

SEE Country Questionnaire on the Tax Treatment of the Creation, Acquisition and Use of ‘Knowledge Capital’

Background and motivation

Today’s world is one in which all countries, OECD and non-OECD alike, must rely on ‘knowledge capital’ to drive sustained economic growth and prosperity.¹ Recognizing this, governments aim to offer a policy framework that supports the creation, acquisition and use of knowledge capital (embodied in patents for example), and in certain cases provide targeted financial (tax and/or non-tax) assistance. The global economic crisis and the need for sustained economic growth to manage worsening public debt positions have brought increased focus on the role of innovation in restoring growth, and the need for efficient provision of financial support. On the tax policy side, it is recognized that R&D tax incentive programmes and tax rules applicable to the acquisition and use of intangibles must form part of a coherent and well-designed innovation strategy.²

Tax policy makers in certain countries in the South East Europe (SEE) region may feel compelled to consider introducing an R&D tax incentive programme, if not soon then possibly in the near future, given the availability of tax assistance in other countries to reduce R&D costs and thus attract R&D activity. Equally if not more important to consider is the tax treatment of acquiring, through purchase or by license, new technologies that have been developed by others. Business incentives to develop or adopt new production technologies also depend on the tax treatment of returns on own-use, licensing out and sale of new technologies.

When rethinking strategies to encourage greater use of knowledge capital, policy makers are confronted with questions over an appropriate amount of home country tax to collect on revenues derived from applications of new technologies, in particular where their development is heavily subsidized, for example by generous tax incentives for product/process development. Policy strategies must take into account the highly mobile nature of the location of intangibles, including patents, and opportunities for tax avoidance that may be realized by transferring patents to offshore (tax haven) holding companies where royalty income can be received tax free. Such strategies encourage policy makers to consider the pros and cons of strategies that subsidize product/process development expenditures, while taxing at full corporate tax rates profits on the domestic use of intellectual property (in domestic production, licenses and sale agreements).

The information gathered here will be used to compare OECD and SEE country experience with tax policy as it impacts knowledge capital, with the aim of 1) elaborating a framework for analyzing the tax treatment of innovation (in particular, the creation, adoption and diffusion of patented knowledge capital); 2) considering alternative tax treatment of the various drivers of innovation (in particular, R&D, accessing patented knowledge capital from other firms, using knowledge capital (own-use, license, sale); 3) identify intended and unintended effects of tax policies including offshore tax avoidance; 4) consider the use of tax incentives alongside other types of public support; and 5) report evidence on country experience.

¹ ‘Knowledge capital’ is used here to refer to a stock of knowledge, as embodied in patents for example. Knowledge capital forms part of a company’s intangible capital, with intangible assets including patents, non-patented stocks of knowledge, copyrights, trademarks, and goodwill. The questionnaire focuses on the tax treatment of patents, as a specific and key type of knowledge capital.

² Innovation activity (involving product innovation, process innovation, market innovation, organisational innovation (OECD (1996)) may be influenced by taxation through a number of channels. Tax policy influences R&D investment (creation of intangible assets), the adoption and dissemination of knowledge (including adoption of environmentally-friendly technologies), risk-taking with respect to the financing of risky innovative businesses, and mobility of highly-skilled workers.

Part I of the questionnaire gathers detailed descriptive information on the tax treatment of R&D, acquiring a patent (purchase versus licensing agreement), and use of a patent (own-use, sale, licensing agreement), with respondents asked to provide information for the tax year beginning 1 January 2010.³ Part II asks for general information on subsidies for R&D provided outside the tax system, and on the experience of policy makers with previous/current tax treatment of R&D, acquiring and using patents, including general findings or views on the effectiveness of R&D tax incentives.

Respondents are kindly requested to complete the questionnaire in electronic (Word document) form, and submit the response to steven.clark@oecd.org and erin.hengel@oecd.org.

³ Where the tax year does not coincide with the calendar year, please consider the tax year that covers a period including 1 January 2010.

PART I. DESCRIPTION OF TAX PROVISIONS

A. Treatment of Research and Development (R&D) Expenditures

• **Basic corporate income tax provisions**

1. Does your country impose corporate income tax (CIT)?⁴ Yes____; No____. If ‘No’, ignore questions 2-6. If ‘Yes’, please indicate the basic CIT rate ____% .

2. Does the CIT base provide a basic deduction for current R&D expenses (i.e. wages, materials used in R&D), with full (100%) current year deductibility of R&D expenses? Yes____; No____.

3. Does the CIT base provide basic tax depreciation allowances for capital R&D expenses (i.e. machinery, equipment, buildings used in R&D)? Yes____; No____. Are the basic tax depreciation allowance provisions (depreciation methods, rates) for capital used to in R&D identical to the basic tax depreciation allowance provisions that would apply if the capital were not used in R&D? Yes____; No____. If ‘No’, please describe how the basic tax depreciation rules differ for capital used in R&D:

• **Additional R&D tax allowance and/or R&D tax credit**

4. Does the CIT base provide an additional R&D tax allowance⁵ for current and/or capital R&D expenses? Yes____; No____. If ‘Yes’, please describe the basic design features of the R&D tax allowance (eligible current/capital expenses, R&D tax allowance rate and calculation, other key design features):

5. Does the CIT system provide an R&D tax credit⁶ for current and/or capital R&D expenses (in addition to a basic deduction for current/capital R&D expenses)? Yes____; No____. If ‘Yes’, please describe the basic design features of the R&D tax credit (eligible current/capital expenses, R&D tax credit rate and calculation, other key design features):

⁴ ‘Corporate income tax’ is used here to mean a tax on business profits (as measured for tax purposes) of incorporated companies.

⁵ ‘Additional R&D tax allowance’ is used to refer to a deduction from the tax base in respect of qualifying R&D current and capital costs, in addition to tax relief provided by a basic deduction for current R&D expenses and basic tax depreciation allowances for depreciable capital used in R&D.

⁶ ‘R&D tax credit’ is used to refer to a deduction from (credit against) CIT liability otherwise payable, in respect of qualifying R&D current and capital costs.

6. If the CIT system provides an R&D tax allowance and/or R&D tax credit, is the tax relief available to all resident taxable corporations? Yes____; No____. If 'No', then please indicate the targeting provisions (e.g. tax relief targeted at firms depending on ownership, firm size, business activity, location etc.):

B. Treatment of Acquisition of a Patent (purchase versus licensing agreement)

• **Purchase of patent**

7. Does the CIT base provide for an immediate deduction of the acquisition/purchase cost of a patent (immediate expensing)? Yes____; No____. If 'No', is the acquisition cost capitalized and deducted (amortized) over time? Yes____; No____. If 'Yes', please briefly describe the amortization rules:

• **Licensing agreement (purchase of rights to use a patent)**

8. Does the CIT base provide for an immediate deduction for royalty payments for the use of/right to use a patent? Yes____; No____. If 'No', please briefly describe the basic corporate tax base rules governing the deductibility of royalty payments for the use of/right to use a patent:

9. Does the CIT system provide any additional relief for the acquisition cost of a patent (in addition to a basic deduction, as under 7 above)? Yes____; No____. Does the CIT system provide any additional relief for the use of/right to use a patent (in addition to a basic deduction, as under 8 above)? Yes____; No____. If 'Yes' to either of these questions, please describe the type of relief (mechanism, rates, thresholds, targeting etc):

10. What is the *statutory* non-resident withholding tax rate on royalty payments for the use of/right to use a patent?⁷ ____%. In recently signed tax treaties, what is/are the treaty non-resident withholding tax rate(s) on royalty payments for the use of/right to use a patent ? ____%.

⁷ The *statutory* rate is specified in legislation (applicable in the absence of reduced rate negotiated under a tax treaty).

C. Treatment of Use of a Patent (own-use, sale, licensing agreement)

- **Own-use of a patent**

11. Where self-developed patented information is used in production (i.e., own-use of a self-developed patent⁸), do special corporate tax rules apply that preferentially tax profits derived from production? Yes____; No____. If ‘Yes’, please briefly describe the preferential tax treatment (e.g. taxation at a reduced rate of profits derived from production using a self-developed patent):

12. Where patented information is acquired (purchased or licensed) from another company, and is used in production, do special corporate tax rules apply that preferentially tax profits derived from production? Yes____; No____. If ‘Yes’, please briefly describe the preferential tax treatment:

- **Sale of a patent**

13. Where a self-developed patent is sold to another company, do special corporate tax rules apply that preferentially tax the proceeds from the sale, compared to the sale (resale) of patent that is purchased from another company? Yes____; No____. Please briefly describe the rules applicable to the sale of a self-developed patent:

- **Licensing agreement (sale of rights to use a patent)**

14. Where rights to use a self-developed patent are licensed to another company, do special corporate tax rules apply that preferentially tax royalty income received from the license (e.g. apply a reduced CIT rate), compared to the taxation of royalty income generally? Yes____; No____. Please briefly describe the tax treatment of royalty income on the license of a self-developed patent, and how the treatment differs from the tax treatment of royalty income generally:

15. Where rights to use a self-developed patent are licensed by a resident parent company to a related company A (i.e., an intellectual property holding company) resident in a low/no tax jurisdiction (‘tax haven’), do anti-deferral (controlled foreign company (CFC)) rules apply that tax the parent company on a

⁸ A ‘self-developed patent’ refers to a patent created by company X (alone or together with other companies) that is held/used by company X (in production, in a sale, or in a license agreement). In this particular question, the focus is on a self-developed patent that is used in production (own-use).

current basis on royalty income received by related company A? Yes ____; No _____. If 'Yes', are tax-planning techniques widely used to avoid application of the anti-deferral rules? Yes ____; No _____.

PART II. EXPERIENCE WITH TAX TREATMENT OF KNOWLEDGE CAPITAL

16. Does your country provide private R&D performers with non-tax assistance (e.g. grants, loans)? Yes ____; No _____. If 'Yes', please describe the types of assistance provided:

17. Please provide a brief summary of your country's experience⁹ with rules governing the tax treatment of R&D (including R&D tax incentives, if provided), the tax treatment of acquiring (purchase, licensing-in) patents, and the tax treatment of using (sale, licensing-out) patents, with a focus on the rationale for policy choices, intended and unintended outcomes of policies:

⁹ Please describe your country's experience with reference to any recent year.