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URL: http://www.deloitte-tax-news.de/german-tax-legal-news/law-to-introduce-rd-tax-incentive-adopted-by-upper-house-of-parliament-submitted-to-president-for-approval.html

03.12.2019

German Tax and Legal News

Law to introduce R&D tax incentive adopted by upper house of parliament, submitted to president for approval

Incentive to apply as from 2020.

The upper house of the German parliament adopted the law introducing a tax incentive for research and development (R&D) on 29 November 2019, following its passage by the lower house of parliament on 7 November 2019. The law still must be signed by the president and published in the federal gazette, which is expected to occur in December so that the law can enter into effect as from 1 January 2020. The law introduces an R&D tax incentive that is particularly intended to support small and medium-sized enterprises (SMEs).

The final law is mostly in line with the draft law introduced into the legislative process by the German government on 22 May 2019 (see GTLN dated 3 June 2019), but it has been amended to align with EU state aid principles (in particular, the EU block exemption regulation that outlines the conditions under which state aid may be granted without the prior notification and approval of the European Commission). In addition, the definition of eligible expenses has been broadened to include expenses for contract R&D activities at the level of the principal (as described further below), among other changes. Once the final law is enacted, the incentive will be available for qualifying expenses incurred on or after 1 January 2020.

The final law will introduce a research allowance amounting to 25% of eligible expenses for qualifying R&D projects. The maximum annual incentive will be EUR 500,000 per company, per fiscal year, meaning that the maximum amount of qualifying expenses is EUR 2 million per company, per year. In the case of affiliated companies, the limit will apply at the group level; in the case of projects involving cooperation between unrelated parties, it will apply to each eligible party individually.

The final law reflects the following notable changes to the draft version:

- The criteria for distinguishing between eligible R&D activities and ineligible market development activities or activities to improve production systems will be based on definitions provided in the EU block exemption regulation.
- Expenses incurred at the level of a principal company for contract R&D activities carried out by a service provider will be eligible for the tax incentive, provided the service provider has its registered seat in an EU/European Economic Area member state.
- Eligible expenses under the new law will be personnel expenses, including employer contributions for old age insurance, life insurance or comparable contributions. The 120% gross-up factor for personnel expenses included in the draft law has been removed. In the case of R&D activities of an entrepreneur with a sole proprietorship, or of the partners of a partnership, the eligible expenses relating to such activities will be calculated based on an hourly rate of EUR 40 for purposes of the R&D incentive. In the case of expenses incurred for contract R&D activities, 60% of the overall expenses that are paid for such activities will be considered eligible expenses.
- The total amount of government incentives for each company and each R&D project (including the tax incentive) may not exceed EUR 15 million.
- The available tax incentive will be determined by the tax authorities and the taxpayer will be notified through a separate assessment notice.The incentive will be offset against the tax that is assessed in the next annual individual income tax or corporate income tax assessment notice. To the extent the income tax assessed is less than the amount of the tax incentive, the incentive will be paid out as a cash grant.
- Due to EU state aid requirements, the term of the law to introduce the R&D tax incentive initially will be limited to six months starting from 1 January 2020, but the law automatically would be extended indefinitely upon the European Commission's approval of the incentive. Approval from the commission is expected within the first six months of 2020.

The details of the administrative process for applying for the R&D tax incentive and the approval/certification process have not yet been provided. These details must be worked out and set forth by the federal ministry of education and research in separate regulations that are expected to be issued in 2020.

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