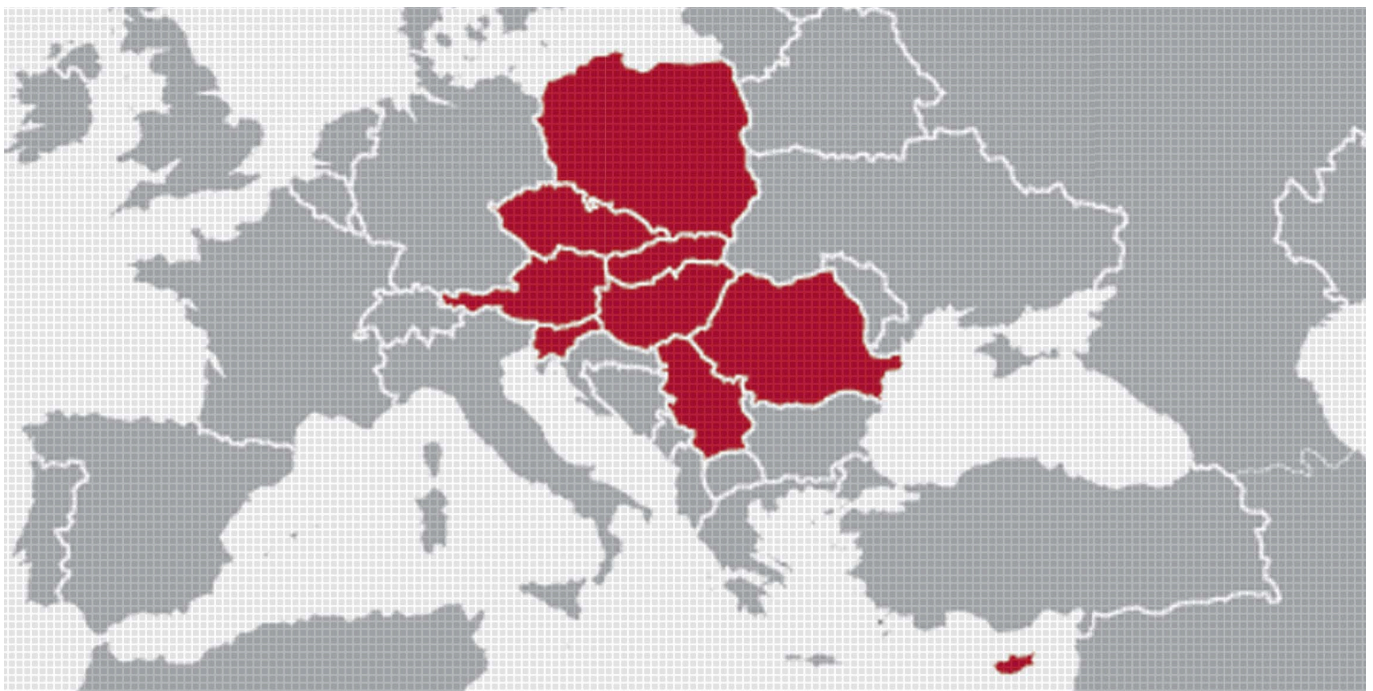


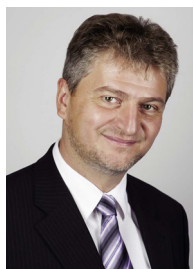
wts CEE | taxbridge

Tax Benefits Related to Research and Development in Central and Eastern Europe



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Zoltán Lambert
Managing Partner
Regional
Coordinator CEE

Dear Readers,

In our last issue of the 2018 WTS CEE Tax Bridge we focus on tax incentives related to research & development costs and royalty revenue. We also look at whether there is any intellectual property box (IP box or patent box) scheme in the CEE countries helping investors optimise their tax burdens.

Clearly, research & development is a major cost element for companies, and it is hard to predict if such developments will bring (create) or take money. Companies engaged in research activities within a group sometimes operate independently from the money and revenue-making entities engaged in retail and manufacturing, meaning that such costs are not deductible at the overall group level (assuming group taxation is not available). In this respect Hungary is somewhat different, since there is a special rule allowing affiliated companies to share such costs. We also see a trend whereby one option to attract foreign investors engaged in technology-driven sectors is simply allowing the double deduction of research & development costs (the Czech Republic, Hungary and Serbia) or letting them claim a research tax premium for certain research and development expenses, like in Austria.

Patent box schemes are spreading across the CEE region too, and if we look at the Cypriot tax system, where taxpayers are eligible to claim a notional tax deduction equal to 80% of net qualifying profits resulting from the business use of qualifying IP, we could say that investors are spoiled; however, it is not so easy to choose between the countries offering the various patent box schemes. Should a client choose the relatively new Slovak patent box system available from January 2018, or should they decide to establish a company in Poland and benefit from the new IP box incentive, which will enter into force from January 2019? If you vote for the Polish system you can use a preferential corporate income tax rate of 5%, compared to the standard rate of 19%.

In our articles you can learn about the slight differences between these systems and read general information about IP regimes and related cost deductions. We hope you will find our articles informative and useful, but please bear in mind that before starting anything you should contact your local tax advisor to understand all the rules and requirements in detail.

Zoltán Lambert
WTS Klient Hungary
Managing Partner
Regional Coordinator CEE

simply to allow the double deduction of research & development costs

various patent box schemes

slight differences

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Our values

Innovative	Passionate	Excellent	Reliable
Being innovative means always being one step ahead by being creative and delivering something unique.	Our clients' success is our passion.	To us, excellence means providing the highest quality consulting solutions.	Our actions are based on a reliable system of values. We keep our promises.



Stefan Wallner
Manager Tax



Helene Grabner
Assistant Tax

Characteristic attributes of subsidised research and experimental development

Authors: **Stefan Wallner, Helene Grabner**

In Austria, companies conducting research and development are financially supported by the state. They may claim a research tax premium for certain research and development expenses. This research premium is valid regardless of the legal form of the company. It is credited to the company's tax account and can then be transferred to the company's bank account. The research premium itself is not taxable, and does not result in a reduction of expenses. Another advantage of the research premium is that it is even available to companies that are making a loss. The research tax premium is subject to some conditions and is legally standardised in Section 108c EStG, the associated regulation for the research tax premium, and in the Frascati Manual. The research tax premium is 12% for the fiscal years from 1 January 2016 to 31 December 2017. From 1 January 2018 the Austrian government raised the research tax premium to 14%.

Definition and requirements

One of the main definitions is set forth in Annex I Part A Z 1 of the research premium regulation:

"Research and experimental development within the meaning of Section 108c (2) Z1 EStG 1988 is a creative activity carried out in a systematic manner using scientific methods with the aim of increasing the level of knowledge and developing new applications of this knowledge. Research and experimental development in this sense includes basic research (Z 2) and/or applied research (Z 3) and/or experimental development (Z 4). It includes the scientific-technical field as well as the social sciences and humanities."

The second chapter of the Frascati Manual, version 2015, is very relevant for the concepts and definitions used to identify research and development. This chapter includes the following specification under bullet point 2.5:

"Research and experimental development (R&D) comprise creative and systematic work undertaken in order to increase the stock of knowledge – including knowledge of humankind, culture and society – and to devise new applications of available knowledge."

According to the Frascati Manual, research & development activity must satisfy five core criteria. The activity must be:

- Novel: New discoveries and applications have been made through research; in the field of business, the novelty must be measured against existing knowledge.
- Creative: There should not be any routine activities; objective new concepts or ideas of qualified researchers that extend the current state of knowledge.
- Uncertain: There has to be some uncertainty about the research result, the time spent, the required resources and the involved costs.
- Systematic: The process must be planned and carried out consciously.
- Transferable and/or reproducible: The results must be both comprehensible and/or reproducible by third parties.

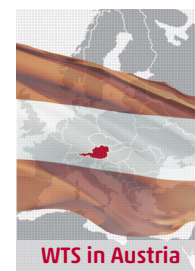
Types of research and development

The term research & development covers three types of activity: basic research, applied research and experimental development. Basic research is experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundation of phenomena and observable facts, without any particular application or use in view. Applied research is original investigation undertaken to acquire new knowledge. It is, however, directed primarily towards a specific, practical aim or objective. Experimental development is systematic work, drawing on knowledge gained from research and practical experience and producing additional knowledge, which is aimed at producing new products or processes or improving existing products or processes.

Subsidised expenses

The target has to be increasing the level of knowledge and using it for developing new applications. Besides the content requirements there are defined expenses which are subsidised. The basis for calculating the premium includes the wages and salaries of employees working in research

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WTS in Austria

five core criteria

basic research

applied research

experimental development

developing new applications

creative activity carried out in a systematic manner using scientific methods

in order to increase the stock of knowledge

and development, expenditure and investment directly linked to research and development, as well as land (under certain conditions). Besides these costs, direct financing costs and overheads are also included in the assessment base, if they can be allocated to research and development.

Application process

The taxpayer must submit a (free) annual report from the Austrian Research Promotion Agency (FFG). The FFG assesses if the substantive prerequisites for research and experimental development actually exist. This FFG report includes a detailed specification of the research and development activities of the company, and subdivides the individual descriptions into three different sections. It has to include a description of the research target, a description of the annual procedure and the scientific method, such as a description about the innovative nature of the research project. To sum up, the FFG checks if the report is consistent with the legal definitions of the research and experimental development characteristics of Section 108c EStG, of the research premium regulation and the Frascati Manual.

FFG report

Completing form E108c is another requirement, which includes the applied value and is a supplement to the tax return of the requested year.

form E108c

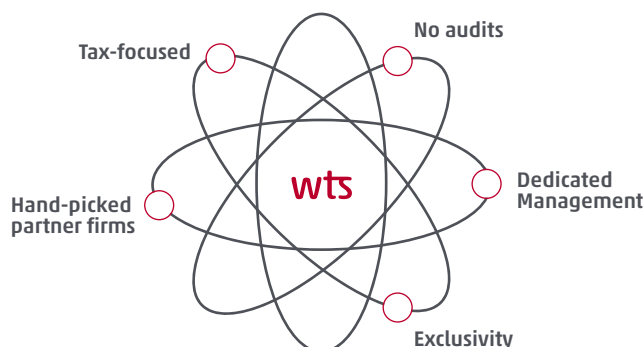
Conclusion

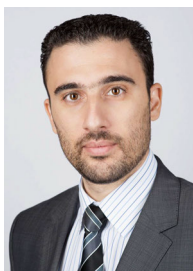
The research tax premium is an interesting way for companies to obtain governmental support for ongoing research and development.

- **Stefan Wallner**
Manager Tax
+43 732 69412 8931
stefan.wallner@icon.at
- **Helene Grabner**
Assistant Tax
+43 732 69412 2418
helene.grabner@icon.at
- **ICON Wirtschaftstreuhand GmbH**
Stahlstraße 14
4020 Linz
Austria
- www.icon.at

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Nicolas Kypreos
Partner

R&D tax incentive scheme

Authors: **Nicolas Kypreos, Andri Lazarou**

Even though the R&D ecosystem in Cyprus is not yet fully mature, the Cypriot Government has put in place a simple, yet favourable, tax incentive scheme in an attempt to promote R&D at companies and encourage innovation and economic growth. In this regard, the Government has introduced key changes to the Income Tax Legislation (ITL) with a view to increasing investors' interest in R&D development in Cyprus as well as investment in innovative small and medium-sized businesses. The key amendments to the ITL mainly relate to the new provisions of the Cypriot Intellectual Property (IP) regime, applicable from 1 July 2016, and the revised provisions related to tax deductions for individuals investing in innovative entities, effective from 1 January 2017.



Andri Lazarou
Assistant Manager

Cypriot IP Box

Under the existing IP box regime, a company can achieve an effective tax rate of less than 2.5% by claiming a notional tax deduction equal to 80% of net qualifying IP profits derived from a wide range of intangibles such as patented inventions, copyrights and trademarks, as defined in the relevant Cypriot legislation. It is important to note that registrable IPs do not necessarily need to be registered in Cyprus in order to benefit from the IP regime.

To protect the owners of IP assets that have already qualified under the current Cypriot IP regime, the amending legislation provides for a transitional period (so-called "grandfathering provisions") which extend the applicability of the old IP regime (subject to conditions) either up to 31 December 2016 or 30 June 2021.

The new regulations (effective as of 1 July 2016) introduce the OECD-recommended "nexus approach", mainly in an effort to link the benefits of the regime with R&D expenditure incurred by the taxpayer. Specifically, the nexus approach limits the application of the IP box regime if the research and development is being outsourced to related parties.

So under the new IP box regime, taxpayers will be eligible to claim a notional tax deduction equal to 80% of net qualifying profits resulting from the business use of

qualifying IPs. For each tax year, the taxpayer may elect to waive this allowance, either in part or in whole. In addition, the ITL provides an additional incentive for taxpayers by extending the annual tax amortisation on IPs over the useful economic life of the IP (capped at 20 years), instead of the five-year claim on a straight-line basis of the old IP regime.

Qualifying IPs based on the new Cypriot IP regime are limited to patents, copyrighted software, utility models and other legally protected patent-like IPs (subject to conditions). Any marketing-related IPs like trademarks, brands, image rights and other IP rights used for the marketing of goods and services as well as any other IP not falling into the adjacent categories are considered non-qualifying IPs.

The new Cypriot IP Box is only applicable for qualifying IPs if

- they were developed by the Cypriot company in Cyprus,
- their development was outsourced to an unrelated party and
- they have been developed by the Cypriot company via a taxable foreign branch.

It is important to note that amending provisions have been introduced to the ITL to ensure taxpayers can elect whether a foreign PE is taxable in Cyprus, so the foreign PE can be classified as a qualifying taxpayer for IP purposes.

Tax deductions for individuals investing in innovative entities

As mentioned above, in an effort to motivate foreign investors to come to Cyprus and invest in innovative businesses, the Cypriot Government has introduced new provisions to the ITL, which state that the cost incurred by a person (legal or physical) for purchasing shares in an innovative small and medium enterprise (innovative SME) is deductible from this person's taxable income (subject to conditions).

The investment cost shall be deducted from the individual's taxable income provided that:

continued on the next page



qualifying IPs

foreign PE can be classified as a qualifying taxpayer for IP purposes

to motivate foreign investors to come to Cyprus and invest in innovative businesses

existing IP box regime

grandfathering provisions

to link the benefits of the regime with R&D expenditure incurred by the taxpayer

new IP box regime

- the allowable deduction does not exceed 50% of the individual's taxable income in the tax year in which the risk-finance investment was made, before accounting for the deduction of allowable insurance premiums and other contributions.
- the total deductible amount does not exceed the maximum amount of EUR 150,000 per year.

It is important to note that the deduction can be claimed in the first tax year in which the investment took place, and also carried forward and claimed for the following 4 years, subject to the aforementioned percentage cap.

The above tax incentive is available to qualifying investors (so-called "independent private investors") for a three-year period beginning on 1 January 2017, unless a new law is passed before the end of that period that extends the application of the incentive. A person incurring expenses in respect of risk-finance investments is considered an independent private investor if they are not already a shareholder in the innovative SME in which they are investing. In the case of a new company, private investors, including the founders, are considered to be independent from the company. The Cypriot tax authority could

*independent
private investor*

deny such a deduction if the private investor does not hold the investment for the minimum period of three years.

In this way the Cypriot Government wants to support start-ups in developing innovative products and services, and strengthen the Cypriot entrepreneurial ecosystem in the long term, instead of creating short-term tax incentives for foreigners and wealth management investors.

*Cypriot entrepreneurial
ecosystem*

→ **Nicolas Kypreos**
Partner
+357 22 028700
nicolas.kypreos@wtscyprus.com

→ **Andri Lazarou**
Assistant Manager
+357 22 028700
andri.lazarou@wtscyprus.com

→ **WTS Cyprus Ltd.**
47 Strovolos Avenue
4th Floor
2018 Nicosia
Cyprus

→ www.wtscyprus.com

Have you read?



Major differences in the VAT system of the CEE countries to the EU regulations

The 2018 autumn issue of WTS CEE Tax Bridge focused on the most important differences in the VAT system of nine Central and Eastern European countries to the EU regulations: Austria, the Czech Republic, Hungary, Poland, Romania, Russia, Serbia, Slovakia and Slovenia.

If you are interested in the publication, please send us an email to the esther.lausek@wtsklient.hu email address!



Dr. Roman Pecháček
Tax Advisor

Special tax deduction to support R&D

Author: **Dr. Roman Pecháček**

The option of applying a special tax deduction to support research and development has been available to taxpayers in the Czech Republic since 2005.

Deduction amount

Taxpayers may deduct every euro spent on research and development twice: firstly as a standard tax-deductible cost, and secondly as a special deductible. Thus taxpayers may deduct 100% of their research and development expenses as special deductibles. In addition, they may deduct 10% of the excess deductible amount as compared with the previous period.

What expenses are deductible?

Taxpayers may deduct expenses which:

- meet the eligible purpose (see above),
- are eligible for tax deduction in general, and
- are recorded separately from other expenses in the books.

Expenses meeting an eligible purpose are those spent on:

- experimental or theoretical work,
- planning and designing,
- calculations,
- technology designs,
- manufacturing a functional product sample or prototype.

Research projects

The main condition for eligibility to make deductions is submitting draft terms for a research project. The draft project terms should describe the intended research and development activities. Documentation must subsequently be created and maintained on a continuous basis, describing the applied procedures, results, achievements and setbacks relating to the project implementation. Projects must be approved before the research commences.

The draft terms must be made out in writing and contain the following information:

- taxpayer's general identification details,
- project execution period,
- achievable and assessable project objectives,
- total estimated project expenses in the individual years of the project,

- names of all persons contributing professionally to the execution of the project,
- description of a method for checking and evaluating the project execution,
- day and place of project approval, and
- name and signature of an approved person acting on behalf of the research and development project.

Taxpayers are required to prove that the activities they carry out involve an aspect of uncertainty regarding the technical solution and an appraisable novelty element.

Binding assessment

If in doubt as to which expenses can be included in the tax deduction, taxpayers may request a decision from the tax authority; such decision is a binding assessment.

However, the practical utility of this concept is questionable, mainly due to the fact that issuing the decision involves a lengthy procedure, which can take up to several months. Furthermore, the assessment is limited to eligible expenses without addressing the activities giving rise to these expenses.

Practical use

Although the deduction option has already been available to taxpayers for 14 years, only very few take advantage of it. This can be illustrated by said taxpayers numbering only 1,262 in 2016.

In actual fact, the tax deduction for research and development is only claimed by large enterprises. Unlike smaller firms, large companies can afford to spend considerable funds on specialised advisors, and without their assistance it is almost impossible to successfully apply this type of tax deduction.



WTS in the
Czech Republic

taxpayers may deduct every euro spent on research and development twice

taxpayers are required to prove

practical utility of this concept is questionable

only very few take advantage of it

tax deduction is only claimed by large enterprises

submitting draft terms for a research project before the research commences

draft terms must contain

→ **Dr. Roman Pecháček**
Tax Advisor
+420 221 111 777
roman.pechacek@alferypartner.com

→ **WTS Alfery s.r.o.**
Václavské náměstí 40
110 00 Prague 1
Czech Republic

→ www.alferypartner.com



Tamás Gyányi
Partner

Corporate income tax initiatives for research and development projects

Authors: **Tamás Gyányi, Emese Balog**

The Hungarian tax system provides a wide range of tax benefits in terms of corporate income tax, local business tax or social security tax to promote taxpayers' research and development (R&D) projects. In this article, we highlight the main features of the available benefits with regard to corporate income tax.

Double deduction of qualifying R&D costs

Taxpayers subject to Hungarian corporate income tax may reduce their corporate income tax base by 100% of the qualifying direct costs relating to their research and development projects carried out for own purposes, or those based on service agreements or in line with special R&D agreements.

Based on a recent article published by the Hungarian tax authority on the experience of corporate tax audits, qualifying direct costs include, for example, R&D services rendered by another party or other invoiced costs relating directly to the given project, such as expert fees.

A very common cost item, however, is the salaries of staff involved in the project. This item is usually determined on a time-spent basis and the yearly average wage of engineers involved in the given project, expressed in hours. The depreciation of assets used for R&D purposes may also be considered part of the tax base reduction.

Sharing of R&D costs between group companies

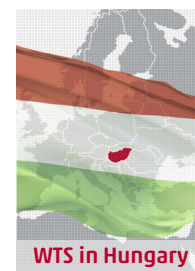
In addition, the Hungarian Act on Corporate Income Tax permits affiliated parties to share in-house R&D costs for tax base reduction purposes, if the related administrative conditions are met: a detailed agreement must be signed and the corporate income tax return must include several pieces of information on this agreement.

Sharing of R&D costs between the customer and the developer

According to recent changes in the Act on Corporate Income Tax, taxpayers purchasing an R&D project may share tax base reductions: the direct costs of such projects can either be claimed by the customer or by the developer based on their mutual agreement. Again, administrative tasks have to be carried out. Such R&D tax base reducing items cannot be passed on to a group company.

Agreements with special organisations

More favourable tax positions can be achieved by cooperating with special organisations such as universities. Companies may take into consideration 300% of the direct costs incurred in connection with R&D projects, but this tax base reduction is topped at a maximum of HUF 50 million (roughly EUR 155,000). This tax benefit may not be used if the taxpayer already claims R&D costs received by its affiliated company.



cooperating with special organisations such as universities

salaries of staff involved

affiliated parties to share in-house R&D costs

→ **Tamás Gyányi**
Partner
+36 1 887 3736
tamas.gyanyi@wtsklient.hu

→ **Emese Balog**
Senior Tax Consultant
+36 1 881 0630
emese.balog@wtsklient.hu

→ **WTS Klient Adótanácsadó Kft.**
Stefánia út 101-103.
1143 Budapest
Hungary

→ www.wtsklient.hu



Rafał Kosiń
Senior Manager

Introduction of the IP Box

Author: **Rafał Kosiń**

The Polish Parliament is developing tax regulations designed to encourage businesses to engage in research and development (R&D). According to the latest proposals to amend the Corporate Income Tax Act, a new incentive called IP Box is to be implemented in Poland via income tax regulations as of 1 January 2019.

*preferential
CIT tax rate is 5%*

IP Box is a preferential form of taxation for businesses that generate income from commercialising intellectual property (IP) rights they have developed. The preferential CIT tax rate is 5%, in comparison to the standard rate of 19%.

What IP rights are covered?

The preferential 5% rate will only apply to income from qualifying IP rights, i.e. rights created, developed or improved by taxpayers in the course of their R&D activities. So R&D activities are the first condition for applying the IP Box regime.

*the list of IP rights
subject to the IP Box
is close-ended*

Additionally, the list of IP rights subject to the IP Box is close-ended and generally includes industrial property rights of a technical character (excluding trademarks) and software copyrights (but not other copyrights). According to the new law, the qualifying IP rights are patents, supplementary protection certificates for inventions, utility models, industrial designs, integrated circuit topographies, supplementary protection certificates for patents involving medicinal products or plant protection products, registered medicinal and software rights.

*rights must be
legally protectable*

To be regarded as qualifying IP rights, the rights must be legally protectable. The preferential regulations may also be applied in relation to IP rights where industrial property protection is in progress (the application with the relevant public authority must be filed). However, if the application for industrial property protection is withdrawn or if the public authority rejects such application, the entity which applied in the

meantime for the preferential regulation must refund the value of the IP Box benefit received, along with penalty interest.

Specific rules for the tax base calculation

The new law provides a list of profits from qualifying IP rights which are subject to the IP Box. These profits must be generated by IP royalties (license fees), sales of qualifying IP, qualifying IP included in the sales price of products or services, and damages for infringements of qualifying IP, if awarded in litigious proceedings, including arbitration.

The value of income subject to the preferential 5% CIT rate is calculated according to a specific formula. The tax base from a qualifying IP right is the product of the profit from that right generated within a tax year and a ratio computed according to the following formula:

$$[(a + b) \times 1.3] / [a + b + c + d]$$

where the letters mean the following expenditures of the taxpayer:

- a – own R&D on the right,
- b – purchase of external R&D on the right from third parties (excluding purchase of qualifying IP rights),
- c – purchase of external R&D on the right from affiliates (excluding purchase of qualifying IP rights),
- d – purchase of qualifying IP rights.

The ratio does not include expenses that are not directly related to the IP right, such as interest, financial charges and real estate expenses. Where the ratio is greater than 1, it is deemed to equal 1.

A loss generated on a qualifying IP right within one year may be deducted from income over the next five consecutive tax years, but is only deductible from income from the same right or from a product or service of the same kind or within the same category in which the right has been applied.

continued on the next page



specific formula

*loss generated on a
qualifying IP right*

Requirements on accounting

record each IP right separately for accounting purposes

Businesses who apply the preferential 5% CIT rate on income from qualifying IP rights are obliged to record each IP right separately for accounting purposes and ensure that their accounting records enable them - to determine a profit/loss on each qualifying IP right. If taxpayers' accounting records are not sufficient to enable them to determine profit/loss on their qualifying IP rights, they have to pay the tax at the standard rate of 19%.

Summary

completely new incentive

This is a completely new incentive in Polish tax law. At the moment, the Polish CIT law provides for an incentive dedicated to research and development activities. This incentive has been included in Polish law

for a few years, and provides for an additional deduction of expenditures related to R&D activities (apart from their deduction as standard tax-deductible expenses). As of 2019, both of these incentives may be applied simultaneously.

→ **Rafał Kosin**
Senior Manager
+48 661 770 705
rafal.kosin@wtssaja.pl

→ **Doradztwo Podatkowe
WTS&SAJA Sp. z o.o.**
ul. Roosevelta 22
60-829 Poznań
Poland

→ www.wtssaja.pl

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Florin Gherghel
Tax Manager

R&D: Exemption from corporate income tax and other tax incentives

Author: **Florin Gherghel**

Companies who only carry out innovation and research & development activities (specific definitions of such activities have to be taken into consideration) are exempt from paying corporate income tax in the first ten years of their activity. State aid rules have to be observed to apply this facility.

Additional deductions for corporate income tax assessment

A supplementary deduction of 50% of the expenses eligible for research & development activities (in addition to the value of these expenses) can be made for corporate income tax purposes.

Accelerated depreciation for specific equipment used in research & development activities (e.g. technological equipment, control devices) may also be claimed. Thus 50% of the value of the asset can be deducted in the first year.

Eligible activities for this incentive may include applied research and / or technological development. Research & development can be performed in Romania / EU and has to be relevant for the company's activity. Research & development activities have to be included in a project fulfilling specific conditions.

Research & development should generate results usable by the company (e.g. for its own benefit, or sale / use of results). If the objectives of the research & development project are not accomplished, the facility can still be applied.

Eligible expenses have to be allocated to a research & development activity, and they are as follows:

- depreciation expenses for assets used in research & development,
- salary expenses of research & development employees,

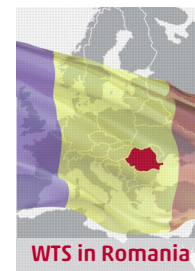
- maintenance & operational expenses for used assets,
- operational expenses allocated to this activity, such as raw materials, third-party services, inventory, etc.,
- direct costs allocated to research & development activity.

State aid rules must be observed to apply this facility.

The Ministry of Education should have set up a register of experts, who can certify that the activities performed are indeed research & development activities. Unfortunately, this register has not been set up yet, and companies are reluctant to claim the above-mentioned incentive in the absence of expert verification.

Exemption from salary tax for research & development employees

No salary tax is to be withheld by employers for the salary remunerations of employees involved in research & development activities, provided that specific requirements are fulfilled (mainly a well-defined research & development project).



WTS in Romania

register of experts

no salary tax is to be withheld

supplementary deduction of 50% of the expenses

accelerated depreciation for specific equipment

generate results usable by the company

→ **Florin Gherghel**
Tax Manager
+40 74 8026865
Florin.Gherghel@ensight.ro

→ **Ensign Finance**
25 Alexandru Constantinescu St.
011471 Bucharest
Romania

→ www.ensight.ro



Bojan Radojičić
Managing Partner

Changes in Corporate Income Tax Law to attract R&D investment

Author: **Bojan Radojičić**

Unlike most EU countries, the tax regulation of the Republic of Serbia does not currently have any special tax regime for investments in research and development (R&D) activities. However, the Serbian regulation has preferential tax regimes for new investments and new jobs, which can also be utilised by investors planning to conduct R&D activities in Serbia.

Current tax treatment of investments into R&D in Serbia

Examples of preferential tax regimes include:

- large investors*

→ according to the Corporate Income Tax Law, large investors, who invest at least RSD 1 billion (roughly EUR 8.6 million) and employ at least 100 people on indefinite contracts, are entitled to a tax holiday of ten years;
- employers who hire new employees*

→ according to the Personal Income Tax Law, employers who hire new employees – who were previously registered as unemployed for six months (or three months in the case of trainees) – have the right to reclaim part of the tax paid on the new employees' salaries. This right is set to expire on 31 December 2019;
- newly-founded companies*

→ according to the Law on Mandatory Social Contributions, employers who hire new employees – who were previously registered as unemployed for six months (or three months in the case of trainees) – have the right to reclaim part of the contributions paid on the new employees' salaries. This right is set to expire on 31 December 2019;
- newly-founded companies*

→ according to the Personal Income Tax Law, newly-founded companies (established until 31 December 2020) can be exempted from paying personal income tax on the salaries of the founder and up to nine employees – previously registered as unemployed for at least six months, or fresh graduates – for the first twelve months;

- according to the Law on Mandatory Social Contributions, newly-founded companies (established until 31 December 2020) can be exempted from paying social contributions on the salaries of the founder and up to nine employees – previously registered as unemployed for at least six months, or fresh graduates – for the first twelve months.

Proposed changes to Corporate Income Tax Law

In November 2018, the Ministry of Finance of the Republic of Serbia proposed changes to the Corporate Income Tax Law. Those changes will mostly introduce tax benefits for:

- companies conducting R&D activities in Serbia,
- companies investing in innovative businesses and
- companies owning intellectual property registered in Serbia.

According to the draft amendments to the Corporate Income Tax Law, companies will be able to deduct costs directly related to research and development activities twice in their tax balance sheets.

Additionally, the draft amendments to the Corporate Income Tax Law introduce tax credits to ease access to capital for newly-founded companies conducting innovative business activities, as well to provide incentives to invest in these companies. Namely, taxpayers which make equity investments into a newly-founded company conducting innovative business activities are entitled to a tax credit amounting to 30% of the invested funds. The maximum tax credit is RSD 100 million (roughly EUR 800,000). For the purposes of this law, innovative business activities are activities which lead to the creation of new products, technologies, processes or services, or significant changes to existing products, technologies, processes and services, according to the needs of the market.



companies will be able to deduct costs twice

tax credit amounting to 30% of the invested funds

*preferential tax
regime for companies
registering software
or copyrights*

Finally, the draft amendments to the Corporate Income Tax Law present a preferential tax regime for companies registering software or copyrights in Serbia in 2019 or in later years: 80% of the revenue generated from utilising ownership rights, reduced by deductible tax expenses on R&D activities which created the registered software/copyright, will not be included in the corporate income tax base.

→ **Bojan Radojičić**
Managing Partner
+381 60 70 330 40
bojan@wtsserbia.com

→ **WTS Tax and Finance Ltd.**
Vojvode Stepe 32
11000 Belgrade
Serbia

→ www.wtsserbia.com

Contact us!

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Lukáš Mokoš
Tax Advisor

Deduction of research and development costs

Author: **Lukáš Mokoš**

Since 2015, taxpayers have been able to deduct higher amounts of research and development (R&D) costs. This incentive put in place by the Slovak government is designed to motivate Slovak taxpayers to intensify their activity in this area.

Generally, taxpayers can benefit from these deductions directly in their submitted tax returns.

The extra deductible amount is defined in the Slovak Income Tax Act as follows:

- 100% of R&D activity costs in the given tax period
- 100% of positive difference between average costs in 2017 and 2016 and average costs in 2016 and 2015

Generally, the possibility to deduct such an amount of costs is allowed only under fulfilment of some preconditions. One of these preconditions is the preparation of an R&D project. This project does not have to be submitted together with the tax return. Taxpayers only have to submit such project during a tax audit. The tax authorities prepare lists of taxpayers who benefit from this extra deduction.

one precondition is the preparation of an R&D project

Dual education process

Taxpayers allowing apprentices to essentially be educated at their company, fulfilling some tax prerequisites, are allowed to reduce their tax base as follows:

- EUR 3,200 for every apprentice, in case of more than 400 hours of education
- EUR 1,600 for every apprentice, in case of more than 200 hours of education

taxpayers allowing apprentices to be educated at their company

Patent box

On 1 January 2018 the Slovak government introduced a tax exemption for incomes derived from intangibles developed by taxpayers in Slovakia. There are two forms here:

- 50% from royalties
- 50% from sales revenue of goods developed using the intangible asset

The costs related to the exempt income are not tax deductible in an equal amount. This should help to avoid tax losses emerging. Taxpayers can benefit from this exemption during the amortisation period of the intangible asset. The law does not prevent both the exemption and extra deduction of R&D costs being claimed at the same time.



tax exemption for incomes derived from intangibles developed by taxpayers in Slovakia

→ **Lukáš Mokoš**
Tax Advisor
+421 2 571042 66
lukas.mokos@mandat.sk

→ **Mandat Consulting, k.s.**
Námestie SNP 15
81101 Bratislava
Slovakia

→ www.mandat.sk



Mateja Babič
Managing Partner

Tax incentives in research and development

Author: **Mateja Babič**

The purpose of introducing research and development (R&D) incentives in Slovenia was to create a more interesting business environment and increase competitiveness by stimulating new knowledge, new patents and improved products and services.

In Slovenia, all taxpayers conducting an economic activity (e.g. corporations, partnerships, sole entrepreneurs, branches of foreign companies) may use the R&D incentive under the same conditions. There are no territorial restrictions, meaning that the external R&D cost of materials or services can be purchased from Slovenian or foreign persons.

Deductible expense and tax allowance - double dip

Profit stemming from a surplus of revenues over expenses is subject to corporate tax in Slovenia. No special treatment of R&D expenses is foreseen as long as expenses are substantiated, and connected with – or result from – the business activity.

Expenses can be direct service or material expenses in the same tax year in which they occur, or they can be presented in the form of a depreciation cost on the R&D assets or intangibles. As a consequence, R&D expenses can first be used to reduce the CIT base in the form of depreciation or directly as costs, and secondly as an R&D allowance.

R&D tax allowance

As a general rule, tax incentives in Slovenia are determined as tax allowances which reduce the tax base, but their total amount may not exceed the tax base in the current tax year. A taxpayer in Slovenia may claim a reduction of its tax base for 100% of the amount invested in R&D during the tax year. The unused part may be carried forward for the next five tax years. If assets are financed from the state or EU budget, the tax allowance may not be claimed.

Investments eligible for the R&D allowance include:

- internal R&D activities of the taxpayer, including the purchase of R&D equipment used exclusively for the R&D activities of the taxpayer;
- purchase of R&D services performed by other persons, enterprises or by other

research organisations, which include the cost of contracts concluded with researchers working on the R&D project, the cost of contracts concluded with R&D organisations and others registered for R&D activities. The R&D services purchased from associated entities should be in line with transfer pricing rules. The purchase of licenses is not included in the amount of the tax allowance.

Documentation requirements

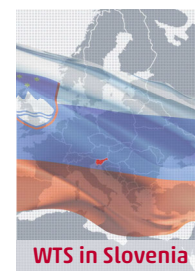
The first rule for taxpayers is that they must define eligible investments in R&D in their business plan or in a special development project/program. The project must be described in detail and in a manner that facilitates subsequent verification by the tax authorities. The taxpayer must keep accurate records of all eligible consumption and other data. At the tax authority's request, the taxpayer must immediately submit the required documentation and data.

A suitable business plan or project should at least contain the following:

- name of the R&D project,
- detailed description of the R&D project subject matter,
- list of predictable R&D project activities, together with the cost estimation and time schedule,
- planned milestones during R&D project implementation,
- R&D project results.

Practical issues

In practice over the past two years we have seen targeted tax inspections of all taxpayers who have declared an R&D tax allowance in the past five years in their CIT declaration. For taxpayers who just had an R&D plan without any substantiated R&D equipment or purchased services, the right to claim the R&D tax allowance is denied.



no territorial restrictions

R&D expenses can first be used to reduce the CIT base in the form of depreciation or directly as costs

a taxpayer in Slovenia may claim a reduction of its tax base for 100%

internal R&D activities

purchase of R&D services

define eligible investments in R&D in their business plan

keep accurate records

targeted tax inspections

→ **Mateja Babič**
Managing Partner
+386 59 071 705
mateja.babic@wts-tax.si

→ **WTS Tax d.o.o.**
Poljanski nasip 8
1000 Ljubljana
Slovenia

→ www.wts-tax.si

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Should you have any questions regarding the above or any other professional issues, please do not hesitate to get in touch with your WTS advisor or use any of the contact details below.

WTS Klient Hungary is the coordinator within WTS Global for the Central and Eastern Europe Region. We focus on regionally important topics and support our multinational clients headquartered in the region. Our clients always have one lead partner for all the countries involved in a project, so they receive a solution from one source but drawing on the knowledge of all the colleagues from different countries.

Our latest publications

The collage displays three newsletter covers from WTS Klient. The left cover, dated 23 November 2018, is titled 'wts klient newsflash' and contains a 'Brief summary of 2019 tax law amendments for decision-makers'. The middle cover, dated November 2018, is titled 'wts klient newsletter' and features 'Comparability methods' and 'Tax and Investment Facts'. The right cover, also dated November 2018, is titled 'wts klient newsletter' and features 'Business valuation based on comparables methods'.

WTS Klient Hungary
 H-1143 Budapest • Stefánia út 101-103.
 Telephone: +36 1 887 3700 • Fax: +36 1 887 3799
 info@wtsklient.hu • www.wtsklient.hu

WTS Klient Ltd.
 Registered seat:
 H-1143 Budapest, Stefánia út 101-103.
 Company registration number: Cg.01-09-930353

WTS Klient Tax Advisory Ltd.
 Registered seat:
 H-1143 Budapest, Stefánia út 101-103.
 Company registration number: Cg.01-09-978231