that the term “used” actually means “consumed.” The impact of this IRS argument is that if the supply item is durable, like a prototype machine, “consumption” does not occur as it might for food or cosmetic prototypes. The fact that the item might have some residual or scrap value leads the IRS to conclude that these kinds of prototype costs are not eligible for the credit. This is a rather new interpretation by the IRS. For years, the IRS raised no argument regarding a prototype’s durability. We see no policy reason why the U.S. Congress would find it reasonable and appropriate to grant qualification status to prototypes for one type of products, but then deny the same qualification status to other types of products, so long as the product costs otherwise qualify for the research credit.

Supply costs were also at issue in *Union Carbide*, where the Tax Court reviewed a number of “process improvement” type projects. The Tax Court parsed out the qualified activities associated with the experimental processes from the activities and costs associated with the products already in commercial production to which the experimental processes related. In all cases, *Union Carbide* was commercially producing the products using the process to which the research in question was related and was certain that some final product that would be added to inventory would result from the process. Thus, the Court viewed these as production runs during which some research on the process was conducted, rather than as purely experimental runs used to test whether a final product could be produced by the process being evaluated. In denying that the costs of the raw materials be qualified

and used during these production runs, the Tax Court stated that “[t]axpayers may not circumvent the narrow definition of qualified research that Congress intended by including as QREs costs of a project that are not incurred *primarily* as a result of the qualified research activities” (emphasis added). However, it should be noted that neither IRC §41 or the regulation thereunder contain a “primary purpose” test such as the one the Tax Court applied in *Union Carbide*.

The controlled group rules are occasionally problematic for some groups as well. These rules expect that taxpayers under common control cooperate and share information within the group. This may not be the case for various groups controlled, for example, by a single foreign parent. This is especially true where the parent invests in a broad array of industries since there may be no compelling reason for these disparate U.S. businesses to cooperate or communicate with one another. If one member of the group files its tax return and claims a credit disregarding the control group rules, it is uncertain if this action binds the entire group to the credit regime it must use.

There is also uncertainty as to how to adjust for intra-group gross receipts. This uncertainty exists because there is conflicting IRS guidance on this point. The IRS has indicated that it intends to issue additional guidance on the matter in order to reduce confusion. Until that guidance is issued, companies that have increased the foreign component of their worldwide sales to an extent that is greater than their U.S. component should consider the initial advice from the IRS, which was to eliminate the gross receipts (from the regular and AIRC regimes) for income received from a Controlled Foreign Corporation (“CFC”). The consistency rule always applies, and therefore, any receipts ignored or included in the most recent years will have to be treated similarly in the base years.

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I. OVERVIEW

Research incentives have existed in the United Kingdom for over 60 years. Currently, tax reliefs are available to companies undertaking qualifying Research and Development (“R&D”) activities. Tax reliefs are also available to companies undertaking vaccine research for the prevention or treatment of tuberculosis, malaria, HIV and AIDS. This is referred to as Vaccine Research Relief (“VRR”). The tax reliefs are available in the form of an enhanced deduction in respect of qualifying expenditure which reduces the tax payable or increases the tax losses arising. In some circumstances, small and medium-sized enterprises (“SMEs”) can surrender their losses in return for a payable tax credit, i.e., a cash repayment from Her Majesty’s Revenue & Customs (“HMRC”).

In 2006, HMRC set up specialist units which deal solely with R&D claims. These units are staffed by specially trained officers and help ensure consistency in dealing with claims.

VRR was introduced in 2002 and applies to qualifying expenditure incurred after April 22, 2003. Qualifying expenditure for VRR follows the same ground rules as R&D.

R&D takes place when a project seeks to achieve an advance in science or technology. The activities which contribute to such endeavors through the resolution of scientific or technological uncertainty are defined as R&D.

An advance in science or technology means an advance in overall knowledge or capability in a field of science or technology (not a company’s own state of knowledge or capabilities alone). An advance in science or technology may have tangible consequences (e.g., a new or more efficient product, or a process which generates less waste) or more intangible outcomes (e.g., new knowledge or cost improvements). A process, material, device, product, service or source of knowledge does not qualify as an advance in science or

technology simply because science or technology is used in its creation. Work which uses science or technology but which does not advance scientific or technological capability as a whole is not considered an advance in science or technology and, subsequently, does not qualify as R&D.

One of the qualifiers for defining R&D activities for tax purposes is that activity set out to solve scientific or technological uncertainty, and that this resolution is feasibly achieved. This inevitably includes system uncertainty. Scientific or technological uncertainty will often arise from turning something that has already been established as scientifically feasible into a cost-effective, reliable and reproducible process, material, device, product or service. Uncertainties that can readily be resolved by a competent professional working in the field are not scientific or technological uncertainties for these purposes. Similarly, improvements, optimizations and fine tuning which do not materially affect the underlying science or technology do not constitute work to resolve scientific or technological uncertainty.

In practice, HMRC is likely to challenge whether activities are qualified R&D and the onus would be on the company to demonstrate that the expenditure is incurred on activities that would constitute R&D and involve scientific or technological uncertainty. The definition of an SME is taken from the Commission Recommendation 2003 / 361 / EC, with certain anti-avoidance and transitional provisions. This defines enterprises as micro, small or medium by reference to various ceilings relating to staff headcount, annual turnover and balance sheet totals.

A company is small or medium size if it altogether has fewer than 250 employees, and either an annual turnover not exceeding €50 million or an annual balance sheet total (Gross Assets) not exceeding €43 million. These thresholds are considered by reference to the consolidated group position. For

this purpose, companies which are at least 25 percent owned are included in determining the thresholds. From August 1, 2008 onwards, the thresholds of SME have been extended, i.e. a company is considered a SME if it has fewer than 500 employees and an annual turnover not exceeding €100 million or an annual balance sheet total not exceeding €86 million.

A company is not considered to be an SME if it is owned, solely or jointly, as to 25 percent or more of the capital or voting rights by enterprises that are not SMEs. This threshold can be exceeded where the ownership is by venture capital companies, institutional investors and public investment corporations so long as they solely or jointly exercise no control over the affairs of the company.

There will also be no transitional provision for adoption of the increased SME limits noted above. Instead, a company which was large under the previous limits will be treated as large up to August 1, 2008, and as an SME for the remainder of the accounting period, and for subsequent accounting periods.

If the R&D is carried out by workers supplied by an unaffiliated, external company, then 65 percent of the payments made in respect of them is a qualifying expenditure. Externally-provided workers have to be supplied through an agency and cannot be self-employed individuals unless employed through a service company. If the provider is connected to the company, then all the payment in respect to the provider's relevant expenditure in providing the staff is a qualifying expenditure. Companies can elect to be treated as connected to each other and the election must be made in writing within two years of the end of the accounting period into which the contract or other arrangement is entered. This is an irrevocable election.

From August 1, 2008, relief for SMEs is limited to a maximum cost per R&D project of €7.5 million. Companies failing the SME tests are considered to be

large companies and may qualify for tax relief under Schedule 12, Finance Act 2002. Large companies incurring qualifying R&D expenditure of at least £10,000 (£25,000 for accounting periods beginning before April 9, 2003) can obtain a tax deduction for an additional 30 percent of qualifying expenditure (25 percent prior to August 1, 2008).

Aside from different deduction amounts, the SME and large company schemes also have other notable differences. Large companies are not allowed a payable credit, but their claims are not reduced for grants or subsidies (as they are for SMEs). Only large companies can claim contributions to independent research carried out by charities, universities and scientific research organizations. Lastly, SMEs must own the intellectual property arising out of the R&D while large companies need not hold ownership.

If a company loses its SME status on or after December 1, 2008 as a result of being taken over by a large enterprise (which can be a single large company, or a collection of smaller entities which when taken together are regarded as large), it will be regarded as a large company for R&D and VRR purpose for the whole accounting period in which the change occurred.

Where an SME “organically” becomes large by growing so that it exceeds the staff and financial thresholds, a transition period will allow SME status to be retained until the limits have been exceeded for two consecutive accounting periods. No such transition period applies where the loss of SME status is due to a merger or takeover.

Where a large company decreases in size or demerges from a larger group of entities, it will not attain SME status until it has met the SME staff number and financial thresholds for two consecutive accounting periods.

Companies in the United Kingdom are also entitled to deduct an additional 40 percent of qualifying expenditure (50 percent deduction for expenditure

incurred prior to August 1, 2008) on R&D into vaccine and medicines for the prevention and treatment of certain diseases. VRR follows the same ground rules as qualifying expenditures for R&D and can be used by companies spending more than £10,000 on vaccine research in a 12-month accounting period. A company can claim both R&D tax relief and VRR. SMEs not in profit can surrender losses arising from VRR in return for a payment of a vaccine tax credit equal to 16 percent of the loss to be surrendered.

For the purpose of obtaining tax relief, qualifying R&D expenditure must meet the following conditions:

A. SMEs

1. *In-house direct R&D*

❖ Expenditure is incurred on:

- (a) Staffing costs (see Note 1 below),
- (b) Software or consumable items (see Note 2 below),
- (c) Qualifying expenditure on externally provided workers after September 27, 2003, or
- (d) Relevant payments to the subjects of a clinical trial.

❖ Expenditure is attributable to relevant R&D undertaken by the company itself. Any intellectual property created as a result of the R&D to which the expenditure is attributable is, or will be, vested in the company (whether alone or with other persons).

❖ Expenditure is not incurred by the company in carrying on activities which are contracted out to the company by any person.

❖ Expenditure is not subsidized.

❖ Expenditure is not capital expenditure as a matter of tax law.

2. *R&D contracted out to a connected party*

- ❖ Expenditure is attributable to relevant R&D undertaken on behalf of the company.
- ❖ Intellectual property created as a result of the R&D to which the expenditure is attributable is, or will be, vested in the company (whether alone or with other persons).
- ❖ Expenditure is not incurred by the company in carrying on activities which are contracted out to the company by any person.
- ❖ Expenditure is not subsidized.
- ❖ Expenditure is not capital in nature.

3. *R&D contracted to third party*

- ❖ 65 percent of the expenditure is taken as qualifying.
- ❖ The company and the subcontractor may elect for connected party treatment as above. This practice is rare because third parties are often reluctant to share their financial data.

B. Large companies

1. *In-house direct R&D*

- ❖ Expenditure is incurred on:
 - (a) Staffing costs,
 - (b) Software or consumable items,
 - (c) Qualifying expenditure on externally provided workers, or
 - (d) Relevant payments to the subjects of a clinical trial.
- ❖ Expenditure is attributable to relevant R&D undertaken by the company itself.

- ❖ Expenditure incurred in carrying on activities contracted out to the company by a large company, or any person otherwise than in the course of carrying on a chargeable trade.

- ❖ The expenditure is not capital in nature.

2. *R&D contracted out by a large company*

- ❖ Expenditure is incurred in making payments to:

- (a) A qualifying body,

- (b) An individual, or

- (c) A firm, each member of which is an individual.

- ❖ The body, individual or firm concerned undertakes the contracted out R&D itself.

- ❖ The expenditure is attributable to relevant R&D in relation to the company.

- ❖ The expenditure is not capital in nature.

- ❖ If the contracted out R&D is itself contracted out to the company, it is contracted out by:

- (a) A large company, or

- (b) Any person otherwise than in the course of carrying on a chargeable trade.

Note 1: Staffing Costs

Staffing costs are defined as those that are paid to directors or employees who are directly and actively engaged in R&D activities. They include all monetary payments such as salaries, wages, fees and bonuses before deductions for PAYE, National Insurance or other agreed sums (such as season ticket loans, etc.). But they do not include the costs of providing benefits in kind. Also

included are all payments to a pension fund by the employer in respect of the company's directors or employees directly engaged in R&D to provide those R&D staff with a pension, retirement annuity or other superannuation benefits.

Recruitment and other related personnel costs, such as relocation expenses, are not included. Payments to agencies for the provision of staff also do not qualify.

If the staff spends only part of their time on R&D efforts, costs should be apportioned to arrive at the qualifying staff costs. In practice HMRC are unlikely to accept that any individual spends 100 percent of his or her time on qualifying projects.

Note 2: Software, consumable items or consumable stores used directly in R&D

The expenditure must be incurred on consumable items used in the R&D that would no longer be useable in their original form.

Where the expenditure is only partly employed directly in relevant R&D, it has to be apportioned appropriately. Where apportionment of expenditure on consumable items is required, a pragmatic approach should be adopted. A general apportionment based on floor area or staff numbers may be appropriate. HMRC accepts heating and lighting expenses as the part of the property used for direct R&D.

Expenditure on software or consumable items employed in the provision of services such as secretarial or administration is not to be treated as expenditure directly related to qualifying R&D. Similarly, general expenditure on utilities or rights to use software will not be considered to be consumable stores.

II. DEDUCTION INCENTIVES

Tax relief was initially developed through consultation with businesses and is available in the form of an extra tax deduction. All companies spending at

least £10,000 on qualifying R&D are entitled to a deduction. Companies with qualifying expenditure fall into two categories that determine the tax incentives available to them. A company will be considered as an SME or large company. Qualified companies of all sizes can claim VRR. R&D expenditures of a revenue nature which relate to a company's trade and are undertaken by the company or on its behalf are deductible for tax purposes. SMEs can claim a deduction of 175 percent (150 percent before August 1, 2008) of the qualifying R&D expenditure, while large companies can claim 130 percent (125 percent before August 1, 2008). An SME can claim an R&D tax credit if it has unrelieved trading losses. The R&D tax credit available is 14 percent of the loss subject to surrender, but it is capped to the company's Pay As You Earn ("PAYE") and National Insurance Contribution ("NIC") liabilities for payment periods ending in the accounting period. Expenditure of a capital nature on R&D relating to a company's trade would normally qualify for capital allowances at 100 percent in the period it is incurred.

For a project to qualify as R&D for tax purposes, there has to be scientific or technological uncertainty which cannot be readily resolved. A common mistake is for companies to focus on the new features of a product they have developed.

III. CREDIT INCENTIVES

In addition to an enhanced deduction for qualifying R&D expenditure, SME companies that make losses can surrender such losses attributable to R&D and obtain a cash repayment. The purpose of the R&D tax credit provisions is to allow a company that makes a trading loss for an accounting period to surrender the part of the loss attributable to the 175 percent (150 percent before August 1, 2008) deduction for qualifying R&D

expenditure in return for a cash payment. The cash payment is limited to 14 percent (16 percent before August 1, 2008) of the attributable loss amount, which amounts to 24.5 percent of the actual qualifying R&D expenditure. However, the cash payment is subject to a “cap” and cannot exceed the total amount of the company’s PAYE and NICs liabilities for payment periods. A “payment period” is a period which ends on the fifth day of a month for which the company is liable to account for PAYE and NIC to HMRC. The effect of this incentive is to allow SME companies that are carrying out R&D, but which are not in profit, to receive a real cash benefit and receive it earlier than would otherwise be the case.

A company’s trading loss for a period for which it claims R&D tax credits is treated as reduced by the amount of the loss surrendered. Therefore, the amount of any trading losses carried forward will be restricted accordingly. Note that this can lead to inefficiency in future periods and prior periods, and companies may be better off not claiming the cash tax credit.

This SME R&D credit is classified as “Notified State Aid” and limits are set on the amounts of aid to be awarded for projects. A company is not allowed to receive this tax credit if it also receives another form of notified state aid for the same project. Other notified state aids include many grants available and a review should be performed to check that no issues arise.

IV. OPPORTUNITIES

For SMEs carrying out qualifying R&D, they can claim the R&D tax credit and receive a cash injection at the early stage of project development, which could be crucial to cash flows.

Finance Act 2008 introduced a cap of €7.5 million on the total amount of R&D and VRR credit a SME can receive in respect of a particular R&D project on qualifying expenditure incurred with effect from August 1, 2008. This also

introduced new rules to prevent companies in difficulty from claiming tax relief under the SME R&D or VRR schemes. A company will be regarded as being in difficulty if its latest published accounts are not produced on a going concern basis. A company will also be prevented from claiming relief if it is going concern status is based on the expectation of it receiving SME R&D or VRR relief or tax credits.

From August 1, 2008, large companies claiming VRR are required to make a declaration about the effect of the relief, including how the claim increased the amount, scope or speed of R&D undertaken by the company.

A company can claim R&D relief and VRR at the same time if it incurs expenditure that qualifies for both. Companies can claim VRR for subcontract payments. There are less stringent rules if such work is subcontracted to universities, charities and scientific research organizations than to others.

In practice, HMRC R&D units aim to process R&D claims as soon as possible and based on experience most repayment credits are processed to SMEs within 28 days of receipt of the claim. Therefore, it is important to ensure that the claim is correctly prepared from the outset as this can result in a more efficient process and ensure repayments are received promptly.

V. COMMENTARY

For a project to qualify as R&D for tax purposes, there has to be scientific or technological uncertainty which cannot be readily resolved. A common mistake is for companies to focus on the new features of a product they have developed. This would not necessary qualify and it may be simply product development from existing science and technology.

Companies that wish to apply for R&D tax relief will have to prepare sufficient documentation including a project definition, technological or scientific

uncertainties, technological or scientific advancements, timesheets and personnel records.

The SME scheme for R&D tax relief counts as a notifiable State Aid, and for that reason HMRC restricts its availability to companies not in receipt of other notifiable State Aids for the same R&D project in question. Where an R&D project has received funding which is a notified State Aid then no expenditure by the company on that project can qualify for the R&D SME relief (which is itself a notified state aid). This often presents a trap for the unwary.

SMEs may choose to sacrifice trading losses carried forward in order to obtain R&D tax credit which is only the lower of:

- (a) 14 percent of the surrenderable loss, or
- (b) The PAYE and NICs due for payment periods ending in the accounting period.

If the company is expecting to be profitable in the following year, it might be better to keep the trading loss instead of claiming the R&D credit. Similarly, if the company was profitable in the prior year, it might be better to carry the loss back and claim a tax refund.

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I. OVERVIEW

Argentina suffered a severe economic crisis from 2001 to 2002, but has enjoyed a healthy economy since that time. The country's Gross Domestic Product ("GDP") experienced significant growth of over eight percent during the five years following the economic downturn. In 2007, Argentina's GDP was approximately US\$255 billion. Argentina's revived economy, natural resources, well-educated population, strong agricultural sector and diverse industries provide the country with a foundation for growing Research and Development ("R&D") efforts. The country continues to expand its tax regulations to encourage R&D efforts across industries and companies. Argentina has a strong history of R&D activities in archetypical, biochemical and medical fields, but has recently made significant strides in software, nanotechnology and biotechnology.

II. DEDUCTION INCENTIVES

Argentina's tax regulations allow for a full deduction on R&D expenditures that relate to attaining intangible property. Such amounts are deductible in the year incurred or during the five-year period thereafter.

III. CREDIT INCENTIVES

Argentina's tax regime is a system of benefits with the goal of improving production and commercial activity. The government is working to achieve these goals through the promotion of R&D, technology transfer and technical assistance. Financial contributions are also available in the form of tax credits to encourage the aforementioned improvements. The tax credit amount utilized by taxpayers cannot exceed 50 percent of total project costs. Additionally, non-transferable tax credit certificates can offset income tax liabilities. These incentives must be applied for, and although all companies are eligible, small and mid-sized enterprises ("SMEs") are favored. Projects that qualify for the

incentives can be carried out by the company applying for a credit or an investigative institution (public or private) that is contracted for R&D purposes. This tax credit applies to R&D projects, SME technology modernization, technological services for SMEs and financial services with the end goal of technology development counseling units for customers and suppliers.

IV. OPPORTUNITIES

In 2004, Argentina sought to increase production activity in the software industry by introducing several incentives that promoted investment in capital goods and infrastructure. First, companies principally engaged in software activities were allowed a 60 percent tax cut on income and were offered “tax stability.” This means existing levies would not be raised nor would new levies be added for 10 years. Second, a fund was set up to promote the software industry. Third, new restrictions on capital outflows needed for equipment importation were forbidden. Last, software firms were granted the option of turning 70 percent of Social Security contributions into credit certificates.

The Argentinean government also identified vaccine research as an area of concentration. In 2005, the Ministry of Education, Science and Technology introduced a US\$3 million funding program to manufacture vaccines combating tuberculosis, diphtheria and tetanus. The funding was also meant to assist in developing improved vaccine manufacturing. Additionally, the University of Cordoba received funds

Argentina’s tax regime is a system of benefits with the goal of improving production and commercial activity. The government is working to achieve these goals through the promotion of R&D, technology transfer and technical assistance.

to purchase new viral genome research equipment and the National Institute of Human Viral Diseases received economic aid to test a vaccine combating hemorrhagic fever. These boosts to innovation in the vaccine sector promoted the development of successful treatments against local strains of pathogens, and in turn, helped the overall medical industry in Argentina become more prominent.

The National Scientific and Technical Research Council (“CONICET”) and Agency for Science and Technology Promotion further encouraged R&D efforts in Argentina. CONICET signed agreements with many technology-based private companies to pay 50 percent of scientists’ salaries. For more than 10 years, the Agency has helped to finance projects through credits from the Inter-American Developmental Bank.

V. COMMENTARY

Argentina’s tax credits and incentives appear to stimulate innovative efforts across industries. The government and independent agencies in Argentina recognize the importance of concentrating on SMEs and strategic industries for optimal economic development. The government continues to focus on these areas to assist in further developments.

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I. OVERVIEW

The Australian Research and Development (“R&D”) tax incentive was created in 1985. At that time, the credit allowed companies to claim 150 percent of their R&D costs as an expense against taxable income. The R&D Tax Concession operates within the legislative framework of the Income Tax Assessment Act of 1936 and the Industry Research and Development Act of 1986. The responsibility for administration of tax incentives is delegated to the Commissioner of Taxation and Innovation Australia (assisted by AusIndustry). Although the tax office determines whether or not claims are eligible, the Commissioner will not disallow a claim without first seeking input from Innovation Australia. The government believes that innovation and research are key factors for economic growth, so they have been perpetually amending the rule in order to tailor it for the rapidly changing global economy. The most recent guidelines for qualifying R&D activities as set by AusIndustry include:

- A. A technical problem that cannot be resolved on the basis of publicly available information,
- B. An original idea to solve the technical problem,
- C. Systematic experimentation to resolve the technical uncertainty,
- D. Company bears both the technical and financial risks associated with its R&D,
- E. Company has control over R&D projects and effectively owns the results, and
- F. R&D activities benefit the Australian economy and results are exploited on normal commercial terms.

Companies engaging in activities that meet the above specifications are eligible for the country’s tax concession if the company is incorporated in Australia and

has prepared and maintained an R&D plan with contemporaneous documentation. While the majority of R&D work should be conducted in Australia, claims for expenditures incurred overseas can be equal to up to 10 percent of the total project costs. The Australian government has also established a number of direct funding programs that include Commercial Ready, a Pre Seed Fund Program and Commercializing Emerging Technologies program (“COMET”). These programs were created to increase and support R&D in Australia.

II. DEDUCTION INCENTIVES

As of the summer of 2008, the Australian government allows a 125 percent tax deduction. For certain small companies a larger deduction may be available. In order to receive any form of tax relief, companies must register annually with the Industry Research and Development Board (“IRDB”). Applications must be submitted each year within 10 months following the conclusion of the company’s income year. Once registered, companies can take a 125 percent deduction incurred on eligible R&D expenditures, which is equivalent to 7.5 cents on the dollar in post-tax benefit. Companies that increase their R&D

relative to their prior three-year average qualify for the R&D Incremental Tax Concession. This provides an additional 50 percent deduction for a total tax deduction of 175 percent, equal to 22.5 cents on the dollar. A 175 percent International Premium Tax Concession is also available for increases in foreign-owned R&D. Companies incorporated in Australia on behalf of a foreign company grouped with an Australian company qualify for this particular tax concession.

The government believes that innovation and research are key factors for economic growth, so they have been perpetually amending the rule in order to tailor it for the rapidly changing global economy.

III. CREDIT INCENTIVES

Small companies can receive a refundable tax offset in the amount of 30 percent of the company's deductions available under the R&D tax concession. If the tax offset is elected, the company will no longer be eligible to claim R&D deductions in that tax year. For those companies who qualify for the additional 50 percent deduction under the incremental tax concession, this amount can be cashed out under the tax offset instead. Small companies eligible for a tax offset must have an annual turnover of less than AUD 5 million and spend at least AUD 20,000, but no more than AUD 1 million on R&D expenditures within a one year time period. Additional registration is not necessary; companies need only register with the IRDB as usual.

IV. OPPORTUNITIES

Venturoaustralia, the Cutler green paper released by the Australian Federal Government, will be used as the basis of a government white paper due at the end of 2008. This release broadens the government's approach to innovation and moves toward a volume-based tax credit. A two-tiered tax system of a 40 percent credit for companies with turnovers exceeding AUD 50 million and a 50 percent credit for other smaller companies would replace the current 125 percent and 175 percent deductions.

Venturoaustralia also considers the importance and past success of government programs. The COMET program will likely be extended for another five years with a funding increase of at least 25 percent. There is also a proposal to launch the Competitive Innovation Grants Program designed to provide a total of AUD 150 million per year to 200 companies. Those companies with successful projects would be required to repay these grants from royalties or other earnings.

V. COMMENTARY

If Australia replaces their current deduction methodology for R&D with the two-tiered tax credit outlined in Venturoaustralia, their tax based support will follow similar guidelines to that of other modern economies. However, by treating R&D expenditures as non-deductible, the actual rate of support will be reduced to 10 percent for large companies and 20 percent for small companies. These rates are low in comparison to the rest of the Asia Pacific region. As provided by the Australian Senate Report on Business Taxation Reform, the Taxation Institute of Australia (TIA) believed the R&D tax concession of 125 percent deduction at a corporate tax rate of 30 percent was “wholly inadequate” and too low in comparison with competitor countries, such as the U.K. The TIA urges for a 180 percent deduction.

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I. OVERVIEW

The Austrian Research Promotion Agency (“FFG”) is the country’s main promotional agency for applied research and innovation. The FFG was established on September 1, 2004 by the Federal Law Gazette with the main goal of supporting businesses in their Research and Development (“R&D”) and cooperative research efforts. The government decided to merge the Industrial Research Promotion Funds (“FFF”), Technology Impulse Society (“TIG”), Bureau for International Research and Technology Cooperation (“BIT”) and the Austrian Space Agency (“ASA”) in order to create FFG. They are wholly owned by the Austrian government and represented by the Federal Ministry of Transport, Innovation and Technology and the Federal Ministry for Economic Affairs and Labour. In addition to administering tax incentives, the organization offers advice and funding for R&D projects. In order to achieve these objectives, FFG has created various programs and is divided into four individual department programs. These include general programs, structured programs, thematic programs and an aerospace program. General programs are the main source of funding for industry R&D activities. Structural programs are launched to foster cooperation between science and industry and innovation in all regions of Austria. Thematic programs focus on priorities, such as new technology or meeting societal needs that have a strategic impact on the economy. European and International Programs help with consulting needs for Austrian companies conducting research on a global level. Lastly, the Aeronautics and Space Agency (“ALR”) sets the programmatic framework and strategic guidance necessary to solidify Austria’s role in international aerospace endeavors.

Austria’s tax allowance percentage is lower in comparison to other countries offering similar incentives. The current system is nonetheless encouraging R&D to expand across industries.

II. DEDUCTION INCENTIVES

Tax breaks for R&D expenditures were first introduced to Austria under the 1988 Income Tax Act. The 2005 Act Amending Taxes and Charges amended prior provisions and enacted the following four forms of tax relief:

- A. A 25 percent tax allowance for spending on “the development or improvement of inventions of value to the national economy,”
- B. A 25 percent tax allowance for R&D carried on systematically and through the use of scientific methods, as defined by the OECD, that is, “money spent on creative work undertaken on a systematic basis to increase the stock of knowledge and the use of this knowledge to devise new applications,”
- C. A 25 percent tax allowance for research expenditures on contractual research and experimental development, and
- D. Instead of a tax allowance, a research premium of eight percent which can be claimed and is payable in cash for that year.

Stipulations regarding the location of R&D activities are unique in Austria. R&D may be performed outside of the country, as long as the external activities account for an integral part of the taxpayer’s own qualifying R&D.

III. CREDIT INCENTIVES

Austria does not currently offer the R&D credit as an incentive.

IV. OPPORTUNITIES

The Austrian government’s creation of the FFG has been very successful at promoting research, technology, development and innovation. The organization’s various programs have greatly increased funding and awareness for R&D activities. In 2005, Austria invested about €5.8 billion in R&D, with about two-thirds of funding provided by the private sector and the remaining third from

the public sector. Public spending on research infrastructure and promotion amounted to €2.1 billion in 2005, which was a 65 percent increase from the previous 10-year average. Furthermore, the number of companies engaging in R&D rose to about 2,000, a 48 percent increase, in the three year time span between 1999 and 2002. The Austrian government has the opportunity to continue to promote the growth of R&D within their country.

V. COMMENTARY

Austria's tax allowance percentage is lower in comparison to other countries offering similar incentives. The current system is nonetheless encouraging R&D to expand across industries.

I. OVERVIEW

Belgium encourages Research and Development (“R&D”) in a variety of ways. Taxation regulations passed by Parliament focus on foreign executives, scientists, patents and pharmaceutical endeavors. The country’s economy is based primarily on private enterprise, but has recently seen more government intervention due to the global economic crisis. However, government intervention is expected to decline once Belgium begins to see an improvement in their economy. Another noteworthy item is the Belgian government’s encouragement of foreign investments by leaving the realm unrestricted and allowing for free transfer of capital profits in and out of the country. These aspects of the Belgian economy are reflected in the country’s R&D tax incentives.

II. DEDUCTION INCENTIVES

There are several federal and regional tax incentives or subsidies available. The Brussels-Capital region, for instance, offers a tax incentive similar to many other countries. Specifically, the region offers a 50 percent subsidy on the marginal costs incurred for scientific research.

A tax break available for companies in all regions of Belgium was approved by Parliament on April 26, 2007. All Belgian companies and Belgian branches of foreign companies are able to take an 80 percent tax deduction on income generated from new patents. This means patent income will be subject to a 6.8 percent effective tax rate, which is one fifth of the statutory rate.

The patent income deduction can be used in conjunction with the investment deduction, which has existed for quite some time. Belgium’s investment deduction allows for a 15.5 percent tax deduction on the value of a company’s R&D investment (percentage for tax year 2010). A deduction rate of 22.5 percent is available to small companies (defined as having less than 20 employees) opting to apply deductions to the depreciation of R&D assets (percentage for tax year 2010).

III. CREDIT INCENTIVES

Belgium taxpayers have the opportunity to convert certain investment deductions into a tax credit. This would mean that the investment deduction is multiplied by the normal tax rate and credited against a taxpayer's overall tax owed. Taxpayers also have the option to carry-forward the credit to the four following tax years if no taxes were due.

IV. OPPORTUNITIES

Beginning on January 1, 2007, employers in the science and / or research fields (i.e. universities, research facilities, approved companies, etc.) are exempt from paying 50 to 75 percent (2009 tax year rate) withholding tax on remunerations paid to researchers. The government created these exemptions in order to encourage the hiring of such employees and the placing of extra financial resources to grow individual companies in this field. Companies are allowed to keep withholding taxes and those employing researchers can immediately use funds in any way that boosts R&D efforts.

On June 30, 2008, Belgium also began offering tax breaks for pharmaceutical firms. Since then, the tax reductions have been worth more than €47 million per year, with €35 million for R&D efforts. Additional tax breaks offered to companies in the pharmaceutical industry include exemptions for orphan medicinal products for serious and rare diseases, medicines reimbursed at low rates and medicinal products developed from voluntary blood

Although Belgium continues to expand its tax regime, critics argue that these incentives are ineffective. Less than 10 percent of Belgian companies engaged in R&D are benefitting from the incentives intended to help them.

donors. Further tax breaks may be allowed for pharmaceutical companies that choose to shift funds from their marketing budgets to their R&D budgets.

V. COMMENTARY

Although Belgium continues to expand its tax regime, critics argue that these incentives are ineffective. Due to high administrative costs, strict conditions and difficult accessibility for enterprises, less than 10 percent of Belgian companies engaged in R&D are benefitting from the incentives intended to help them. Small firms, who could greatly benefit from R&D tax breaks, are often discouraged from applying for tax incentives because of their low profits and the time delays in collecting the required attestations.

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I. OVERVIEW

Over the last few years, the Brazilian government has introduced a series of tax incentives to encourage Research and Development (“R&D”). The country’s commitment to science and technology has advanced Brazil’s reputation as the most technologically advanced Latin American country in several sectors. For example, the ability to launch space vehicles and manufacture satellites is a clear indicator of Brazil’s status as the Latin American leader in space technology. Technological research is typically conducted by public universities and research institutes, with approximately 73 percent of funding being provided by the government. Brazil is also one of only three Latin American countries with a research center solely focused on physics, chemistry, material science and life sciences. This facility is called the Synchrotron Laboratory and provides a location for scientists to conduct R&D activities.

Another important research sector that Brazil focuses on is technology. The country’s main focus in this sector is the software industry. The government has created a structured set of policies that assist in the promotion of software development. This strong focus and government assistance has made the software sector a main recipient of investments and target for development within Brazil. As of 2005, recent laws for R&D were welcomed and referred to as “Lei do Bem” (“Good Law”).

Brazil offers tax breaks specifically to organizations in the information technology (“IT”) industry to encourage both investment and development within the software sector.

II. DEDUCTION INCENTIVES

In 2007, national taxation was updated through the elimination, maintenance or change of existing incentives.

Modifications were made to the existing “Multiple Deduction” via article 19-A, which resulted in the creation of a law that offers a 160 percent deduction of expenditures for companies conducting R&D, in relation to automation and information technology activities. To qualify, innovations must be conducted by one of the following parties:

- A. A taxpayer,
- B. Hired national research institution, individual or university, or
- C. Hired research legal entity

This deduction amount can rise to 180 percent, depending on the number of employed researchers in accordance to the rules set forth in the legislation. Additionally, a 20 percent deduction is available to companies whose efforts result in a patent or cultivar. This multiple deduction regime is limited to taxes in the fiscal year, without the option of a carry-forward. However, companies engaged solely in R&D activity can carry over expenses in accordance to the “Innovation Companies” policy.

Another deduction incentive offered by the Brazilian government is Article 18. This article offers a benefit that provides for the hiring and payment of small companies to be excluded from income when used for technology R&D purposes. Regardless of whether or not intra-company or external hire activity are involved, the value for R&D expenditures can be deducted from the agent company's tax basis. This means that theoretically, the agent company is not incurring income with a taxable basis.

III. CREDIT INCENTIVES

Brazil does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

Brazil offers tax breaks specifically to organizations in the information technology (“IT”) industry to encourage both investment and development within the software sector. Incentives available to the software sector include a reduction in the industrial products tax payable in equipment or supplies purchased for IT software and services development. IT companies also receive a deduction on income tax due for expenditures relating to R&D activities. Furthermore, fourteen sector funds have been created since 2000. These funds are worth about R\$846 million, and provide stable public R&D cash flow, and are mostly disbursed in the form of grants which carry particular objectives, recipients and durations.

V. COMMENTARY

Although considered a developing nation, Brazil offers tax deductions similar to those offered by developed countries. The government’s introduction of R&D tax incentives demonstrates the nation’s commitment to innovation in the market. While the Brazilian economy has a concentrated focus on IT, there are many other industries with innovation that do not have focused R&D tax deductions.

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I. OVERVIEW

Beginning in 1983, the Canadian Revenue Agency (“CRA”) and Department of Finance have administered and governed a scientific research and experimental development credit (“SR&ED”). The credit is an incentive offered to Canadian taxpayers each year and has become one of Canada’s largest corporate incentives. The CRA receives tens of thousands of claims for billions of dollars each year. The SR&ED incentive boasts an ongoing legislative credit program that assists in stimulating the Canadian business economy. Currently, the Canadian government is working to ensure that the credit allows for the growth of Canadian businesses in the most efficient way possible. The government focuses on incentivizing their private business sector to continue conducting innovative research with the aim to keep Canada at the forefront of scientific and technological research worldwide. The government believes that the SR&ED credit extends far beyond the individual businesses into many other sectors of the Canadian business market.

At the onset of the SR&ED program, qualified activities were preapproved and money was provided to the taxpayer up front. Initially, there was no filing deadline for taxpayers. Claims could be filed as long as the requirements outlined in IC 75-7R3 were met (i.e., seven-year filing period). The pay up front method caused many problems due to the volatile nature of research activities. Once taxpayers began conducting the activities, they often needed to update their claims to accurately document actual activities that took place. This proved to be an incredible amount of work for the CRA. Starting in 1994, the Department of Finance started an 18-month requirement on SR&ED claims. At that time, many taxpayers began rushing to put in claims before the law went into effect causing a backlog of claims.

In 1997, the CRA and Department of Finance determined that they needed to improve the program and the way credits were audited. They then worked to

put a more efficient system into place. This included: hiring national technology sector specialists, hosting public information seminars, providing first-time claimant services, providing pre-claim project review services, providing account executive service, creating more detailed application policies, building CRA and SR&ED websites, holding SR&ED Partnership Committee meetings, writing mandated timeframes requiring the CRA to prioritize SR&ED claims and creating a revised T661 filing form (effective June 30, 2003 and further revised in 2008). While the CRA and Department of Finance continuously work to improve the credit and their SR&ED audit procedures, today the credit is allowing many businesses to continue their innovative research.

Eligible Activities

Taxpayers may claim eligible activities based on legislation written by the Department of Finance. Eligible activities must include systematic investigation or research carried out in a scientific or technological field by means of experiment or analysis. The three main categories of eligible activities include basic research, applied research and experimental development research.

The CRA has three main criteria that a company's activities must meet to be considered SR&ED: scientific

or technological advancement, scientific or technological uncertainty, and scientific and technical content.

The scientific or technological advancement test determines if the activities advance the understanding of scientific relations or technologies. The scientific or technological uncertainty test ascertains if the activities' results, or the way in which results are

Canada boasts a rich R&D talent pool which, supported by the SR&ED program, makes Canada an attractive place to locate R&D activities for CCPCs and non-CCPCs alike.

achieved, result in findings that would be unknown or indeterminable if relying on generally available scientific or technological knowledge / experience. The scientific and technical content test decides if there is sufficient evidence that qualified personnel, with relevant experience in science, technology or engineering, has performed a systematic investigation through experimentation and / or analysis.

Eligible Expenditures

Taxpayers may claim eligible expenditure based on legislation written by the Department of Finance. Expenditures that are eligible for the claim include the salaries or wages of employees engaged in SR&ED, the cost of materials utilized in SR&ED and expenses associated with contracts to perform SR&ED. Taxpayers also have the ability to include overhead expenditures in one of two ways. Under the first or most traditional method, expenditure amounts are eligible for both tax credits and deductions. The second or proxy method allows taxpayers to calculate a notional amount of their overhead expenses. The calculated amount is then eligible for the tax credit.

II. DEDUCTION INCENTIVES

The SR&ED income tax deduction allows immediate expensing of 100 percent of allowable expenditures. This includes capital assets, with exception to land and buildings, in the year of purchase.

III. CREDIT INCENTIVES

The Canadian tax credit is applied to income taxes otherwise payable. The amount of the credit is determined by taking 20 percent of the total qualified expenditures in that year. Unused credits can be carried forward 20 years and back three years in order to be partially or fully refundable.

For qualified Canadian Controlled Private Corporations (“CCPC”), the credit is 35 percent for all qualified expenditures up to three million dollars, and 20 percent for all expenditures over three million dollars. Tax credits earned on current expenditures are fully refundable, and tax credits earned on capital expenditures are 40 percent refundable.

The federal SR&ED tax credits may be summarized as follows:

Type of Entity	Nature of Expenditure	ITC Rate	Refund Rate	ITC Rate	Refund Rate
		on Total Expenditures up to Expenditure Limit		on Total Expenditures in Excess of Expenditure Limit	
Qualifying CCCPs	Current	35%	100%	20%	40%
Qualifying CCCPs	Capital	35%	40%	20%	40%
Other Corporations	Current and Capital	20%	–	20%	–
Individuals and Unincorporated Businesses	Current and Capital	20%	40%	20%	40%

In addition to these federal SR&ED tax credits, R&D tax credits are also available in most Canadian provinces and territories, and are applicable to reduce provincial / territorial income tax otherwise payable or, in many cases, refundable. Provincial / territorial credits are summarized below:

Province	Rate	Description
British Columbia	10%	Refundable and non-refundable tax credit for eligible expenditures incurred in B.C. after August 31, 1999 and before September 1, 2014, by a corporation with a permanent establishment ("PE") in the province.
Alberta	10%	Refundable tax credit for eligible expenditures incurred in Alberta after December 31, 2008 by a corporation with a PE in the province.
Saskatchewan	15%	Non-refundable tax credit for eligible expenditures incurred in Saskatchewan by a corporation with a PE in the province.
Manitoba	20%	Non-refundable tax credit for eligible expenditures incurred in Manitoba by a corporation with a PE in the province.
Ontario <i>Innovation Tax Credit (OITC)</i>	10%	Refundable tax credit for eligible expenditures incurred in Ontario by a corporation with a PE in the province.
Ontario <i>Business-Research Institute Tax Credit (OBRI)</i>	10%	Refundable tax credit for eligible expenditures incurred in Ontario by a corporation with a PE in the province as part of an eligible research institute contract.
Quebec <i>R&D Wage Tax Credit</i>	20%	Refundable tax credit for R&D wages of a corporation that carries on business in Canada and performs R&D in Quebec, or has such work carried out in their behalf in Quebec. The corporation no longer needs to have a PE in Quebec. This credit is also available for 50% of amounts paid to an unrelated subcontractor for R&D performed by employees in Quebec and for 100% of amounts attributed to wages paid to employees of a related subcontractor in Quebec.

Province	Rate	Description
Quebec <i>Credit for contract payments to / for R&D entities and projects</i>	CCPC - 37.5% Others - 17.5%	Refundable tax credit for contract and other payments to certain eligible entities (only 80% of payments to unrelated persons are eligible).
New Brunswick (N.B.)	35%	Refundable tax credit for eligible expenditures incurred in N.B. by a corporation with a PE in the province.
Nova Scotia	15%	Refundable tax credit for eligible expenditures incurred in N.S. by a corporation with a PE in the province.
Manitoba	20%	Non-refundable tax credit for eligible expenditures incurred in Manitoba by a corporation with a PE in the province.
Newfoundland	15%	Refundable tax credit for eligible expenditures incurred in Newfoundland by a corporation with a PE in the province.
Yukon	15%	Refundable tax credit for eligible expenditures incurred in the Yukon by a corporation with a PE in the Yukon or an individual who was resident in the Yukon on the last day of the taxation year in which the credit is claimed. General rate is 15% with a 20% rate for expenditures paid to Yukon College.

IV. OPPORTUNITIES

An enhanced refundable credit rate of 35 percent is available to CCPCs on their first three million dollars of expenditures. When combined with provincial tax credits (in particular, those that are refundable), Canadian R&D tax incentives are among the most generous in the world, provide important non-dilutive financing for R&D activities and allow CCPCs to grow. Canada boasts a rich R&D talent pool which, supported by the SR&ED program, makes Canada an attractive place to locate R&D activities for CCPCs and non-CCPCs alike.

V. COMMENTARY

While the CRA and the Department of Finance have worked for years to create one of the most notable research credits in the world, the country still has several areas that need improvement. The government is working to create a smoother auditing guideline for their government auditors. Claimants are reporting that the audits are getting more and more difficult to handle and that CRA auditors are ignoring many written government policies. The government is committing much effort and time to correct these issues. They are also continuing to work with first-time claimants in order to make the process as easy as possible. Additionally, there are many legal and factual criteria that

While the CRA and the Department of Finance have worked for years to create one of the most notable research credits in the world, the country still has several areas that need improvement.

companies must comply with in order to meet CCPC status when trying to take advantage of refundable SR&ED credits. These criteria might keep some companies from choosing to qualify for the status. Even with the strenuous criteria for CCPCs and ever growing auditing problems, Canada will most likely continue to be at the forefront of R&D tax incentives.

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I. OVERVIEW

Chile has not had a strong Research and Development (“R&D”) history due to past problems surrounding intellectual property rights. However, interest in R&D is on the rise with about 0.7 percent of Gross Domestic Product (“GDP”) spent on R&D efforts as of 2007 / 2008. One third of this spending was carried out out by the private sector. The Chilean government hopes to continue increasing R&D initiatives and enacted a new law in 2008 to facilitate this goal. Chile aims to increase technology spending in order to advance from an economy reliant on exploiting natural resources to an economy centered on human capital and innovation. Additionally, the government formed a Council on Innovation and Competition to promote new sectors and industries.

II. DEDUCTION INCENTIVES

A tax deduction is allowed for R&D expenditures for the spending amount in full or amortized amounts over six consecutive years. R&D expenses must relate to scientific and technological research for the taxpayer’s benefit. If the expense is not necessary for gross income in the taxable year deducted, it will still be deductible.

III. CREDIT INCENTIVES

In January 2008, the government introduced a tax bill aimed at increasing R&D incentives, specifically for private companies, universities and research centers. In accordance to Law 20.241, companies can use 35 percent of R&D costs incurred as a result of the joint efforts between private companies and accredited institutions as a credit against corporate tax. Contractual agreements between the entities must exist and certify that the money will be spent on R&D within the institution’s realm of expertise. Funds in excess of this 35 percent credit amount will be deemed as necessary spending to produce income and,

thus, deductible from the taxable basis of the corporation. This credit incentive is the equivalent of a state contribution equal to 46 pesos out of every 100 pesos on qualified spending, making it a significant tax advancement. While helpful, the credit does have a ceiling equivalent of 15 percent of the company's annual gross revenue or equivalent to 5,000 monthly tax units.

IV. OPPORTUNITIES

In 2008, the Chilean government invested US\$100 million in innovative projects. These resources were intended for the country's five strategic sectors—aquaculture, software development for international markets, tourism, mining and fruits / processed foods. Also, Innova Chile agreed to promote networks for financing original ideas and assisting start-up companies on projects with an international focus. Aside from the emphasis on particular industries, particular businesses have particular attention from the government of Chile. Small and medium-sized enterprises (“SMEs”) benefit from five new support centers. These centers help SMEs acquire, adopt and adapt useful technologies. They generally focus on introducing new information technology (“IT”) and improving the efficiency of current IT.

The Chilean Economic Development Agency (“CORFO”) also introduced an incentive program in 2000 for high-technology, IT and biotechnology projects. These investments must be valued at a minimum of US\$1 million. The CORFO program includes incentives such as: co-funding pre-investment studies (feasibility studies and analysis), co-funding start-up and fixed asset expenses, grants for

Chile aims to increase technology spending in order to advance from an economy reliant on exploiting natural resources to an economy centered on human capital and innovation.

a year of employee training and co-funding of R&D spending. Additionally, Chile's government provides incentives such as grants, reimbursements, exemptions and tax rebates for businesses located in areas designated with having their own sets of investor eligibility, project eligibility and incentives. These identified areas are remote and have experienced industrial decline, or are foreseen as places of growth for new sectors, such as high-technology.

V. COMMENTARY

Chile has identified the need to increase R&D efforts within the nation. Part of the reason innovation in Chile has not flourished is due to the country's record of weak intellectual rights protection. The government is hoping to further focus on strengthening intellectual property protection and continue its efforts to incentivize particular industries and SMEs.

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I. OVERVIEW

China is an important hub for international Research and Development (“R&D”) efforts. The Chinese labor force provides an ideal employee base for R&D activities because skilled work is readily available at a low cost. For example, the high number of talented engineers in Beijing has attracted some of the world’s largest companies to establish R&D facilities in this metropolis. China also has a long-term development policy in science and technology that aims to enhance the technological capabilities of companies. From 1996 to 2000 alone, China granted about 250,000 patents to both domestic and overseas entities. The country also seeks to target emerging technologies and invest in advanced materials, microelectronics, biotechnology, information technology, industrial automation and energy. To achieve these goals, the government encourages international R&D alliances and foreign-owned R&D centers through policies such as duty-free import on certain equipment for foreign R&D centers.

II. DEDUCTION INCENTIVES

Enterprises engaged in the development of new products, technologies or techniques can deduct both:

- A. R&D expenses not specifically allocated to the creation of an intangible asset, and
- B. An additional 50 percent of these expenses as a current expense.

If R&D expenditures have been allocated to a particular intangible asset, its cost can be amortized from a 150 percent basis of these expenses. The amortization period may not be shorter than 10 years.

III. CREDIT INCENTIVES

China does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

In 2003, China introduced new tax incentives to the high-tech industry. Software companies can be eligible for a two-year tax holiday exemption followed by a 50 percent reduction of the enterprise income tax rate (“EIT”—25 percent). This incentive commences during the enterprise’s first profit-making year. To qualify, a company must meet the following key requirements:

- A. Have more than one self-developed software product or own the copyright thereof, or provide technical services such as computer information system integration that has passed qualification and grade certification,
- B. Have a development fund for software technique and products that do not exceed eight percent of the enterprise’s annual software income,
- C. Have an annual sales income of software that is over 35 percent of the total annual income of the enterprise, with the income of self-developed software amounting to over 50 percent of the software sales income, and
- D. Have a proportion of technical staff in the work of software development and technical service shall not be lower than 50 percent of the total staff.

Furthermore, if an entity meets the following criteria, they can be considered a “key software enterprise” and receive additional incentives:

Although incentives tailored to the technology industry are in place to aid these entities, the incentives are difficult to secure in practice.

- A. Annual software sales exceeding RMB 100 million,
- B. Annual export volume exceeding US\$500,000, with software amounting to more than 50 percent of the annual revenues, or
- C. Annual export volume of software amounting to over 70 percent of the annual revenue.

Key software enterprises, if not otherwise eligible for EIT exemption at the end of year, shall pay standard EIT at a lowered rate of 10 percent.

Software developers can also benefit from a value added tax (“VAT”). Entities developing and selling internally designed software or importing such software into China for localized reconstruction and sales can receive a refund on the part with the actual VAT burdens exceeding three percent. Localized reconstruction is defined as the redesign, enhancement and alteration made to imported software. These criteria must be met because resale of imported software only after conversion to Chinese characters will not qualify.

V. COMMENTARY

Although incentives tailored to the technology industry are in place to aid these entities, the incentives are difficult to secure in practice. Companies frequently face practical difficulties such as overlaps and / or conflicts between jurisdiction of government branches and business models used by the companies.

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I. OVERVIEW

Over the last 15 years, Colombia has transitioned from a highly regulated economy to a free market economy. While both personal and corporate tax rates are some of the highest in Latin America (up to 33 percent), the country has continued to grow. During this growth, the Colombian government has recognized the importance of Research and Development (“R&D”) in strategic industries, such as agriculture, and has implemented tax incentives to encourage innovative activities.

II. DEDUCTION INCENTIVES

In general, Colombian tax law provides that businesses may deduct ordinary and necessary business expenses from their gross tax base to arrive at a net tax base amount. Business expenses allowed as deductions must be necessary for carrying out the business, reasonable, have a causal relationship with income generating activities, incurred and accrued in that tax year, and supported by proper documentation. The necessity and the reasonability of the expenses are determined based on commercial criteria, which also takes into consideration the usual spending that is associated with income producing activity, depending on the taxpayer.

Although Colombia does not currently offer a strong R&D incentive, the government is steadily increasing support towards R&D activities.

More specifically, organizational expenses must be capitalized and amortized for tax purposes over five years using straight-line or declining balance methods. Organization expenses include installation, R&D, organizational activities, and acquisitions and explorations in the fields of oil, gas and mining. The five-year amortization

period may be shortened considering the nature and duration of businesses in which the investments are made.

In regards to costs of acquisition, exploration and exploitation of non-renewable natural resources, the amortization for tax purposes must be made in a term of at least five years, using the units of production method or the straight-line method. If the investments in exploration are unsuccessful, the amortization must be made in the year in which such activity was deemed unsuccessful and in any other cases within the following next two years.

In the cases in which the taxpayer is obliged to transfer assets at the end of a contract such as BOT, BOOT and concession contracts, the amortization must be made during the term of the contract using straight-line or declining balance methods.

III. CREDIT INCENTIVES

Taxpayers that invest in reforestation areas are entitled to credit an amount equivalent of up to 30 percent of such investments, as certified by the competent environmental authority. The credit may not exceed 20 percent of the income tax of the relevant year.

The VAT paid on the importation of heavy machinery for basic industries (mining, oil and gas, heavy chemistry, siderurgy, extractive metallurgy, power generation, power transmission) may be credited for the payment of the income tax of the importer.

IV. OPPORTUNITIES

Colombian tax law allows for incentives pertaining to specific industries or developing areas.

Colombian tax law also allows the deduction of 40 percent of all investments made in tangible fixed assets directly used in income producing activities. The assets acquired from local related parties do not grant the right to this deduction. The depreciation of these assets must be made, for tax purposes, using the straight-line method.

Individuals and legal entities that make investments in new reforestation plantations, coconut, oil-producing palms, rubber, olive, cacao, fruit trees, irrigation works and draining, deep wells and silos for treatment and primary benefit of agricultural products, will be entitled to deduct on an annual basis from their income the amount of such investments.

Legal entities that make investments in scientific or technological investigations, either directly or through investigation centers, technical development centers, universities approved by the Colombian government or other entities determined by the Colombian government, are entitled to deduct annually an amount equivalent to 125 percent of their investments. In order to benefit from the deduction, the National Council of Science and Technology must previously approve the research project. The yearly deduction cannot exceed 20 percent of the net taxable income of the taxpayer before deducting these investments.

Legal entities that make investments in initiatives towards environmental control and improvement are entitled to deduct those investments on an annual basis. The deduction in this case may not exceed 20 percent of the net taxable income of the taxpayer before deducting these investments.

Finally, under certain terms and conditions, the following activities are exempt from income tax:

- ❖ Sale of wind energy and biomass or agricultural waste energy
- ❖ Hotel services rendered in new and rebuilt hotels
- ❖ Ecotourism

- ❁ Forestry
- ❁ Hydrocarbon seismic services
- ❁ Software development
- ❁ Development of new medicine products

Additionally, Colombian law establishes a free trade zone regime for the development of certain industrial and services activities that allow the reduction of the corporate income tax rate from 15 to 33 percent.

V. COMMENTARY

Although Colombia does not currently offer a strong R&D incentive, the government is steadily increasing support towards R&D activities. The tax code highlights particular fields as areas of strategic importance and incentivizes activities in these fields. As the Colombian tax code continues to expand, R&D credits and other tax opportunities could be added to reach all industries conducting R&D and further promote such activities.

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I. OVERVIEW

Cyprus greatly encourages foreign investment and strives to be a European Research and Development (“R&D”) leader. The country appeals to foreign investors because of its strategic geographical location as an export gateway, EU membership, stable macro-economy and banking sector, modernized legal and financial systems, strong telecommunications, educated workforce and low tax rates. The tax rate in Cyprus is 10 percent, one of the lowest in the European Union. While financial services and tourism are two major components of the economy, Cyprus also boasts one of the fastest growing high-tech industries in southeast Europe. The government hopes that Cyprus will attract foreign investment to bolster R&D efforts in these fields as well as others. The country’s tax regime is gradually changing to include more R&D friendly legislation to support and develop existing industries and strengthen the skill base of the country as a whole.

II. DEDUCTION INCENTIVES

Cyprus does not currently offer any deduction incentives.

III. CREDIT INCENTIVES

Cyprus does not currently offer the R&D credit as an incentive.

The high-tech industry in Cyprus is flourishing with a large number of projects in the information technology (“IT”) and IT service industries.

IV. OPPORTUNITIES

The country’s tax regime includes investment incentives, such as allowances. More specifically, grant scheme measures (especially in the industrial sector) have been introduced by the government to attract foreign investments, increase productivity and restructure the manufacturing industry.

The high-tech industry in Cyprus is flourishing with a large number of projects in the information technology (“IT”) and IT service industries. IT and related industries continue to grow due to foreign and domestic investment. Aside from these sectors, the government also hopes to grow the medical and biotech research fields. One step taken by the government toward making Cyprus a R&D leader was the joint project with the Harvard School of Public Health. This partnership is seen to further international research, education and technology for the betterment of environment and public health. The project aims to attract talent in the areas of science and technology. Accordingly, this project led to the establishment of the Cyprus International Institute for the Environment and Public Health and the Harvard School of Public Health—Cyprus Program, located in Nicosia and Boston respectively. A research foundation and technology incubation program have been established for the purposes of support framework and financial assistance; these resources are available to businesses seeking involvement in the medical and biotech research industries.

V. COMMENTARY

If Cyprus hopes to become an R&D center, the government will have to expand incentive opportunities to further encourage innovation. The country’s tax rate is already low, so tax deductions and credits may not be seen as effective as in countries with higher rates, but such incentives could still be incorporated. Additionally, other opportunities for financial assistance could be explored and expanded to include a wider range of industries.

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I. OVERVIEW

During the late 1990s, Denmark experienced a rise in Research and Development (“R&D”) expenditures due to an increase in private investment. Recently, the private sector has lost much of the impact that they once had on the country’s R&D expenditures. However, R&D in Denmark is expected to remain stable because the country is planning to fulfill the Barcelona Agreement, which states that all European Union (“EU”) members should spend at least three percent of their gross domestic product (“GDP”) on R&D efforts by 2010. Many councils and foundations are in place in Denmark to help fund and encourage R&D so that the country is able to fulfill its agreement and increase innovation.

II. DEDUCTION INCENTIVES

Denmark offers R&D tax deduction incentives to encourage innovation. and corporations engaging in R&D have two deduction options. They can either deduct the full amount of expenditures in the year in which they are incurred or amortize these costs over a four year period. As a general rule, costs incurred prior to the business opening or starting cannot be deducted until the business formally opens or begins. However, the Tax Authorities can, on request, put in place an exemption in order to deduct costs that are incurred prior to the business start.

Such an exemption is not easily obtained.

Likewise, expenses related to the exploration of raw materials are deductible. A deduction of 50 percent can be claimed if expenditures relate to a research project in which the taxpayer collaborated with a public research institution. This deduction may not exceed DKK five million, and the project must be pre-approved by a public research body.

While furthering incentives for innovation within the private sector may help Denmark fulfill the Barcelona Agreement, the country must continue to encourage R&D in all sectors.

A public research body must also approve projects eligible for the 25 percent deduction. Entities participating in certain foreign European R&D projects can qualify for an allowance of 25 percent of R&D expenditures. Qualifying projects include:

- A. A common European research project (EUREKA), Esprit, Brite or Race,
- B. Programs under the Northern Industrial Foundation,
- C. EU programs for common activities in the area of research and technology development, and
- D. EU energy research program (THERMIE).

III. CREDIT INCENTIVES

Denmark does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

The 25 percent allowance mentioned above is an opportunity for Denmark to participate with other members of the EU in R&D efforts. This allowance encourages R&D work on EU projects and helps a number of countries come together for the purpose of innovation. The choice of deducting all of the costs in one year or amortizing them over five years gives companies an additional opportunity to spread the deduction over years in which they are manufacturing innovative new products.

V. COMMENTARY

While furthering incentives for innovation within the private sector may help Denmark fulfill the Barcelona Agreement, the country must continue to encourage R&D in all sectors. The three percent of GDP goal in the Barcelona is only a beginning for EU countries.

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I. OVERVIEW

The Finnish government believes that an important factor in economic success is an efficient innovation system that generates new knowledge and capabilities. The Science and Technology Policy Council plays a vital role in developing the country's innovation system. Finland encourages Research and Development ("R&D") efforts and ranks second among countries in the Organization for Co-Operation and Development ("OECD") in terms of R&D as a percentage of the gross domestic product ("GDP"). Although R&D efforts are continually progressing in Finland, expenditure increases and decreases can vary greatly from year to year. In 2003, R&D spending totaled five billion euro due to increased endeavors in the electronics industry. Although a decrease in activity in this industry caused a slight drop in R&D in 2004, R&D spending was on the rise again in 2005.

II. DEDUCTION INCENTIVES

The allocation and deductibility of R&D expenses is more favorable than the general expense allocation rule. In general, expenses which generate or maintain income over a period of at least three years are allocated equally to the years in question up to a maximum period of 10 years. However, expenses incurred by R&D efforts (except for the acquisitions of research buildings) may, at the taxpayer's discretion, be either deducted in the year in which the obligation to pay them arises, or depreciated over two or more years regardless of the period of effect. The maximum depreciation rate in taxation for buildings or constructions, or parts of building or constructions, used exclusively for Research and Development is 20 percent (compared to four percent, e.g., warehouses or factories, or seven percent, for e.g., residential and office buildings).

III. CREDIT INCENTIVES

Finland does not currently offer the R&D credit as an incentive.

IV. OPPORTUNITIES

Finland encourages the cooperation among users, companies, research institutions, universities and public institutions by providing direct government support through funding. The country focuses on knowledge-intensive industries and technologies such as forestry, chemicals, metals, information technology, biotechnology and environmental technology. Innovation in these industries is encouraged in both the public and private sectors. Beginning in 2006, the Finnish Funding Agency for Technology and Innovation (Tekes) worked to form five strategic centers to ease collaboration among companies, universities, research organizations and funding resources. The agency provides funding for R&D and allows companies to utilize their centers while carrying out research.

While several proposals have been made to introduce some form of tax incentive for innovation, the present method of direct support aimed at companies has been effective as a supplement, rather than a substitute, to a company's own R&D funding.

V. COMMENTARY

The Finnish government does not currently provide R&D support through taxation. While several proposals have been made to introduce some form of tax incentive for innovation, the present method of direct support aimed at companies has been effective as a supplement, rather than a substitute, to a company's own R&D funding. Another challenge faced by the Finnish government is how to pursue extensive and diverse areas of innovation while leading global developments in core

areas. Finland also struggles to encourage growing companies in their R&D efforts. It is often difficult for growth-oriented, competence-based start-up companies to secure an amount of funding that would allow them to grow and succeed in the economy.

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I. OVERVIEW

France views government support of Research and Development (“R&D”) as a way to keep large companies based in France and encourage the growth of small and mid-sized enterprises (“SMEs”). The French R&D tax credit “Crédit d’Impôt Recherche” was first introduced in the 1980s and is continuously updated to accommodate the current needs of all industries and companies of all sizes. In 2008, total French R&D expenditures amounted to 2.1 percent of the gross domestic product (“GDP”). The country is committed to achieving an R&D spending level of three percent of GDP by 2010. This goal is in

France views government support of Research & Development (“R&D”) as a way to keep large companies based in France and encourage the growth of small and mid-sized enterprises (“SMEs”). The French R&D tax credit “Crédit d’Impôt Recherche” is continuously updated to accommodate the current needs of all industries and companies of all sizes.

accordance with the European Union’s Lisbon Strategy for a knowledge-based economy, and the Barcelona Agreement of committing at least three percent to R&D initiatives to GDP. Notably ambitious efforts surrounding the R&D strategy began in 2006. The Research and Innovation Bill was adopted in April of that year to encourage synergies between science and industry and instill strategic direction. The following year, in 2007, a High Council for Science and Technology and a National Research Agency were created to increase and consolidate the competition in R&D endeavors. French companies can seek R&D incentives through international programs, specific programs within the private sector and national research

opportunities emphasizing health, biotech, resource management, information technology, communications and space.

II. DEDUCTION INCENTIVES

France does not currently offer any deduction incentives.

III. CREDIT INCENTIVES

The R&D tax credit is an area of focus for the 2008 budget bill in France. Many new reforms will be made and improvements from prior years will continue to be updated. The French tax credit also includes manpower and equipment dedicated to in-house R&D, subcontracted research activities, technological surveillance, patent filing and patent protection as eligible expenditures.

Beginning January 1, 2008, the R&D tax credit has been assessed exclusively on the basis of the volume of R&D declared by companies (elimination of the right to allocate part of the credit based on the increase in R&D expenditure as compared to former “part en accroissement” and the maximum limit on expenditure of €16 million): 30 percent of R&D expenses for an initial bracket of up to €100 million, and five percent of the R&D expenses over and above this threshold.

Moreover, companies may ask the tax administration or the Ministry of Research whether its research project is eligible for the research tax credit (known as the “rescrit fiscal” procedure). If no reply is received within a period of three months, the tax administration cannot call into question the research tax credit calculated by the company. Furthermore, companies have the possibility to request an audit with regard to the allocation of R&D expenditure in order to secure the research tax credit.

IV. OPPORTUNITIES

The research tax credit is offset against the amount of corporate income tax to be paid, or otherwise it is refunded to the new companies, Young Innovative Companies (“YICs”), young university enterprises and small and middle-sized growth companies (“SME”). The receivable may be assigned to a credit institution.

In particular, France offers additional support to the companies benefit from the R&D tax credit for the first time by providing an introductory bonus. This opportunity is a one-time 50 percent tax credit on qualifying expenses for the first business year and a 40 percent tax credit for the second year.

Moreover, non-public companies that have been in business for eight years or less and invest at least 15 percent in R&D are considered “Young Innovative Companies” (“YICs”). These companies are exempt from the social costs of employees performing R&D. Employees can include researchers, technicians, patent attorneys, people working in testing and managers up to the CEO level. YICs do not have to pay corporate income tax for their first three years of business and only pay half of the standard taxes for the following two years (not to exceed €100,000). YICs may also be entitled to local tax relief on the values of properties.

Furthermore, the French Recovery Plan (rectified finance law for 2008) provides for an exceptional measure whereby, as from January 2, 2009, *all companies* may obtain immediately on request the following: the refunds of the 2005 to 2007 on outstanding R&D and the refund of the estimated 2008 tax credits for the part exceeding than the estimated corporate tax.

V. COMMENTARY

The French R&D tax incentive system is complicated and part of it is difficult to understand. However, reforms are underway for simplification.

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I. OVERVIEW

Germany continues to maintain one of the largest populations, and consistently ranks as one of the highest producers in regards to gross domestic product (“GDP”) within the European Union (“EU”). In turn, the country has become an important international location for Research and Development (“R&D”) activities. While all 27 member states of the EU have agreed to attempt to achieve the goal of R&D expenditures of three percent of their future GDP, Germany has well exceeded this requirement. Germany’s market size, combined with its abundant skilled work force and strong reputation in efficiency has helped the country reach the forefront of innovation in several industries. Although Germany maintains the highest level of R&D expenditures in the motor industry, the country also has a strong R&D showing in the medical, environmental, information technology, climate protection and biotechnology fields. These industries benefit from the highest governmental incentives. The country, however, no longer offers tax credits, which were abolished in the mid 1990s. Germany has instead chosen to foster innovation through incentives such as grants and deductions.

II. DEDUCTION INCENTIVES

According to German Income Tax Law, all current R&D expenditures are fully deductible from taxable income. This will probably come into dispute with the passing of German financial accounting legislation in 2009 (*Bilanzmodernisierungsgesetz*). Acquired know-how has to be accounted for as depreciable asset. For tax purposes, no declining balance depreciation can be taken. Only straight-line rates are allowed and the magnitude of the straight-line depreciation depends on the remaining lifetime of the acquired know-how.

III. CREDIT INCENTIVES

As outlined above Germany, at present does not offer an R&D credit as an incentive, but negotiations are currently taking place for its reintroduction.

IV. OPPORTUNITIES

The German government encourages R&D initiatives through the dispersal of grants. The country follows a “High Tech Strategy,” which is comprised of a series of programs and initiatives aimed to allocate about €17 billion to research and technology by 2009 (see above—€2,200 billion x 0.77 percent). Focused areas of innovation are medical, environmental, information technology, climate protection and biotechnology. For example, the “Medical Devices Action Plan” creates incentive programs with a focus on intelligent implants, rehabilitation methods, imaging and regenerative medicines. Incentives from the “Medical Devices Action Plan” and its parent plan “High Tech Strategy” encourage enterprises through R&D and investment incentives.

Funding is provided to companies through grants. These grants usually cover up to half of all costs related to an R&D project. Larger grants may be available for companies in the new member states of Germany or small and mid-sized enterprises (“SMEs”) R&D grants may also be available on regional levels. All 16 states in Germany have grants usually targeted at SMEs. These grants typically cover a maximum

Both German industries and government are engaged in extensive R&D efforts and these activities are currently encouraged almost solely through high tech strategy, incentivizing innovation through grants and deduction of self-incurred R&D expenses.

of 80 percent of project costs and do not always require collaboration between the project research institute and the company. Another option for incentivizing R&D is an R&D loan or guarantee. German government programs provide R&D loans that are usually not field specific, do not have application deadlines and may cover more costly projects. Each state also has its own R&D loan program to help SMEs jumpstart their R&D efforts. At present, it is absolutely unclear whether the actual economic crisis will affect governmental efforts to further support R&D projects.

V. COMMENTARY

Germany's main pitfall is the lack of R&D tax credit incentives; this may change in the future. Both German industries and government are engaged in extensive R&D efforts and these activities are currently encouraged almost solely through high tech strategy, incentivizing innovation through grants and deduction of self-incurred R&D expenses.

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I. OVERVIEW

The major components of the Greek economy are tourism, shipping and services. The government continues to strengthen and expand the economy as a whole, through general-purpose development incentive laws. Tax incentives are in place to encourage Research and Development (“R&D”) and counteract high corporate tax rates in Greece. The currently applicable corporate income tax rate is 25 percent. A five percent cut is expected over five years, with a one percent decrease planned for 2010 and each year onwards until 2014.

II. DEDUCTION INCENTIVES

R&D expenses are fully deductible from taxable income, within the year during which they are incurred or, if they relate to fixed equipment, in equal installments over three years. This is subject to general deduction prerequisites defined in the law. Moreover, an additional tax deduction of amounts equal to 50 percent of R&D expenses incurred up to December 31, 2008, is granted under prerequisites. It remains to be seen whether such additional deductions shall be extended so as to cover R&D expenses incurred as of December 31, 2008 and onwards.

III. CREDIT INCENTIVES

Greece does not currently offer an R&D credit as an incentive.

Tax incentives are in place to encourage Research and Development (“R&D”) and counteract high corporate tax rates in Greece.

IV. OPPORTUNITIES

Investment incentives are outlined in Law 3299 / 2004. Incentives consist of (i) state grants to cover part of the cost of an investment plan; (ii) subsidies

equal to all or part of the installments paid on financial leasing contracts for the acquisition of new machinery and other equipment; (iii) tax allowances, namely income tax exemptions of non-distributed profits; and (iv) state subsidies to cover part of the cost for the creation of new employment positions. Certain incentives are enhanced in the case of small and medium undertakings, as such undertakings are each time defined by the EU legislation. With the exception of tax exemptions, all other incentives must be applied for.

For the purposes of differentiating the available regional development aids, Greece has been divided into three areas. Area A includes the most developed regions of Attica and Thessaloniki, area C has unemployment problems and sparse population, and area B includes all others in between. Qualifying activities include:

- ❖ Provision of services of highly advanced technology
- ❖ Software development
- ❖ R&D of new technology, industrial planning and quality management
- ❖ IT
- ❖ Service and infrastructure related to broadband telecommunications
- ❖ Production of electricity through renewable energy sources (solar, wind energy, landfill, etc.)
- ❖ Mining, quarrying and related activities
- ❖ Parking lots
- ❖ Hotels, camping grounds, marinas, convention centers, ski resorts, spas, golf courts and theme parks
- ❖ Logistics and warehousing
- ❖ Supply chain services
- ❖ Rehabilitation centers

- ❖ Biological agriculture, animal breeding and aquaculture
- ❖ Environmental care and safety

The minimum size for qualifying investments ranges from €30,000 to €500,000, and depends on the type of the envisaged investment and the size of the undertaking concerned (as such criteria are defined by the EU legislation). In the event that the incentive consists of an investment grant or a subsidy for financial leasing, the investor's participation must be no less than 25 percent of the overall investment cost. Undertakings that make use of the tax allowance benefit are entitled to create a tax-free reserve. The amount of the tax allowance ranges from 15 to 40 percent of the investment cost or of the financial rentals, depending on the area and type of the investment project. The amount of the tax-free reserve is computed by application of the appropriate tax rate on the amount of the tax allowance. There are certain time-related compliance requirements prescribed for investments that enjoy the incentive benefits.

Law 3299 / 2004 provides for some exceptions and / or special conditions relating to the incentives granted to certain categories of undertakings. Exceptions (i.e., non-eligible entities / activities) include steel industries, synthetic fiber industries, shipyards and businesses having the legal form of a civil law entity, joint ventures and state-owned entities.

V. COMMENTARY

Greece incentivizes R&D through several paths towards state aid. The addition of tax credits to the tax scheme could be helpful for fostering R&D growth.

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I. OVERVIEW

Hong Kong is located on the south coast of China, but not considered part of mainland China. For the last 14 years, this territory has been considered the freest economy in the world according to the Index of Economic Freedom and has enjoyed its own taxation policies distinct from China's. Although Hong Kong's economy has an extremely strong service sector (90 percent of the gross domestic product ("GDP")) and a less significant industry sector (nine percent of GDP), the Hong Kong government still encourages Research and Development ("R&D"). Inland Revenue, Hong Kong's tax administration, issues taxation provisions through ordinances. A tax deduction ordinance, originally reserved only for "scientific research," was revised in 2005 to include "research and development."

II. DEDUCTION INCENTIVES

Hong Kong allows for the immediate tax deduction of revenues and capital expenditures relating to R&D. R&D is defined as:

- A. Activity in the field of nature or applied science for the extension of knowledge,
- B. Systematic, investigative or experimental activities for the purposes of a feasibility study or in relation to market, business or management research,
- C. Original and planned investigations undertaken with the prospect of attaining new scientific or technical knowledge and understanding, and
- D. Application of any research findings or other knowledge to a plan or design for the production or introduction of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of their commercial production or use.

To qualify, expenditures must be incurred while engaging in R&D and must be related to a trade, profession or business. This does not include spending on land or buildings, nor additions or expansions to land or buildings. Only spending on original research qualifies. Additionally, if R&D was carried out partly outside of Hong Kong, the expenditure must be apportioned on a reasonable basis. If a grant, subsidy or other reimbursement is received, the net expenditure will be deductible. Payments to approved research institutes can also be deducted, irrespective of capital or revenue purposes. Approved research institutes are limited to universities, colleges, institutes, associations or organizations that have been approved in writing by the Commissioner of Inland Revenue.

III. CREDIT INCENTIVE

Hong Kong does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

Although Hong Kong does not offer any enhanced tax credits, the immediate tax deductions help foster innovation. Hong Kong has the opportunity to continue to grow their program in hopes that they can foster a business environment that encourages R&D.

The definitions for qualifying R&D appear to be fairly clear. However, there may be a “claw back” of deductions. Under certain circumstances, an entity’s R&D deduction may be revoked.

V. COMMENTARY

The definitions for qualifying R&D appear to be fairly clear. However, there may be a “claw back” of deductions.

Under certain circumstances, an entity's R&D deduction may be revoked. For example, expenditures that once qualified on plant or equipment that is subsequently sold or destroyed will no longer qualify. This has the ability to discourage businesses from continuing R&D efforts.

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I. OVERVIEW

Over the years, global companies have established a large Research and Development (“R&D”) presence in India. It is estimated that by 2020 India will be amongst the top knowledge-producing nations globally. In the meantime, India not only steadily supports R&D, but also recognizes the need for incentive improvements. Along with this trend, R&D efforts have recently received increasing importance from the Indian federal government. The country’s R&D expenditures increased from US\$4 billion in 2002-03 to US\$7 billion in 2005-06, and scaled to over US\$9 billion in 2008. In 2008, R&D expenditure made up approximately one percent of India’s gross domestic product (“GDP”). The government has mandated a tax of five percent on the importation of technology under foreign collaborations. These dollars are then allocated to domestic R&D initiatives for the enhancement of the country’s overall R&D development.

While information technology (“IT”) is typically associated with India, the country also has a strong presence in the pharmaceutical and biotechnology sector. Currently, there are over 1,400 public / private companies dealing with the larger segment classified under “chemicals” in the country. Of these, nearly 40 percent deal with drugs and pharmaceuticals. Each year, the Indian pharmaceutical industry spends about 10 times the amount spent by the Indian IT industry on R&D. Pharmaceutical companies have been heavily advocating R&D tax breaks to help manage their large R&D expenditure.

India not only steadily supports R&D, but also recognizes the need for incentive improvements. Along with this trend, R&D efforts have recently received increasing importance from the Indian federal government.

II. DEDUCTION INCENTIVES

Companies engaged in specified businesses are eligible for a weighted deduction (in their corporate income tax calculation) of 150 percent of the expenditure incurred on scientific research carried out at prescribed in-house R&D facilities. This weighted deduction is also available in respect to capital expenditure, excluding the cost of any land and building. Currently, this deduction is available until March 31, 2012. Specified businesses for this purpose include biotechnology, manufacturing or production of drugs, pharmaceuticals, etc. Businesses not specified above are eligible to claim a 100 percent deduction for revenue and capital expenditure, excluding expenditure on acquisition of land. Additionally, a weighted deduction of 125 percent is available for the amount paid to a preapproved scientific and research association or to a preapproved company having scientific R&D as its main focus. Incomes of venture capital funds that have been invested in specified research oriented sectors are exempt from taxation. The income of an approved scientific research association is exempt from taxation subject to prescribed conditions. The biotechnology sector, which is expected to involve significant R&D efforts, has a 10-year income tax holiday in specified regions. This holiday is currently planned to last until April 2017.

III. CREDIT INCENTIVES

Tax incentives for R&D in India are presently in the form of either weighted / accelerated deduction for expenses or as an exemption from tax liability in certain cases. Incentives in the form of tax credits or tax refunds are currently not offered in India.

IV. OPPORTUNITIES

Special Economic Zones (“SEZs”) present an opportunity for entrepreneurs to set up their R&D centers in India. A unit in an SEZ is eligible to a host of fiscal incentives including a 15-year graduated income tax holiday, exemption from

R&D withholding on technology imports, exemption from service tax, custom duty, etc. Besides a 100 percent tax holiday for a period of 10 years in the case of biotechnology and weighted deduction on R&D outlays in specified sectors, the healthcare and pharmaceutical industry also benefits from additional opportunities.

The Organization of Pharmaceutical Producers of India (“OPPI”) requested a tax incentive for clinical trials conducted in India. Currently the following expenditures qualify for a weighted deduction:

- ❁ Service tax on clinical trials of new drugs on human participants by approved clinical research organization duly approved by the Drugs Controller General of India are exempt from tax, and
- ❁ Customs duty on 15 types of equipment has been reduced from 7.5 to five percent for pharmaceutical and biotechnology companies.

V. COMMENTARY

Although India is attempting to grow its R&D efforts, the country still needs to improve transitions from product development to research. In comparison with R&D intensive nations, India’s tax incentives are not particularly generous. People across industries suggest that the government needs to take further steps by way of fiscal incentives to encourage R&D within various sectors. Special incentives directed at small scale enterprises (“SMEs”) would be especially helpful for encouraging R&D efforts in smaller firms. An alignment of the approval process involving various government agencies would also help in further attracting foreign investment into the sector.

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I. OVERVIEW

The Irish taxation system encourages and fosters Research and Development (“R&D”) through a structured set of incentives. Since 2000, Ireland has been making significant tax code changes to support R&D efforts and aims to be world renowned for its R&D knowledge base by 2010. To achieve this goal, the Irish government set forth a benchmark in the National Development Plan to spend €2.5 billion on R&D between 2000 and 2006. In 2000, Science Foundation Ireland (“SFI”) was created to focus on biotechnology, and information and communications technology. SFI was initially provided with €635 million to invest in quality scientists, labs and resources. The Irish government is able to attract multinational companies and encourage cooperation between industry and academic research through initiatives such as SFI, the R&D tax credit regime, Government grants and other tax incentives.

II. DEDUCTION INCENTIVES

Ireland does not offer any specific R&D deduction incentives per se. However, a company carrying out an Irish trade may take a corporation tax deduction for non-capital type R&D expenditure incurred wholly and exclusively for the purposes of its trade. This is in addition to the R&D tax credit outlined below.

III. CREDIT INCENTIVES

In 2004, Ireland introduced a new R&D tax credit, allowing a credit of 20 percent for increases in R&D activities within the European Economic Area. Recent legislation has increased the credit to 25 percent for expenditures that are incurred after January 1, 2009. This tax credit is allowed against a company’s corporate tax liability for the current year, and any unused balance may be offset against the previous years’ corporate tax liability or carried forward indefinitely against future corporate tax liabilities. In certain circumstances

and subject to limits, the company may seek a refund of tax from Revenue where excess R&D tax credits exist. In 2007, the Finance Act maintained R&D definitions set forth in the 2004 Act and made two main adjustments. First, the base year relating to qualified incremental expenditures became measurable against 2003. The implementation of 2003 as the base year became effective in 2009. This means that any incremental qualifying R&D expenditure in excess of that incurred in 2003 qualifies for the relief. If a company had no qualifying R&D expenditure in 2003 then all expenditure qualify. Second, companies subcontracting R&D efforts may qualify up to a maximum of 10 percent deduction of qualifying expenditures. The Finance Act of 2004 also contains important R&D definitions that remain in effect, despite modifications that have been made to the tax code. R&D activities are defined as systematic, investigative or experimental activities conducted in a field of science or technology. These activities must satisfy the following two criteria to ensure qualification:

- (1) Seek to achieve scientific or technological advancement, and
- (2) Involve the resolution of scientific or technological uncertainty.

Scientific or technological uncertainty typically arises in one of two situations. There must be either:

- (1) Uncertainty about whether or not a goal can actually be achieved, or
- (2) Certainty that the goal will be met, but uncertainty around the methods to comply with cost or specifications, such as reliability or ability to replicate.

Ireland has an R&D Capability Grant Scheme to further R&D efforts. This scheme helps a company's R&D activities by providing funds for the capital costs associated with establishing an R&D unit and running it for a certain period.

The Act includes further rules for qualifying R&D. For example, companies are entitled to the credit even if they do not own the intellectual property rights. Also, a qualifying activity must seek to achieve a scientific or technological advancement. In order to claim the R&D tax credit, a company must include a claim for relief in their corporate tax return, and do so within 12 months from the end of the accounting period in which the qualifying expenditure is incurred.

Buildings are treated separately in calculating the R&D tax credit. To qualify, the company must be entitled to claim industrial buildings capital allowances on the building / structure. The incremental basis does not apply for expenditure on buildings and there is no base year. Relevant expenditure by a qualifying company can be claimed over four years. Recent legislation has allowed the full credit to be claimed in the year of acquisition. However, this has not yet been implemented as it is subject to EU approval. The credit will be clawed back if the building or structure is sold or ceases to be used for the purposes of R&D activities within 10 years of the accounting period for which it is claimed. Generally for plant and machinery to qualify for the R&D tax credit, it must be used “wholly and exclusively” carrying out the R&D activity.

IV. OPPORTUNITIES

Ireland has an R&D Capability Grant Scheme to further R&D efforts. This scheme helps a company's R&D activities by providing funds for the capital costs associated with establishing an R&D unit and running it for a certain period. Companies can apply for this scheme and may have the following costs covered:

- ❁ Personnel costs
- ❁ Instruments, equipment, land
- ❁ Consulting and equipment services

- ❖ Directly incurred overhead
- ❖ Operating expenses
- ❖ Feasibility studies and technology acquisition costs

V. COMMENTARY

Ireland continues to focus on and improve its R&D incentives. The nation's laws clearly define what can be claimed and what cannot. Fixing the base measure year at 2003 is a little arbitrary and can adversely impact companies with significant / peak qualifying R&D expenditure for 2003.

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I. OVERVIEW

Research and Development (“R&D”) has been on the rise in Israel for the last decade as scientists and engineers have relocated to the country from the former USSR. Israel already had a favorable reputation, with major advancements in computer and communication technologies. However, this influx of professionals has further strengthened the nation as an R&D center. Israel provides incentives and benefits for industry, tourism and real estate to encourage local and foreign investment. These incentives focus on R&D activities, especially those conducted in the technology industry.

II. DEDUCTION INCENTIVES

R&D expense deductions were first allowed under section 20A of the Income Tax Ordinance of April of 1981. Originally, expenses (including capital expenses on scientific research in industry, agriculture, transportation or energy with authorized approval) could be deducted in the year paid out if:

- A. Research efforts were assumed by the owner of the enterprise for the development and improvement of the enterprise itself, or
- B. The state helped finance research undertaken by a taxpayer (not the enterprise owner) or by a third party (not the enterprise owner or taxpayer) and the resulting expenses were in consideration for a portion of the resulting research rights.

In 1983, the Elscint Law was enacted as a set of amendments to section 20A. Section 14 of the Elscint Law allowed for deductions on a ratable basis. Capital expenditures on scientific research incurred for one’s own enterprise were allowed a deduction split into three equal amounts and deducted in annual installments. The value of any grant given by the state is to be excluded from the total deductible amount. The Elscint Law was repealed in 1988, but the

amendments remain in effect. As of 2000, expenses related to an R&D project approved by the Israeli government can be deducted in whole for that tax year up to a specified ceiling, which is usually 40 percent. Qualifying projects must have a goal of making advancements in industry, agriculture, transportation or energy. R&D costs for developing or advancing enterprises are allowed amortization over three years.

III. CREDIT INCENTIVES

Israel does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

The Office of the Chief Scientist (OCS) of the Ministry of Industry, Trade and Labor encourages R&D through support programs. These programs have an annual budget of about \$300 million, spread over about 1,000 projects conducted by 500 companies.

The OCS's main program is the R&D Fund, which offers grants of up to 50 percent of approved R&D spending.

If the project is successful post-commercialization, royalty payments must be used to repay the grant.

International support programs also exist between Israel and countries such as the U.S., Canada, Singapore, Britain, South Korea and Australia to encourage collaborated R&D efforts.

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V. COMMENTARY

Israel is trying to encourage and expand R&D efforts, and the country has already taken some steps to incentivize R&D. Incentives, however, could still be improved to further foster innovation.

I. OVERVIEW

Italy has a variety of incentives to encourage Research and Development (“R&D”) activities. Most of these incentives are given in the form of grants and funding with the goals of strengthening existing and encouraging new activities, research, training and innovation. Italy’s industrial policy introduced action programs to the nation and focused on encouraging smaller businesses to pursue R&D activities. The nation hopes to further promote innovation and small business growth in the future.

II. DEDUCTION INCENTIVES

Expenditures on R&D activities are deductible in Italy. Current expenses are deductible in full in the year incurred or amortized over five years using the straight-line method. Machinery and equipment are depreciated over 10 years and buildings over 33 years.

Generally, to qualify for a tax deduction, an entity must engage in innovation. Under Italian law, a variety of activities can be considered innovation, such as the renewal of a product or service, new manufacturing, procurement, transportation or distribution methods, changes in management, organization, working activities and training, basic, industrial or applied research, technology transfer and pre-competitive development activities.

III. CREDIT INCENTIVES

A tax incentive in the form of a credit has been granted in Italy by the Finance Law for 2007 (Art. 1, c. 280-284, Law n. 296 / 2006) for R&D activities. The tax credit is granted to individual entrepreneurs, companies and PE’s in Italy of non-resident subjects in the fiscal years running from January 1, 2007 through 2009.

The tax credit does correspond to 10 percent of costs and expenses originating from activities linked with industrial research and pre-competitive development. The benefit will be increased to 40 percent if R&D activities are carried out according to agreements signed with universities and / or public research entities. A threshold of €50 million has been set for each tax period.

In order to obtain the tax credit, it is necessary to file an online request on a pre-arranged model approved by the Italian tax authority. This credit has to be indicated in the tax return and can be used to offset tax debit referred to the fiscal year in which the costs have been incurred. Eligible costs and expenses are those born in the achievement of:

- ❖ Industrial research activities: planned research and / or surveys with the aim to achieve knowledge advancement and improve new products, processes and services, and
- ❖ Pre-competitive developments: acquisition and use of new scientific and technological knowledge in order to produce modify or improve new plans, products, processes or services.

In line with the EU regime of state aids, R&D costs and expenses eligible for the tax credit could include:

- ❖ Employment costs (employees, searchers, technical and auxiliary staff)
- ❖ Instruments and tools costs
- ❖ Buildings costs
- ❖ Contractual costs of research (technical advice, patents and licences)
- ❖ General costs and other operating costs (additional costs directly connected with the research plan)

IV. OPPORTUNITIES

Other opportunities are set forth by:

Law 488 / 92 regards the development of production activities in Italy's underdeveloped areas. It is based on call-for-tender procedures and is marked by highly flexible operational modalities and predetermined timeline procedures, as established by the calls for tender. Projects are selected through an efficient method that allows the allocation of resources based on clear and transparent criteria; after receiving the application form including the technical report and business plan, the relevant authority will evaluate the feasibility of the project and decide its funding eligibility. Law 488 / 92 provides funds for small, medium-sized and large enterprises operating in the following sectors: mining, manufacturing, trade, services and tourism, construction building, production and distribution of energy. Funds are available for investment projects aimed at setting up new plants as well as expansion, modernization, restructuring, re-activation, conversion and relocation of existing plants. Eligible areas are the Southern regions and the underused areas of the center-north with growth prospects and the greatest potential for development.

Industry 2015 benefits entities conducting R&D and also strategizes development and competition for the nation's production across industries. Three new support pathways were introduced under Industry 2015: Industrial Innovation Projects,

To ensure that the R&D tax credit is distributed properly and appropriately, the government has fixed a yearly maximum expenditure for these incentives which means that companies may have some difficulties in acceding to the R&D incentives program.

Enterprise Networks and the Enterprise Finance Fund. Industrial Innovation Projects encourages advancement in sectors of strategic importance such as energy efficiency, sustainable mobility and new life technologies. For 2007 through 2009, a total of €1.1 billion was dedicated to this program, allowing businesses to select the most helpful type and form of funding. Enterprise Networks exists as contracts between businesses, specifically small and mid-sized enterprises (“SMEs”), for increasing market presence and strength. Lastly, the Enterprise Finance Fund was created for use with activities requiring credit risk mitigation tools and private equity operations. The goal of this fund was to ease access to credit and risk capital for businesses, especially SMEs.

V. COMMENTARY

Italy recently increased its grant incentive programs, resulting in encouraging tools for the nation’s R&D endeavors. However, in order to ensure that the R&D tax credit is distributed properly and appropriately, the government has fixed a yearly maximum expenditure for these incentives which means that companies may have some difficulties in acceding to the R&D incentives program.

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I. OVERVIEW

Japan strives to be a nation with strong and competitive technological capabilities. The government views Research and Development (“R&D”) incentives as an important way to improve technical knowledge and strongly encourages investment in R&D. Although Japan experienced a decrease in R&D efforts during the 1990s, they were on the rise once again in 2000. The country’s R&D investment has boosted the economy to the extent that R&D stock has been the single largest factor contributing to Japan’s economic growth since the 1990s. Japanese companies continue to invest in R&D without deeply weighing profit trends, and this influx of investments continuously helps boost the economy.

II. DEDUCTION INCENTIVES

Japan does not currently offer any deduction incentives.

III. CREDIT INCENTIVES

The “2008 Tax Reform” was passed on April 30, 2008. This reform slightly adjusted R&D incentives, primarily as it related to the credit rate. Prior to 2008, corporations claimed eight to 10 percent of current R&D expenditures and an additional five percent of incremental expenditures. Qualifying expenditures continue to include spend on experimental and research work with the intent to create new or improved products, designs and production methods. Pure research expenses do not usually qualify for the Japanese credit. Examples of qualifying expenditures include material costs, salaries of employees working only on R&D, depreciation on equipment used, overhead and any other relatable expenses. The total expenditures on these qualifying amounts were then subject to a 20 percent limitation of annual corporate tax due. With the introduction of the 2008 Tax Reform, the credit limit increased from 20 to 30

percent. The reform maintained the option for a one-year carry forward of excess credit. Small and mid-sized enterprises (“SMEs”) on the other hand have several R&D incentive elections to choose from. SMEs may select the aforementioned credit scheme or elect a credit equal to the lesser of 15 percent of all R&D expenses for the current year or 20 percent of the national corporate income tax due (prior to accounting for the credit).

IV. OPPORTUNITIES

R&D expenses incurred in relation to the efficient use of certain materials can also qualify for a tax benefit. The Japanese government encourages activities such as joint R&D efforts with the government and R&D institutes by offering a tax credit on those activities equal to the lesser of 15 percent of the total spending and either 12 or 14 percent of the corporate tax due. With such additional incentives, Japan will most likely continue to move forward as a world leader in R&D.

V. COMMENTARY

Japan hopes to spur R&D growth through the encouragement of SMEs. Although some of the largest companies contribute significant amounts of spending to R&D efforts, other countries such as South Korea, Taiwan and China are producing comparable and cheaper products and growing in

**Although Japan’s
R&D incentives are
considered generous
in comparison to other
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technical knowledge. Japan wants to increase their own competitiveness by fostering small company growth in niche markets (i.e., robotics and machinery). To successfully compete with nations growing in production capabilities and R&D, Japan must continue to consider long-term

investment and encourage SME growth. Although Japan's R&D incentives are considered generous in comparison to other nations, the corporate tax rate is high. Many economists suggest that first and foremost the 40 percent corporate tax rate must be lowered to increase competitiveness.

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I. OVERVIEW

The competitiveness of a small economy and its attractive nature for potential investors are measured in terms of the quality and training of the workforce. According to this distinction, Luxembourg is one of the most advanced countries in this area with 8.78 researchers per 1000 labor force. The majority of this multilingual, native workforce has degrees from universities abroad, as individuals are able to choose from a large number of prestigious programs in neighbouring countries. Luxembourg also offers opportunities to continue professional training programs. Furthermore, the Grand Duchy can pride itself with the presence of European and international schools, as well a number of public and private research centers.

The public expenditure in this area has grown significantly in the last five years and is set to reach one percent of the country's gross domestic product ("GDP") in the near future. Luxembourg does not only rely on home grown R&D, but also takes advantage of the activities in the surrounding countries.

Generally speaking, the Luxembourg government has recognized that R&D is a key factor to continuous economic growth. The public expenditure in this area has grown significantly in the last five years and is set to reach one percent of the country's gross domestic product ("GDP") in the near future. Luxembourg does not only rely on home grown R&D, but also takes advantage of the activities in the surrounding countries. Strong ties to foreign institutions are therefore in place. Luxembourg is thus strategically placed in the middle of these institutions and local scientists are often used to bridge the language and cultural

barriers that exist between the different countries. As a result, Luxembourg is able to tap into the R&D advancements of a variety of countries.

II. DEDUCTION INCENTIVES

Along with the government's recent expansive push for R&D in general, specific aid has been created. The aid exists for the promotion of operations involving the creation, extension, modernization, adaptation and diversification of specific regions. These aids are offered in order to assist in the economic development of the region in which they are offered. Beneficiaries of this type of aid may be industrial companies and service providers.

This rate is considered as a "net subsidy equivalent." The net subsidy equivalent represents the final benefit the company is expected to gain from the financial aid for investment in fixed assets. It is calculated by deducting the tax payable on the subsidy by means of depreciation of the fixed asset in question from the nominal amount of the subsidy. Where the financial aid and / or the investments are spread over time, this amount is discounted.

Additionally, investments made by small or medium-sized enterprises ("SMEs") within one of the above mentioned regions may also benefit from increased regional aid of a gross amount of 10 percent of the eligible costs. In order to receive regional aid, at least 25 percent of the eligible costs must be financed by the equity of the recipient undertaking.

III. CREDIT INCENTIVES

Maximum benefits available as a percentage of the eligible investment:

Activities	SMEs	Corporations	
	Small < 50 People	Medium ≤ 250 People	> 250
New Investments	15%	7.5%	-
R&D:			
Basic Research	85%		75%
Industrial Research	60%		50%
Pre-competitive Development	35%		25%

Provided that the maximum rate of the R&D deductions do not exceed 50, 75 and 100 percent of the eligible costs respectively, the rate of aid applicable to pre-competitive development research, industrial or fundamental research may be increased by 5, 10, 15 or 25 percent in accordance to the rule and tax law.

Besides a general tax credit averaging 12 percent of most capital expenditures, Luxembourg also offers direct grants and incentives. In particular, basic research may be subsidized up to 75 percent of the eligible investments. Furthermore, a national investment bank (“SNCI”) offers loans on favorable terms in order to promote the development of projects, which are deemed to be favorable to the economic development of Luxembourg. Despite its close relationship with the different ministries, the SNCI is very business minded and decisions are made in a very unbureaucratic way.

IV. OPPORTUNITIES

Besides the general issues of corporate taxation, R&D facilities in Europe generally face the following dilemmas in relation to the ownership of Intellectual Property (“IP”):

- ❖ In the first years of development, the R&D center must remain the owner of the IP in order to ensure deductibility of all R&D expenses. This includes expenses relating to failed projects.
- ❖ However, once a practical idea has been developed to such an extent that it can be licensed to intra-group or third party companies, then such IP should be transferred to a more tax efficient group vehicle that concentrates on the management of licenses and related royalty flows.

Since the transfer of IP must occur at market value, the realization of a taxable capital gain on the transfer is unavoidable. A high level of uncertainty exists in this area as the market value of IP is very difficult to establish in practice. This can lead to discussions and even litigation with the local tax authorities. The government is however willing to meet with corporations prior to transactions to ensure that they will complete them in a way that is favorable for deductions.

Furthermore, a number of tax efficient IP structures exist which involve Luxembourg companies. However, in order to reduce the risk of challenge by foreign tax authorities (such as limiting the deductibility of certain royalty payments or levy of a withholding taxes on such payments), it is advised for a Luxembourg company to show that it has offices and employees on the ground in Luxembourg. Combining the R&D facility with such a structure would give an entity a very strong and favorable tax position.

V. COMMENTARY

Projects must be in the general economic interest and contribute to the structural improvement and development of the economy to benefit from an R&D tax credit.

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I. OVERVIEW

Over the years, Malaysia has continued to modify annual budgets with tax incentives that directly or indirectly benefit from Research and Development (“R&D”) endeavors. Acts such as the Promotion of Investments Act, 1986, Income Tax Act, 1967, Customs Act, 1967 and many others bolster activities in the R&D, training and environmental protection sectors. Direct incentives grant an amount of relief from paying income taxes and indirect incentives allow for exemptions from sales taxes and duties. R&D is mostly incentivized through the Promotion of Investments Act, 1986 through tax incentives and other opportunities.

II. TAX INCENTIVES

R&D is defined by the Promotion of Investments Act, 1986 as a “systematic or intensive study carried out in the field of science or technology with the objective of using the results of the study for the production or improvement of materials, devices, products, produce or processes.” This definition, however, does not address quality and routine testing of materials, devices, products or produce, research in the social sciences or the humanities, routine data collection, efficiency surveys or management studies, market research or sales promotion. Companies which carry out design, development and prototyping as independent activities are also eligible for tax benefits.

Direct incentives grant an amount of relief from paying income taxes and indirect incentives allow for exemptions from sales taxes and duties. R&D is mostly incentivized through the Promotion of Investments Act, 1986 through tax incentives and other opportunities.

Typically, an eligible company is one that undertakes research according to the needs of the nation and brings benefits to the Malaysian economy, earns at least 70 percent of income from R&D activities and has the appropriate percentage of qualified personnel performing research and technical functions (at least 50 percent for manufacturing-based R&D and at least five percent for agriculture-based R&D).

The main incentives available in relation to R&D activities are as follows:

❖ **Contract R&D Company**

A contract R&D company is a company that provides R&D services in Malaysia to companies other than related companies. A contract R&D company is eligible for either of the following incentives:

- A. Pioneer Status with a five-year tax exemption on 100 percent of its statutory income (i.e., tax adjusted income after capital allowance claims). Unutilized capital allowances and accumulated losses incurred during the five-year pioneer period can be carried forward and deducted from income made by the company after the pioneer period.
- B. Investment Tax Allowance (“ITA”) of 100 percent on qualifying capital expenditure incurred within a period of 10 years. The allowance can be used to offset against 70 percent of the statutory income for each year of assessment (a 100 percent offset is allowed for companies located in the states of Perlis, Sabah and Sarawak and the designated “Eastern Corridor” of Peninsular Malaysia). Unutilized allowances can be carried forward to subsequent years until these are fully utilized. The remaining 30 percent of statutory income is taxed at the prevailing corporate tax rate. In recent years, the corporate tax rate has gradually been reduced over three consecutive years from 28 percent to the current rate of 25 percent.

❖ **R&D Company**

A R&D company is a company that provides R&D services in Malaysia to its related companies and to any other companies. An R&D company is eligible for the ITA mentioned above, but is not entitled to the pioneer status tax exemption.

❖ **In-house R&D**

A company that undertakes in-house R&D in relation to its business is eligible for ITA of 50 percent on the qualifying capital expenditure incurred (for R&D purposes) within a period of 10 years. The allowance can be used to offset 70 percent of the company's statutory income for each year of assessment (a 100 percent offset is allowed for companies located in the states of Perlis, Sabah and Sarawak and the designated "Eastern Corridor" of Peninsular Malaysia). Unused allowances can be carried forward to subsequent years until fully utilized. The remaining 30 percent of statutory income is taxed at the prevailing corporate tax rate.

A company that incurs revenue expenditure (i.e., not being capital expenditure) for the purpose of undertaking approved in-house research in relation to its business is also eligible for a double deduction in respect of such revenue expenditure.

❖ **Contributions to an approved research institute or payments for the use of services of an approved research institute or approved research company (including a contract R&D company or an R&D company)**

The above contributions / payments are eligible for a double deduction (to the payer) except in the case of payments to a related R&D Company.

III. CREDIT INCENTIVES

Malaysia does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

In addition to the tax incentives mentioned above, several allowances and exemptions are also offered by the Malaysian Government to encourage R&D efforts. Any building which is used for the purpose of research undertaken by an R&D company or a contract R&D company will qualify for Industrial Building Allowances. These allowances provide an initial allowance of 10 percent and an annual allowance of three percent. Capital expenditure incurred on plant and machinery acquired for the purpose of R&D activities may also qualify for capital allowances. Additionally, machinery, equipment, materials, parts and samples used for R&D may be exempt from import taxes, sales tax and excise duties.

Aside from the incentives for R&D activities, there are additional opportunities for companies in the biotechnology sector. Any company that undertakes approved biotechnology activities and qualifies as a “Bionexus company” is entitled to a 10-year tax exemption. This exemption commences in the first year in which income from the approved business is derived. It is also proposed that such companies are entitled to a concessionary income tax rate of 20 percent for a 10-year period following the expiry of the tax exemption period (although the concessionary tax rate has yet to be enacted). Additionally, any company or individual investing in a Bionexus company undertaking approved biotechnology activities is entitled to a tax deduction equivalent to the total investment made in seed capital and early stage financing. There are various criteria that must be satisfied in order to qualify as a Bionexus company.

V. COMMENTARY

Although Malaysia is not a significant R&D center, the nation continues to make significant strides to promote R&D and pay extra attention to advancing sectors crucial to the economy.

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I. OVERVIEW

Malta has a favorable environment conducive to business, and has established agencies to incentivize business growth and enacted legislation to govern industrial development. Legislation was originally outlined in the Industrial Development Act of 1988, which was modified in 2001 to become the Business Promotion Act (“BPA”). The BPA provides incentives for enterprises engaged in certain defined activities as indicated below. In 2007, and following discussions with the European Union, the Malta Enterprise Act was introduced, which included new incentives covering six main themes:

- ❖ **Investment Aid:** Companies engaged in specific activities can benefit from tax credits on capital investment and job creation.
- ❖ **Small and Mid-size Enterprise (“SME”) Development:** Grants targeting the creation and development of innovative start-ups, and the development of forward looking small and medium-sized enterprises.
- ❖ **Enterprise Support:** Assistance to businesses to support them in developing their international competitiveness, improving their processes and networking with other businesses.
- ❖ **Access to Finance:** Assistance through loan guarantees, soft loans, loan interest subsidies or royalty financing in the case of highly innovative projects.
- ❖ **Employment and Training:** Incentives administered by the Employment & Training Corporation. Enterprises are supported in recruiting new employees and training their staff.
- ❖ **Research and Development (“R&D”) and Innovation:** Various incentives offered to stimulate innovative enterprises to engage in Research and Development.

Incentives are given to companies engaged in the following activities, referred to as qualifying activities:

- A. Assembly and manufacturing of any goods, materials, commodities, equipment, plant and machinery,
- B. The repair, overhaul or maintenance of pleasure crafts and yachts,
- C. Information and Communication Technology (“ICT”) developments activities, software development and IT services including call centers,
- D. R&D activities,
- E. Eco-innovation, waste treatment and environmental solutions,
- F. Provision of facilities directly required in the production of films and television programs, and
- G. Provision of private health care services (involving an investment of not less than €2.5 million in medical equipment).

II. DEDUCTION INCENTIVES

The Income Tax Act provides an incentive to companies engaged in R&D by granting a deduction equal to 150 percent of the actual expense incurred by the company. The deduction is available to companies who prove to the Commissioner to have been incurred for the use and benefit of the trade or business of the company. The deduction may be inflated by 150 percent when the scientific research is of a capital nature. The expense is spread equally over a six-year period.

Additional assistance may be provided by the Malta Enterprise in the acquisition of capital assets by facilitating access to finance to companies. Loan guarantees are given in order to assist enterprises in their acquisition of capital assets. Enterprises may also be granted interest bearing loans (with interest rates which are set at a lower rate than the commercial interest rates)

for the acquisition of expenditure which is approved by the Malta Enterprise. Alternatively, the Malta Enterprise Corporation may subsidize the bank's commercial interest rate in order to assist enterprises in obtaining capital assets.

Additionally, as part of its incentive program, the Malta Enterprise provides cash grants to enterprises engaged in qualifying activities. These grants are available to enterprises during the set-up phase in new markets or to existing companies which are engaged in developing their existing or new markets. This incentive is available to companies which qualify as such by the Malta Enterprise.

III. CREDIT INCENTIVES

Investment tax credits are available for companies carrying on a qualifying activity. The investment tax credit is calculated on the basis of qualifying investments made or on new jobs created, and is deducted from the tax charge of the company. Tax payable can be reduced or ultimately eliminated

under the tax credit scheme. The investment tax credit is calculated as either 50 percent of the total eligible investment amount or 50 percent of the initial two-year wage costs for newly created jobs in the case of small enterprises, whichever is the most beneficial. The amount of investment tax credit is reduced to 40 percent in the case of medium-sized enterprises and to 30 percent in the case of large enterprises. The size of the enterprise is established by reference to "The New SME Definition" guidelines published

Despite the assistance provided by the Malta Enterprise during this stage, this process is sometimes seen as being bureaucratic. Most of the incentives are available to a company only if such company is engaged *solely* in defined activities.

by the European Commission. Any unutilized investment tax credits are carried forward to subsequent years and inflated at a rate prescribed by guidelines issued by the Malta Enterprise. The inflation rate is currently set at 4.99 percent. Tax credits are also available to enterprises engaged in the fields of science and technology, when employing highly qualified and specialized personnel.

IV. OPPORTUNITIES

The Malta Enterprise Corporation is the nation's agency for enterprise promotion and development. The Malta Enterprise provides incentives for foreign direct investors and local enterprises demonstrating commitment towards growth, increase in value added and increase in employment. Enterprises engaged in a qualifying activity may benefit from these incentives.

V. COMMENTARY

Most of the incentives offered are available to enterprises through an application process which requires a three-year business plan including projections of the company's turnover and of the percentage sales in relation to other major markets. Despite the assistance provided by the Malta Enterprise during this stage, this process is sometimes seen as being bureaucratic. Most of the incentives are available to a company only if such company is engaged solely in defined activities, thus limiting the objectives of the company to the qualifying activity which gives rise to incentives under the Malta Enterprise Act.

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I. OVERVIEW

The increase in global competition has recently shed light on Mexico's need to improve tax incentives, and specifically those related to Research and Development ("R&D"). In 2003, Mexico fell behind China as the second largest trading partner with the U.S. In response, the Mexican government pushed innovation efforts to the forefront, aiming to greatly increase the nation's R&D

The Mexican government pushed innovation efforts to the forefront, aiming to greatly increase the nation's R&D efforts, equal to only 0.39 percent of the gross domestic product ("GDP"). R&D tax incentives along with science and technology programs were enacted and enhanced to address the nation's shrinking levels of innovation.

efforts, equal to only 0.39 percent of the gross domestic product ("GDP"). R&D tax incentives along with science and technology programs were enacted and enhanced to address the nation's shrinking levels of innovation.

During the administration of Ernesto Zedillo in 1999, an overhaul of the previous R&D system was proposed to increase the funding provided to science, change structures, remove barriers and optimize resources. Links between public research centers and private industries were strengthened by removing the caps on research center budgets. The government instead began encouraging these centers to seek funding from the private sector. These changes, coupled with other government initiatives, continue to foster Mexico's R&D growth.

II. DEDUCTION INCENTIVES

Mexico allows for R&D expenditures to be deducted as incurred, as opposed to taking a deduction in the year of income accrual.

III. CREDIT INCENTIVES

In 2001, Mexican tax laws were amended to provide an income tax credit equal to 30 percent of R&D spending and technology investments. Innovation must be conducted within Mexican borders to achieve either one of the following goals: product development, or development of materials / processes for scientific or technological innovation. A government committee manages the R&D incentive and companies seeking the credit must apply to this committee by October 30 of that particular tax year. In some cases, a credit of less than 30 percent may be granted if the committee deems appropriate. Mexico also allows a credit carry-forward of 10 years if the credit granted in a particular year exceeds the tax liability for the corresponding year, with the carry-forward amount being indexed for inflation.

IV. OPPORTUNITIES

Mexico's main public and decentralized body for spurring national innovation constantly pursues its goal for the current and future visions to reform the R&D system. The National Council on Science and Technology ("CONACYT") originated from the will of Congress on December 29, 1970. Since that time, the council has continually worked towards their goals to consolidate science and technology within Mexico, create solutions to address problems and needs, and raise the social welfare and standard of living. CONACYT believes this goal can be attained by forming a specialized state policy, increasing scientific and technological capacity and the quality and competitiveness of

innovation. The council put actions and benchmarks in place to help reach its future 2025 vision. These items are as follows:

2002 - The Special Program of Science and Technology was created as a conglomeration of scientists, technicians, businessmen, academics and governors to encourage communication and cooperation among these groups.

2006 - R&D efforts continue to grow as Mexico strives to achieve one percent of GDP in science and technology.

2025 - Mexico will invest over two percent of its GDP in R&D endeavors, have one of the 10 most important economies worldwide and be one of the 20 most scientific and technologically developed nations.

V. COMMENTARY

CONACYT identifies the following areas as especially problematic in Mexico and hopes to encourage innovation within these categories to helping less fortunate citizens:

- ❖ Information technology and communication
- ❖ Biotechnology
- ❖ Advanced materials
- ❖ Manufacturing design and processes
- ❖ Urban and rural infrastructure and development

From a tax standpoint, there are two limitations that may significantly affect the application of the tax incentive mentioned in Section III:

- A. The recipient of the tax incentive will be obligated to recognize as an accruable income the amount of the credit that will be offset against income tax due in the fiscal year, thus the recipient will have to pay income tax on the credited amount, which may limit the benefit of the credit.

- B. As from the entry into force of the single rate business tax in 2008, the benefits or special tax regimes granted through several tax incentives were rendered ineffective due to the fact that the tax does not provide particular provisions that recognize the benefits of these tax incentives. This is better explained considering that the single rate business tax is a minimum tax with respect to income tax. Therefore, although a taxpayer may benefit through the application of a tax incentive for income tax purposes, such as the credit for investment in R&D, such taxpayers will not be able to credit the R&D incentive against this other “minimum tax.”

While aiming to increase its R&D efforts, Mexico faces several challenges. The nation would be helped by an economic structure permitting the production of high value products at a lower cost per kilogram, a new development model for worldwide growth, and an overall stronger science and technology system.

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I. OVERVIEW

In 2008, government of New Zealand took significant steps to encourage innovation, and continues to do so through 2009. A new tax scheme is intended to increase private sector Research and Development (“R&D”) and investment in intellectual property. New Zealand’s Inland Revenue Department oversees the R&D credit, which is to be filed the same day as tax returns. To prove credit eligibility, companies must provide thorough documentation of their activities for the year.

II. DEDUCTION INCENTIVES

Companies may be entitled to claim a tax deduction on R&D expenditures that are neither depreciable capital assets nor of a revenue nature. In order to claim a deduction, the expenses must be incurred through scientific research, research or development, and the expenditures are either expensed or capitalized. This ability to claim a deduction accompanies the option of receiving a tax credit, effective April 1, 2008.

A new tax scheme is intended to increase private sector Research and Development (“R&D”) and investment in intellectual property. New Zealand’s Inland Revenue Department oversees the R&D credit, which is to be filed the same day as tax returns.

III. CREDIT INCENTIVES

Companies in New Zealand may qualify for a 15 percent tax credit on R&D core and supporting activities. Core activities must be systematic, investigative or experimental, and have the goal of uncovering new knowledge, or improving or creating products, processes or services. Core activities

also have the goal of resolving uncertainty. Supporting activities are considered requirements or integral parts of carrying out core activities, such as the commercial and legal work around patents. In order to qualify for the New Zealand tax credit, the company must be based in New Zealand, conduct the majority of R&D work in New Zealand and own the results of the research. Universities, government research organizations and companies acquiring core technology are not eligible for the credit. The country does not limit the tax credit to any particular entity type, but the entity must spend at least NZD 20,000 per year on R&D and carry the financial and technical risks for the initiatives.

IV. OPPORTUNITIES

New Zealand offers several R&D opportunities by offering both a tax deduction and tax credit. Since these two can be used in conjunction with one another, companies may be dually incentivized to pursue R&D initiatives.

V. COMMENTARY

New Zealand offers vast incentives to companies who choose to perform R&D within their country.

I. OVERVIEW

While Norway has relatively weak Research and Development (“R&D”) incentives, the government understands the growing importance of encouraging innovation. The government has tried to implement tax schemes with the goal of increasing cooperation between policy makers, industry, education and environmental sectors, enhancing commercialization of research results and improving higher education. They hope to grow their overall R&D percentage of the gross domestic product (“GDP”). Results of their tax schemes include a rise in public R&D investment, which grew annually at 10 percent in the industrial sector and two percent in the institute sector in recent years.

II. DEDUCTION INCENTIVES

In 2001, the government introduced a public financial support system for companies purchasing R&D knowledge from universities and institutes. This system, called FUNN, was upgraded to the SkatteFUNN in 2002. SkatteFUNN specifically allows for tax deductions for small and mid-sized companies (“SMEs”). Currently, this tax scheme has been expanded to encompass all entity types. R&D has been encouraged under this system, as tax deductions of one kroner typically result in a two kroner investment from the economy. In order to be eligible for the SkatteFUNN deduction, companies and projects must meet certain standards. Qualifying expenditures must relate to activities

While Norway has relatively weak Research and Development (“R&D”) incentives, the government understands the growing importance of encouraging innovation. The government has tried to implement tax schemes with the goal of increasing cooperation.

that are limited, focused, seek new knowledge, information or experience that will be of use to the entity to create new or improved products, services or methods. All entity types are entitled to an 18 percent deduction on qualifying expenditures. SMEs are companies with under 250 employees, an annual turnover of €40 million or less (or balance sheet maximum of €27 million) and less than 25 percent of the entity is owned by a larger entity. These companies are allowed a 20 percent deduction. For enterprises of all sizes, the ceiling for R&D expenses is from 2009 increased from NOK 4 million to NOK 5.5 million, and from NOK 8 million to NOK 11 million for those companies cooperating with approved institutions. In 2007, a maximum hourly rate and hours per year for in-house R&D employees was introduced. Payroll and indirect expenses should not exceed NOK 500 per hour and hours should not exceed 1,850 per year.

III. CREDIT INCENTIVES

Norway does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

Norway offers additional opportunities to certain economic sectors through focused grant funding. The government hopes to encourage R&D activity in marine research, information and communication technology, medical and health care research, and environmental and renewable energy. Legislation has been put in place to facilitate the technology transfer from universities to the industry. Intellectual property ownership rules were amended on January 1, 2003 to allow research institutions the right to exploit inventions, thus encouraging commercialization.

V. COMMENTARY

Norway faces several challenges for increasing R&D efforts within the country. With an extremely low proportion of R&D workers, the country struggles to expand their technical workforce. The nation will need to encourage employment in the R&D sector to grow innovation efforts. Norway also needs to focus on expanding R&D efforts to more industries. Currently, initiatives are mostly focused on the oil and gas industry. Expanding to other industries would assist in growing their annual R&D percentage of GDP.

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I. OVERVIEW

The Philippines actively promotes the development and use of renewable energy sources and offers tax incentives to accomplish these objectives. Tax holidays, breaks and exemptions are used to encourage investment in pipeline projects, environmental regulations and energy saving projects. Tax incentives in these fields, in addition to ones in other industries, were established by the Filipino government to stimulate Research and Development (“R&D”), and investment endeavors.

II. DEDUCTION INCENTIVES

The Filipino government takes up R&D expenses in one of two ways. First, R&D spending can be treated as an ordinary and necessary expense, in which case the amount would be currently deductible. Second, R&D spending can also be amortized over at least a 60-month period. The amortization period begins in the month that the benefits from past spending are realized. In order to benefit from the amortization method, R&D expenses must be paid or incurred in connection with the trade or business, not treated as deductible expenses and charged to a capital account.

III. CREDIT INCENTIVES

The Philippines currently does not offer R&D tax incentives.

IV. OPPORTUNITIES

The Board of Investment (BOI) grants basic incentives for businesses. Income tax holidays are available over the

Tax holidays, breaks and exemptions are used to encourage investment in pipeline projects, environmental regulations and energy saving projects.

course of six to eight years (for pioneer status entities) or over four years (for new projects with non-pioneer status). Projects undertaken in less developed regions of the country will receive a six-year holiday, regardless of the entity's status.

To target renewable energy and power generation, the Philippines Energy Plan was initiated. This plan began in 2005 and will end in 2014, and concentrates on increasing energy production and attracting domestic participants. This is one way the government advocates one of the nation's strategic industries.

V. COMMENTARY

Filipino tax legislation allows for some basic R&D and investment incentives. However, the government could also introduce incentives that concentrate on more strategic industries, instead of solely focusing on energy.

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I. OVERVIEW

Poland underwent a political transformation in 1989, which prompted a push towards incentivizing Research and Development (“R&D”) initiatives. When Poland joined the European Union on May 1, 2004, the nation began to put more focus on R&D initiatives as the country recognized the important role innovation played in strengthening the economy. R&D is on the rise as Poland dedicated about €1.2 billion to innovation in 2000 alone. Polish research is mostly driven by the Ministry of Scientific Research and Information Technology, and the 2005 Act on Principles for Financing Science.

II. DEDUCTION INCENTIVES

Beginning January 1, 2006, Polish companies throughout the country were allowed to deduct 50 percent of qualifying expenditures related to new technology. New technology is defined as knowledge of intangible assets (including patents, licenses, unpatented techniques, organization and management within an organization), especially R&D results that have not been used anywhere within the previous five years. This incentive accompanies a company’s option to deduct depreciation on the initial value of new technologies. Depreciation cannot be shorter than two years for software and copyrights, one year for development work and 60 months for all other intangibles.

Grants are awarded based on the assessment of submitted proposals. In addition to submitting a proposal, enterprises should also guarantee that the infrastructure carry out the appropriate research, be registered in Poland and display adequate competence to be eligible for a grant.

III. CREDIT INCENTIVES

Small and medium-sized enterprises (“SMEs”) planning new investments in Poland may obtain a subsidy granting technological credit, with the possibility of obtaining a technological premium. Applications for technological credits are submitted to the credit-granting banks. The total R&D budget equals to €409,85 million.

Poland does not currently offer an R&D credit as an incentive for large enterprises.

IV. OPPORTUNITIES

Government support for R&D is granted by the Ministry of Economy or the Polish Agency for Enterprise Development. Financing is available for the projects related to:

A. Conducting R&D and implementing their results in the production process:

R&D undertakings in the field of applied research and development works, as well as investment projects concerning implementation of results of which were carried out for R&D, are prevalent with a budget of about €780,35 million. The subsidy can be granted to any type of applied researches or development works which results in launching of a new product or service into the market. The total public aid intensity equals from 25 percent up to 70 percent of R&D eligible costs and from 30 percent up to 70 percent of investment eligible costs.

B. Investments in R&D laboratories (including creation or extension of R&D centers):

A subsidy can also be granted to the enterprise to facilitate the purchase of necessary equipment related to conducting R&D activities, or the

investment in highly innovative projects that will work towards the services sector resulting in the establishment of an R&D center. Total budget for the projects related to the extension of R&D laboratory accounts for €196 million. The total public aid intensity equals from 30 percent up to 70 percent of eligible investment costs.

Grants are awarded based on the assessment of submitted proposals. In addition to submitting a proposal, enterprises should also guarantee that the infrastructure carry out the appropriate research, be registered in Poland and display adequate competence to be eligible for a grant.

V. COMMENTARY

As the nation works toward advancing R&D efforts, the government has the opportunity to introduce more deductions and credit incentives that target the involvement of SMEs in R&D efforts. In order to become a country that thrives in R&D, Poland needs to continue to support companies in their R&D efforts.

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I. OVERVIEW

In August 2005, the Portuguese government introduced a tax deduction for investments related to Research and Development (“R&D”). This deduction was made applicable from January 2006 through December 2010. A similar deduction applied for tax years 1997 through 2003 under the Decree-Law 292 / 97. From 1997 to 2003, Portugal had a fast growing R&D investment rate (18 percent per year) and a very strong R&D incentive system. After an R&D investment slowdown in 2004, the Portuguese government established a new tax regime. As one of the highest priorities for Portuguese economy, the goal was to increase public support for R&D investment.

II. DEDUCTION INCENTIVES

Under the new scheme (Sistema de Incentivos Fiscais em Investigação e Desenvolvimento Empresarial, SIFIDE), an investment deduction against an IRC liability is available for qualifying R&D expenses. The deduction amount is the sum of:

- ❖ A basic deduction, equal to 20 percent of the qualifying expenses for the relevant year, and
- ❖ An additional deduction, equal to 50 percent of the amount by which the qualifying expenses for the relevant year exceed the average R&D expenses incurred over the two preceding years, with a ceiling of €750,000.

Any unused deduction may be carried forward for six years. Under the supplementary Portuguese State Budget for 2009, the above referred rate is now increased to 32.5 percent and a limit of €750,000 elevated to €1.5 million. This is applicable to investments made beginning January 1, 2009. Qualifying R&D expenses include:

- ❖ Expenses incurred with the acquisition of new tangible fixed assets, other than land and urban buildings, exclusively and permanently used for R&D activities,

- ❖ Expenses incurred with personnel directly dedicated to R&D activities,
- ❖ Expenses incurred by directors and managers involved in the management of R&D institutions,
- ❖ Operational costs relating to R&D activities, with a limit of 55 percent of the allocated salaries and wages of personnel directly involved in R&D activities,
- ❖ Expenses incurred for hiring R&D services from public or other reputable R&D entities,
- ❖ Contributions to the capital of R&D institutions, and contributions to public or private investment funds dedicated to finance companies involved in R&D activities,
- ❖ Expenses incurred for the registration and maintenance of patents (these are only applicable to small and medium caps),
- ❖ Expenses incurred for the acquisition of patents allocated to R&D activities, and
- ❖ Expenses incurred for audits relating to R&D.

In order to make use of the deduction, the qualifying investor must include in their documentation file:

- ❖ A compliance statement, issued by a verification body appointed by the Minister of Science, Technology and Higher Education, concerning the qualifying R&D expenses incurred, and

Under the new scheme (Sistema de Incentivos Fiscais em Investigação e Desenvolvimento Empresarial, SIFIDE), an investment deduction against an IRC liability is available for qualifying R&D expenses.

- ❖ An annual statement confirming that there are no unpaid taxes and social security contributions.

This R&D investment tax credit may not be used concurrently with any other similar tax incentive.

III. CREDIT INCENTIVES

Presently, there are no credit incentives regarding R&D available in Portugal.

IV. OPPORTUNITIES

The Portuguese government offers several incentive programs to foster innovation. Besides the above referred Tax Incentives for Company Investments in R&D (SIFIDE), other incentives are available through programs such as the Incentive Scheme for Business Modernization (SIME I&DT), which provide subsidized loans and grants. SIME I&DT began in 2006 as a replacement to SIME Inovação (which began in 2000). The updated program provides grants and loans with a maximum of €1 million for non-reimbursable incentives and €4.5 million for reimbursable incentives. These projects should have a minimum investment of €50,000 (for small or mid-sized companies) or €200,000 (for all other entities), be applicable to the company's line of business and have a maximum duration of two years. The grants and loans provided are intended to cover the costs of labor, overheads, equipment, training and external expertise. Both SIFIDE and SIME I&DT programs encourage applied industrial research, development and prototype creation, commercialization and industrial design.

V. COMMENTARY

Portugal has taken action within recent years to reenergize its R&D policies, however the deduction period still remains at five years. When the government eliminated prior incentives and noticed a drop in R&D initiatives, a tax scheme was quickly reintroduced to remedy the situation.

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I. OVERVIEW

Puerto Rico has longstanding policies of encouraging outside investment and attracting pharmaceutical and biotechnology companies. The government has always believed that developing new technologies as a byproduct of Research and Development (“R&D”) is a crucial component of sustained economic growth. Industries advocate strengthening R&D activities to achieve continuous technological advancement. Legislation in Puerto Rico acknowledges the importance of innovation and drives R&D initiatives through cash grants and tax credits.

II. DEDUCTION INCENTIVES

Companies with operations covered under the 1998 Tax Incentives Act (“the 1998 Act”) qualify for a special deduction equal to 200 percent of their R&D expenditures. However, effective June 30, 2008, no new applications will be processed under this act.

III. CREDIT INCENTIVES

The Economic Incentives Act for the Development of Puerto Rico (“the Act”) (effective July 1, 2008) provides grantees under a 50 percent tax credit on R&D expenditures (which include both operating and capitalized expenditures). The use of this credit is subject to certain limitations. The credit can be sold to third parties if its use is limited in the future. Expenses incurred on R&D

Legislation in Puerto Rico acknowledges the importance of innovation and drives R&D initiatives through cash grants and tax credits.

include clinical trials, toxicological tests, investment in infrastructure and renewable energy equipment. The Act also reduces the corporate tax rate for eligible businesses to four percent, and one percent for pioneer companies investing in and developing life science advancements.

IV. OPPORTUNITIES

The Act grants tax credits to eligible businesses carrying out R&D activities in Puerto Rico and focuses on eligible businesses engaged in scientific or industrial R&D. This includes laboratories working solely on improving or developing new products or processes. These operations qualify for all the exemptions allowed under the Act including property taxes, sales and use taxes, and municipal license taxes. Puerto Rico also has a Program of Economic Incentives for R&D Projects (“the Program”). The Program is managed by the Office of Science and Technology and is a promotional tool for marketing innovative ideas. The Program works to fuel and optimize intellectual capital, human capital and natural resources. Additional focus is directed towards encouraging cooperation between public, private and high education institutions. Any entity demonstrating the potential to fulfill the research ideas they propose can seek funding from the Program. Priority is given to projects within the health, biotechnology, pharmaceutical, manufacturing, information technology (“IT”) and communications industries. Additionally, U.S. companies with operations in Puerto Rico may be eligible to include expenditures incurred in Puerto Rico for the U.S. R&D tax credit (see U.S. section).

V. COMMENTARY

Puerto Rico continues to place R&D at the forefront of political and economic agendas. Recent additions, such as the Economic Investments Act, have leveled the playing field across industries engaging in R&D efforts. For example, the Act extended tax breaks to life science companies that were previously reserved for manufacturing businesses. Puerto Rico can continue to foster R&D through tax deductions and credits, and may consider special incentives for small and mid-sized enterprises similar to what many other countries have in place. This could help attract companies of this size.

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I. OVERVIEW

Russia has had a cyclical Research and Development (“R&D”) history. Prior to 1990, the country was a powerhouse for science and technology; particularly in physics, nuclear technology and space technology. The collapse of the Soviet Union, however, brought with it a significant reduction of the industrial and military sectors, to which the majority of R&D investments were dedicated. R&D investment declined to two percent of the gross domestic product (“GDP”) in 1990, and dropped to one percent of GDP by 1999. Many scientists and technologists moved away from Russia, further discouraging the advancement of R&D efforts. Russian tax incentives introduced in 2006 through 2008 demonstrated movements in the right direction for the country to again foster innovation.

II. DEDUCTION INCENTIVES

R&D expenditures on new or improved products are deductible for Corporate Income Tax (“CIT”) purposes under Russian law. Prior to 2007, these expenses were categorized based on positive / successful results or unsuccessful results. Expenses related to success could be evenly deducted over two years and unsuccessful results could be deducted evenly over three years. In 2007, these two schemes were modified to allow for expenses to be deducted in full for the respective tax year, regardless of success. Furthermore, in 2006, deductible losses that had been carried forward could not exceed 30 percent of the present year profit tax base. This carry forward policy changed in 2007 to allow for full carry forward deductions without any restrictions. An adjustment to the tax code made in 2007 included the removal of the value added tax on patent and license transactions. Beginning January 1, 2008, a transfer of exclusive rights to inventions, utility models, industrial designs, computer programs, data bases, topologies of integrated microcircuits, know-how and rights to the

use of the indicated results of intellectual activity under a licence agreement became exempt from (not subject to) Russian VAT. Several kinds of scientific research, experimental development and technological works, related to the creation of new products and technologies or to the improvement of producible goods and technologies, also became exempt from Russian VAT. Finally, starting from January 1, 2009, several kinds of R&D expenditures according to a special list of scientific researches and experimental development works (efforts) approved by the Russian Government, became deductible for CIT purposes with multiplying index 1.5 as a period expense, i.e., in that period when they were factually born.

III. CREDIT INCENTIVES

A company, conducting scientific research or experimental development works, technical re-equipment of its manufacturing, engaging in implementation or innovation activity (including the creation of new or improvement of existing technologies, or the creation of new kinds of raw and other materials) can be granted an investment tax credit. This credit is granted in the form of putting-off

the term for payment of taxes with a subsequent gradual payment of the investment tax credit amount and the interest charged on it at the rate of $\frac{1}{2}$ to $\frac{3}{4}$ of the refinancing rate established by the Central Bank of Russia. An investment tax credit allows the taxpayer to reduce its tax payments within the period from one to five years to 50 percent of the tax payable without taking into account the investment tax credit.

Russia is working to get out of the past decade's dip in R&D efforts. The Russian Tax Code modifications should help the nation work toward its previously high position of research and knowledge.

IV. OPPORTUNITIES

The information technology (“IT”) sector began gaining attention from the Russian Government in 2005. The government set goals for the advancement of this industry. From the time the goals were set, the IT sector has grown 15 to 20 percent each year. Special Economic Zones (“SEZs”) were created to encourage R&D. These zones are offering CIT rate reduction from 20 to 15.5 percent (in case the respective reduction is provided for in regional legislation), unified social tax rate reduction from 26 to 14 percent, a five-year absence of property and land tax and unlimited deduction of R&D expenses for CIT purposes. Starting from January 1, 2007, IT companies are entitled to a reduced unified social tax rate. Additionally, beginning January 1, 2009, IT companies are able to deduct hardware and computer costs as a period expense (but not by means of depreciation). In order to qualify for these incentives, a company must have at least a 50-person staff, generate a minimum of 90 percent of income from software development and other IT practices, have 70 percent of income from services to foreign customers and be accredited by the state.

V. COMMENTARY

Russia is working to get out of the past decade’s dip in R&D efforts. The Russian Tax Code modifications should help the nation work toward its previously high position of research and knowledge.

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I. OVERVIEW

The Singapore government has advocated the importance of Research and Development (“R&D”) efforts since the 1980s. Through the past decade, Singapore has increased productivity and placed much focus on technology. The nation’s society has become increasingly modernized, and has encouraged advancements in science, technology and management methods. In May 1997, the Committee on Singapore’s Competitiveness (“CSC”) was formed to assess Singapore’s economic competitiveness over the next decade and propose strategies to strengthen Singapore’s position. Two of the strategies guided by this plan were related to R&D. The government set goals to strengthen small and mid-sized enterprises (“SMEs”) and influence technology and innovation. The nation believed the economy could benefit from SME growth, along with upgrades to existing industry clusters and activity shifts. As of 2008, the Singapore government continues to foster innovation. In a recent budget speech, the government revealed its plan to increase R&D spending to \$7.5 billion by 2010. This figure is equal to three percent of the country’s gross domestic product (“GDP”), which is quite ambitious compared to most other countries dedicating two percent of GDP to R&D initiatives.

II. DEDUCTION INCENTIVES

In line with the government’s aim to encourage all business enterprises to increase R&D activity, a package of new R&D measures was introduced in the 2008 Budget. These measures include:

- A. Liberized R&D tax deductions,
- B. New R&D Tax Allowance (RDA) scheme, and
- C. New R&D Incentive for Start-up Enterprises (RISE) scheme.

Under the liberized R&D tax deductions rule, taxpayers who undertake R&D in any area in Singapore will be able to claim a tax deduction for the expenditure

incurred. This is a departure from the existing rule. Previously a deduction was only available to a taxpayer who carried on a manufacturing or service trade / business, and the R&D had to relate to that trade carried on by the taxpayer. With this liberalization, a further deduction of 50 percent of the qualifying R&D may be claimed by the taxpayer.

The new RDA scheme is intended to encourage businesses, particularly profitable SMEs, to engage in R&D in Singapore. Under this scheme, a company will be granted an R&D allowance amounting to 50 percent of the first S\$300,000 of chargeable income for each year of assessment from 2009 to 2013 (both years inclusive). This allowance may be used to deduct against the company's assessable income in any subsequent year up to 2016.

The new RISE scheme, effective from year of assessment 2009 through 2013 (both years inclusive) allows a start-up that spends at least S\$150,000 on R&D to convert up to S\$225,000 (representing 150 percent of S\$150,000) of its losses into cash grants of up to S\$20,250 (nine percent of S\$225,000) from the Singapore government. The losses that have been converted would not be available to be carried forward. RISE is available to a start-up in its first three years of assessment.

III. CREDIT INCENTIVES

Singapore does not currently offer credit incentives for R&D.

IV. OPPORTUNITIES

The three new tax schemes will give much added incentive for all companies to engage in R&D. Start-ups which do not have taxable profits will benefit

The new RDA scheme is intended to encourage businesses, particularly profitable SMEs, to engage in R&D in Singapore.

from reduced costs for R&D. A small company (around the 80th percentile) that expend S\$150,000 on R&D will find its effective tax rate reduced from the present nine percent to near zero. A medium-sized company (around the 90th percentile) will see a reduction of its effective tax rate from 15 to 10 percent.

V. COMMENTARY

While the government of Singapore continues to make a conscious effort to introduce new ways to incentivize innovation, it may wish to consider offering R&D credits as an added enticement.

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I. OVERVIEW

South Korea has become a nation that is on the rise in science and technology. This transformation is a result of the government's ambitious goals for innovation, along with incentivizing Research and Development ("R&D") efforts. The nation began investing in R&D in 1959 with the creation of the Korean Atomic Energy Commission. This commission conducted R&D, production, and decimation and management of peaceful atomic energy. In the mid 1960s, the Ministry of Science and Technology ("MOST") was established to oversee R&D initiatives. Around this time, the Korea Institute of Science and Technology was formed as an industrial research lab. Over the years, MOST, along with the government, has fostered innovation and set goals for South Korean enterprises. MOST aims to make South Korea an international leader in science and technology by 2010. By 2025, the country hopes to be the seventh largest power in science and technology (from the 10th largest power in 2007). As the nation strives towards these goals, R&D expenditures have been growing about 9.5 percent annually. During 2007, the country's spending was equal to about 3.5 percent of the gross domestic product ("GDP"). This rapid expansion has been made possible by the well-educated population,

Deductions for R&D expenditures are available in the form of depreciation in the case of acquisitions of R&D equipment or facilities. The amount expended for non-capital R&D expenses are also deductible. It should be noted, however, that the deduction for R&D spending is the same as other deductible expenses, in that the deduction would be at the taxpayer's applicable tax rate.

networked society and extensive innovation system. Recent R&D focus has been on biotechnology, nanotechnology and aerospace.

II. DEDUCTION INCENTIVES

Deductions for R&D expenditures are available in the form of depreciation in the case of acquisitions of R&D equipment or facilities. The amount expended for non-capital R&D expenses are also deductible. It should be noted, however, that the deduction for R&D spending is the same as other deductible expenses, in that the deduction would be at the taxpayer's applicable tax rate.

III. CREDIT INCENTIVES

South Korea introduced several new tax reforms in 2009 to offer permanent tax support for R&D investments. Previously, tax credits offered for R&D expenditures in research and manpower development had been "periodic" and repeatedly extended on five- or three-year terms. In order to provide a more stable tax incentive system, the periodic expiration of the tax credit for R&D expenditures has been abolished and replaced by a permanent tax credit system. While the overall system has been made permanent, some tax credit provisions still remain temporary, and new temporary tax credits will continue to be utilized to address emerging situations. Additionally, the rates of several tax credits have been increased.

The Special Tax Treatment Control Law ("STTCL") which governs tax incentives was modified in 2009. For small and mid-sized enterprises ("SMEs"), the credit will be equal to (i) 50 percent of the incremental increase in the average R&D expenditures over the prior four years, or (ii) 25 percent of the R&D expenditures incurred for that year at the option of the taxpayer. Large corporations (not SMEs) with R&D spending that is greater than or equal to the prior year spending, can utilize a new method to compute their R&D tax credit. The new credit is, at the option of the taxpayer, (i) three percent of R&D spending during

the tax year, plus 50 percent of the ratio of R&D spending to gross sales (to a maximum of six percent), or (ii) an amount which is the sum of 50 percent of the incremental increase in the average R&D spending over the prior four years and 40 percent of the incremental increase in the average outsourced (to universities or small to medium-sized companies) R&D spending over the prior four years.

Also, in the environmental sector, to simultaneously encourage R&D and environmental safety, tax credits on anti-pollution facilities and energy conservation equipment will increase from seven to 10 percent, and 10 to 20 percent respectively. This rate will be lowered in 2010, and the increased tax credit will expire in 2009 for energy conservation equipment.

IV. OPPORTUNITIES

A new provision for an R&D reserve designed to secure growth potential by providing tax incentives earmarked for the preparatory stage of R&D investments has recently been created. Companies may set aside up to three percent of revenue in an R&D reserve account to help fund future R&D initiatives. Once the reserve amount is used for qualified R&D activities, one third of all amounts expended are added back to taxable income for each taxable year for three years, starting from the fourth year of the tax year when the reserve account was established. If the actual amount expended during the three years is less than the reserve amount, the shortfall is added back to taxable income in the fourth year.

Additionally, the government has recently enacted a tax credit to encourage investment in R&D facilities. Companies investing in building facilities for research and testing, technical manpower training or commercial deployment of new technology may take a tax credit which equals 10 percent of the investment amount. However, this credit is temporary and will expire at the end of 2009.

Finally, the government has created tax incentives for foreign direct investment. South Korea, through the use of STTCL, has a number of programs to promote foreign direct investments and bring in foreign technologies. There are about 24 incentive programs to be reviewed, such as a five-year corporate tax holiday and a two-year tax discount for foreign companies investing in South Korea.

IV. COMMENTARY

South Korea has definite goals for increasing R&D efforts, however, the deduction and credit rates could be increased to be more competitive.

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I. OVERVIEW

The encouragement of technological improvement and innovation, and Research and Development (“R&D”) projects has recently become a priority for public authorities in Spain. In this context, Spain follows the example of many other European Union (“EU”) nations by fostering innovation through R&D tax incentives.

II. DEDUCTION INCENTIVES

Spanish Corporate Income Tax law allows the application of an unrestricted amortization to assets and expenses related to R&D activities. In this sense, companies may freely amortize tangible fixed assets and intangible assets used for R&D activities (a special rule applies for buildings, as only the part of them used for R&D activities may be depreciated, and this depreciation has to be made under the straight-line method over 10 years). An unrestricted amortization may be taken on the R&D expenses capitalized in intangible assets, excluding amortization of those assets in which unrestricted amortization can be taken.

III. CREDIT INCENTIVES

Spain offers an R&D tax credit on certain expenses defined as R&D activities. Spanish taxation distinguishes between R&D activities and technological innovation and provides incentives for both.

R&D activities include scientific and technological research with the goal of gaining knowledge, expanding upon the understanding of an area or utilizing the outcomes of research in producing new materials, processes or designs, or improving upon these existing items. Activities also include the development of certain qualifying software technology. Technological innovation has a focus of improving existing materials, products or processes, as opposed to creating new ones.

For both the R&D and technological innovation tax credits, work must be conducted fully in Spain or in any other state, as long as the latter is a member of the EU or the European Economic Area.

The tax credit available for R&D activities is computed as 25 percent of the R&D basis. If the basis exceeds the prior two-year average for R&D spending, the amount may qualify for a 42

Spain has a very detailed R&D tax scheme, distinguishing R&D activities as separate from technological innovations, and offering substantive credits for both. Although these credits were scheduled for phasing-out, this measure has recently been repealed by the Spanish Government, which combined with the 50 percent reduction over income from patents, and other intangibles may lead to interesting tax planning opportunities.

percent credit. Additionally, another 17 percent credit may be granted if costs were incurred by research employees working solely on R&D efforts. An eight percent credit on investments in fixed tangible and intangible assets used solely for R&D purposes (excluding real property and land) also applies. In all cases, the base for the credit is reduced by 65 percent of any applicable grant funding.

The technological innovation credit was created to address expenses relating to technological-diagnosis activities aimed to identify and define advanced technological solutions, as well as to acquire advance technology in the form of patents, licenses, know-how and designs (with a €1,000,000 ceiling) and the costs of obtaining certificates of quality. The tax credit is then computed as eight percent of expenses incurred on the carrying out of the technological

innovation activities as defined above minus 65 percent of any applicable grant funding.

IV. OPPORTUNITIES

In the past, Spanish tax authorities have interpreted the R&D deduction established in the corporate income tax law in the sense that a Spanish company may qualify for this incentive even if it is reimbursed for the costs by other entities. Thus, if the other company may benefit from a R&D deduction in its jurisdiction, a double use of the same R&D item would be possible.

Furthermore, in 2008, the European Commission approved tax credits proposed by the Spanish government for patent, design and other innovation revenue. This tax scheme essentially reduces the amount of income to be included in the tax base in the case of certain qualifying intangibles to 50 percent instead of lowering the tax rate. Unlike in other countries, this incentive does not operate over the net amount but over the gross one (i.e., expenses are not cut in half), which may lead to a very reduced effective rate on this income. This particular tax scheme is open to entities of all sizes. This opportunity will help Spain, along with several other EU countries, continue to grow in their development.

V. COMMENTARY

Spain has a very detailed R&D tax scheme, distinguishing R&D activities as separate from technological innovations, and offering substantive credits for both. Although these credits were scheduled for phasing-out, this measure has recently been repealed by the Spanish Government, which combined with the 50 percent reduction over income from patents, and other intangibles may lead to interesting tax planning opportunities.

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I. OVERVIEW

Sweden has consistently ranked highly for its dedication to Research and Development (“R&D”) investment. Most of the incentivizing for this research has been provided directly to universities or through research councils. As Sweden continues to prioritize R&D initiatives, annual expenditures will amount to about four percent of overall the gross domestic product (“GDP”). From 2003 to 2005, this percentage dropped slightly from 3.95 to 3.89 percent, but Sweden remained a top country for R&D spending. Sweden developed a Research and Innovation Bill that will be effective from 2009 through 2012. This bill dedicates about SEK 5 billion to R&D efforts. This large R&D boost was created for two reasons: first, to help Sweden stay competitive by continuously increasing knowledge, and second, to resolve issues facing today’s society. The Swedish government hopes to maintain high standards of quality and use of competition to drive R&D efforts, particularly within the sectors of environmental improvement, conservation and disease.

II. DEDUCTION INCENTIVES

Business-related R&D expenditures are deductible in Sweden, although the pace at which the deductions occur may vary depending on the nature of the activities. In many cases, companies are able to immediately deduct the expenditures. These expenditures may also include the retrieval of information. R&D activities do not have to be dedicated to a specific line of business or be of scientific or technical nature to qualify for tax benefits. Although this definition is rather broad, companies may not, however, deduct research expenses that are incurred outside of the company’s field of interest.

Although not applicable only to R&D activities, the Swedish incentives related to foreign key personnel are often applicable to R&D employees. To qualify as “key personnel” under the incentive legislation, it is required that the skills or talents possessed by the foreign person in question should be impossible or extremely

difficult to find in Sweden. The main feature of the tax relief legislation provides a 25 percent reduction of taxable income of a foreign key person; similarly, the employer gets a 25 percent reduction of the basis for social security contributions. If a reduction is granted, it may apply to the first three years of employment in Sweden. Foreign key personnel will also be able to receive tax-exempt contributions from employers for moving to and from Sweden, holiday travel to a home country and school fees for children.

III. CREDIT INCENTIVES

Sweden does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

Government R&D funding in Sweden is mostly dedicated to academic institutions. While the business sector contributes about 77 percent of R&D activities, most of this work is carried out and financed by the industrial sector. The Research and Innovation Bill allocates a significant portion of funds to academia based on

Sweden has not historically had a specific R&D incentive.

The Research and Innovation Bill addresses some areas that were previously lacking and continues to focus on expanding R&D.

quality. A quality criterion can include publications, references to publications and external research funds. The Bill also seeks to increase the use of government investments in research by the community and businesses. The nation will raise the level of commercialization of research results by setting up innovation offices to facilitate this process. Funds are allocated within the Bill to accomplish this objective.

V. COMMENTARY

Sweden has not historically had a specific R&D incentive. The Research and Innovation Bill addresses some areas that were previously lacking and continues to focus on expanding R&D. The government could, however, provide more funding and benefits specific to R&D.

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I. OVERVIEW

Switzerland has a long tradition of fostering Research and Development (“R&D”) efforts, and such activity helped put Switzerland in fourth place globally and third place in Europe (out of 52 countries) for information technology (“IT”) usage and adoption in 2004. Switzerland has had much economic success, largely in part of the country’s strong achievements in scientific disciplines. The Swiss workforce forms an ideal foundation for innovation because workers are well-trained, multilingual and focused on precision manufacturing, pharmaceuticals, high-technology, nanotechnology, medical devices and biotechnology. Much of the R&D work conducted in Switzerland results in patented technology, as this nation produces the most patents per capita. Switzerland encourages R&D efforts through tax holidays, financial assistance and the Swiss Innovation Promotion Agency (“CTI”). For over 60 years, CTI has fostered the flow of knowledge between businesses and universities. CTI aims to quickly take laboratory findings and commercialize these successes into useful products and services.

Switzerland encourages R&D efforts through tax holidays, financial assistance and the Swiss Innovation Promotion Agency (“CTI”)

CTI aims to quickly take laboratory findings and commercialize these successes into useful products and services.

II. DEDUCTION INCENTIVES

R&D costs are commercially justified expenses and are therefore tax deductible. Generally, there is a distinction between the research and the development phases of projects. The expenditures during the research phase are tax deductible at the time that the costs are incurred, whereas the costs for the development may be accounted in the balance sheet if certain conditions are met. On accounted intangible

assets, ordinary tax deductible depreciations up to 40 percent per annum are allowed. Should there be a loss in value which is not due to the passage of time unlimited extraordinary depreciations are also tax deductible. The reason for such a loss is not relevant, but the loss must be permanent.

Provisions which are commercially justified are tax deductible. There is a special provision for future R&D assignments to third parties, which is allowed as a deduction of up to 10 percent of the taxable profit, however this is only up to a maximum of CHF 1 million.

III. CREDIT INCENTIVES

Switzerland does not currently offer the R&D credit as an incentive.

IV. OPPORTUNITIES

R&D incentives in Switzerland primarily consist of subsidies or loans from cantons, grants, exemptions on profits and capital gains, and depreciation allowances. For example, the Berne Economic Development Agency, located in the canton of Berne, offers special incentives for small and mid-sized enterprises (“SMEs”). If a project has been approved by CTI, cantons such as Berne offer contributions up to a maximum of 50 percent of the company’s R&D spending, not to exceed CHF 100,000. However, financial assistance will not be provided for any portion of R&D expenditures incurred by an educational institution.

As of January 1, 2008, Switzerland’s federal law on New Regional Policy (“NRP”) and its related ordinances entered into force. With the NRP, the Federal Council envisions improving the economic attractiveness of rural areas in Switzerland. Companies creating new jobs and strengthening the economy located in one of the 30 regions within 11 cantons, representing about 10 percent of the Swiss population, will be entitled to apply for a tax

holiday. However, the new business must be in the general interest of the local economy to qualify for such tax relief. A tax holiday would be granted if the following conditions are met:

- ❖ Establishment of new business activities in a qualifying area of economic development,
- ❖ Performance by an industrial enterprise or a production-related service center,
- ❖ Creation of new jobs either directly or indirectly (through its suppliers and / or partners), or preservation of existing jobs long-term in case of a changing business environment, and
- ❖ Particular economic relevance of the planned project for the area (e.g., collaboration with research institutes and educational institutions that are directly connected to the planned project, numbers of jobs created, extent of the planned investment within the economic area, and extent of planned or executed purchases and ordering of goods and services).

Full or partial tax holidays up to a 10-year period may be given for federal, cantonal and municipal profit and capital taxes. Additionally, companies engaging in R&D in Switzerland may also benefit from federal funding via CTI. A company collaborating with a university or research institute can receive financial assistance that covers the costs of the university or institute's work. The company benefits from this collaboration and gains knowledge without having to actually finance the outside party.

V. COMMENTARY

Switzerland offers several R&D tax opportunities. Because the Swiss government takes a more *laissez-faire* approach, companies do not receive credit. Although such benefits are not currently in place, Switzerland is nonetheless a very successful global leader in its R&D endeavors, but could further benefit from credits.

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I. OVERVIEW

For many years, Taiwan has considered Research and Development (“R&D”) to be an integral part to their national economy. In the 1970s, the Science and Technology Development Program was introduced by the Taiwanese government. This program fosters the growth of “knowledge-intensive” industries through grants and subsidies. The program focuses on the development of geothermal energy, battery-powered vehicles, electronics, cancer treatment, pharmaceuticals, nuclear safety and high precision instruments. Taiwan also offers direct R&D tax incentives as presented in the Statute for Upgrading Industries (“SUI”). SUI is an amended version of the former Statute for Encouragement of Investment (“SEI”) enacted in the 1960s. SUI offers tax holidays and tax credits, and is in effect from January 1, 1991 to December 31, 2009.

II. DEDUCTION INCENTIVES

Taiwan does not currently offer any deduction incentives.

Taiwan also offers direct R&D tax incentives as presented in the Statute for Upgrading Industries (“SUI”). SUI offers tax holidays and tax credits and is in effect from January 1, 1991 to December 31, 2009.

III. CREDIT INCENTIVES

SUI allows for a tax credit of 30 percent of the total R&D spending incurred by a company for the current tax year. To qualify as credit-eligible R&D spending, expenses must be incurred for research on new products or technologies, or towards the improvement of production, technology or processes. Expenses must be incurred by a company or research institution in Taiwan. Companies claiming the credit must also provide adequate

documentation to support their qualifying R&D activities and expenditures. For any given tax year, the R&D deducted amount cannot exceed 50 percent of the income tax liability for the corresponding year. The government allows carry-forwards for five years, also up to the previously mentioned 50 percent limit. Unused credits may, however, be used in full during the final carry-forward year.

IV. OPPORTUNITIES

Taiwan encourages new product development in the private sector by providing subsidies on half of R&D development costs and matching funds on the remaining half. Companies may apply for the subsidy and match fund if the entity has an R&D department with sufficient R&D workers and a record of R&D work to demonstrate their ability to conduct the studies and commercialize results. Resulting products that could help companies receive this benefit include those that are developed in emerging and top industries, make use of key technologies, have good market potential and have intellectual property rights.

Companies engaged in R&D may also qualify for accelerated depreciation under Article 5 of the SUI. Equipment and instruments used solely for R&D, experimental, inspection or energy conservation purposes can be depreciated on an accelerated two-year basis. Small entities can benefit from Taiwan's Small Business Innovation Research Program ("SBIR"). Small and mid-sized enterprises ("SMEs") with less than 200 employees or capital below NT\$80 million can receive benefits during their Initial Research Phase and R&D Phase. During the Initial Research Phase, programs are limited to six months and assistance for each program cannot exceed 50 percent of total assistance granted. During the R&D Phase, programs should run no more than two years, or three years for activities in the biotechnology and pharmaceutical industries. The 50 percent assistance limit on individual projects applies in this phase as well.

V. COMMENTARY

While Taiwan offers several incentives, the government could make the restrictions lighter in order to allow more companies to utilize them.

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I. OVERVIEW

Thailand offers several Research and Development (“R&D”) tax incentives and programs to foster innovation in the country. The partnership of three government bodies—the Revenue Department, the National Science and Technology Development Agency (“NSTDA”) and the Board of Investment—was formed to help the government to achieve its goal of increasing R&D by introducing tax incentives across all industries. The group is focusing the majority of their efforts on biotechnology, which is a sector of high importance for the Thai economy.

II. DEDUCTION INCENTIVES

Since 1996, the Revenue Department has launched two methods of deduction incentives in order to support this policy. The first is a 200 percent deduction for the cost of hiring qualified researchers working on R&D projects. The second is a special initial depreciation on the date of acquisition for machinery (including all related equipment) used in R&D projects at the rate of 40 percent of total acquisition cost. Investors in R&D will be able to gain the tax privileges even in case of funding their own R&D unit qualified under the criteria of the Research and Development Certification Committee Secretariat, NSTDA.

The Board of Investment (“BOI”) grants a promotion to qualified projects in the field of basic research, applied science, experimental development and R&D on several types of biotechnology.

III. CREDIT INCENTIVES

Thailand does not currently offer an R&D credit as an incentive.

IV. OPPORTUNITIES

The Board of Investment (“BOI”) grants a promotion to qualified projects in the field of basic research, applied science, experimental development and R&D on several types of biotechnology. There is also an exemption from import duties on machinery used solely for R&D purposes. Additionally, the Thai government offers an exemption from corporate income tax for eight years. Moreover, businesses located in the Thailand Science Park will receive a 50 percent income tax deduction for an additional five years after the expiration of the period of income tax exemption.

V. COMMENTARY

Thailand continues to reform its R&D policies to foster innovation. To raise awareness of the R&D policies in place, information on the current tax scheme could be made more readily available. R&D tax reform should continue to incentivize businesses in order to establish Thailand as a leader in R&D.

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I. OVERVIEW

In 2008, Turkish tax legislation was modified to increase investment in Research and Development (“R&D”). The government hopes an increase in R&D activity will help cover the growing Turkish budget deficit. Turkey spends about one percent of its national gross domestic product (“GDP”) on R&D expenditures, which is below the global average of two percent. Incentives have been enacted to foster innovation and effects from these incentives are expected to be realized in three to four years.

II. DEDUCTION INCENTIVES

Companies with at least 50 employees in their R&D department can deduct 100 percent of R&D investments from their tax base. The government has allowed companies to create technology based R&D centers. These centers are defined as public bodies established by the law that employ the full time equivalent of at least 500 R&D personnel. Taxpayers can also benefit from technopreneurship capital subsidies on personnel working on R&D and support for R&D in pre-competition cooperation projects. Wages paid are exempt from income tax up to 90 percent for personnel with doctorate degrees and 80 percent for all other personnel. Additionally, the Ministry of Finance will pay half of the share of the

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employers' insurance premium for employees working on R&D. In the pre-competition cooperation projects, the contributions of enterprises constituting cooperation shall be monitored on the special account opened on behalf of the enterprise that is set in the cooperation protocol. These amounts transferred to special accounts shall be accepted as R&D expenditure of enterprises contributed in the expenditure period and cannot be used for any purpose except for the project. The amounts collected in the project account shall not be considered as revenue in determining the profit of the enterprise that opened the special project account.

The government also offers subsidies of up to 100,000 Turkish Lira to assist with R&D projects. These amounts can be applied in the years following the year in which they are granted. The subsidies given to those engaged in R&D and innovation by public bodies and institutions, foundations established on the basis of law and international funds shall be kept in a special fund account. This fund shall not be taken into account in determining taxable profits or R&D expenditure in relevant year. For R&D tax incentive purposes, a fund transfer to another account must be done by adding to capital in five years time following the account period in which the fund is acquired, or by withdrawing the fund from the enterprise. Taxes not accrued on in a timely manner will be considered to be loss.

III. CREDIT INCENTIVES

Turkey does not currently offer any traditional R&D credits, but does offer an allowance as an incentive. When a taxpayer has an increase in their R&D spending from the prior year, they receive an R&D allowance. This allowance can be utilized against earnings for tax purposes. If the allowance cannot be utilized during the current year, it can be transferred to future accounting periods. These transferred amounts are taken into consideration in the following years with an increase calculated by the re-valuation ratio.

IV. OPPORTUNITIES

The Technological Research Council of Turkey (“TUBITAK”) and the Turkish Technology Development Foundation (“TTGV”) provide R&D support. TUBITAK funds R&D spending and TTGV provides capital loans. To receive R&D support, expenses must be incurred for appropriate projects according following criteria:

Creative studies, environment friendly production design and hardware activities conducted on a systematic basis as well as activities with experimental, scientific and technical content and exclusive output, which provide scientific and technical improvement in its field, focus on scientific and technological uncertainty in order to enrich knowledge encompassing research and development, culture, human and society, and to make use of this in order to design new processes, systems and applications.

TUBITAK designs and implements funding programs with the goal of boosting Turkey’s competitive advantage on a global R&D scale. Funding instruments, facilitating cooperation between industry and academia, evaluating socio-economic impacts on funding programs, and dealing with new programs and activities are some of the tasks performed by TUBITAK.

Within the TTGV is the Technology Development Project Support (“TDP”). TDP supports R&D activities while simultaneously leaving technological expertise up to the company undertaking the project. To qualify for financial assistance, projects must be under two years in length and under US\$1 million in value. Loans are available for 50 percent or less of the project budget, and do not have to be paid back for one year. There is then a four year interest-free payback period. However, a service fee of three percent of the project’s total budget will be imposed.

V. COMMENTARY

While Turkey offers R&D incentives, it would be helpful for taxpayers if the incentives were more centralized, with less complex legislation behind them.

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