Contribution of taxation and customs policies to the Lisbon strategy

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PURPOSE: an analysis of national and EU R&D tax incentives.

CONTENT: in adopting the Lisbon Strategy, the Member States committed themselves to investing 3% of GDP, by 2010, in R&D. Of this amount, 2% should come from the private sector. In 2005, the Commission Communication on the contribution of taxation and customs policy to the Lisbon Strategy, stated that the Commission intended to promote a more consistent and favourable tax environment for R&D, whilst at the same time recognising Member States' powers over national tax policy (See COM /2005/0226). To that end, this report provides guidance to the Member States on how to improve their R&D tax treatment and to help develop mutually consistent solutions to common problems. The report does do by:

- clarifying the legal conditions for Member State R&D tax incentives arising from EU law, notably relevant ECJ jurisprudence on the EU Treaty freedoms and State aid rules;

- highlighting general design features for R&D tax treatment and incentives based on expert analysis of good practice; and

- presenting, for future discussion, a number of possible initiatives that address issues of common interest in a consistent way.

EU law and R&D tax incentives: All R&D tax incentives implemented by the Member States must conform to fundamental Treaty freedoms and the principle of non-discrimination. Any R&D tax incentive imposing restriction on where the R&D is performed (territorial restriction) has to be scrutinised in order to verify compatibility with EC Treaty provision (Article 43 freedom of establishment and Article 49 freedom to provide services). The Commission is currently examining the compatibility of Member State legislation in this respect and has identified a number of problematic cases that have been, or are being, discussed in the Member States. The territorial restrictions of one Member States' R&D tax incentives are currently before the ECJ (Commission vs. Spain). In others (e.g. France, the Netherlands , Belgium) Commission initiatives have already prompted Member States to amend their tax legislation or practice. In order to analyses these issues further, this section of the report goes onto examine, in detail the following:

- *R&D tax incentives' compatibility with the EU's fundamental freedoms*: The Commission is of the view that both explicit and implicit territorial restriction are incompatible with the EU Treaty. The paper also addresses questions relating to fiscal supervision, loss of tax revenue, the prevention of tax avoidance and promoting national R&D and national competitiveness.

- *R&D tax incentive's compatibility with State Aid rules*: National R&D tax incentives are not only subject to legal constraints imposed by the Treaty but they also need to be in line with Community State Aid rules. In certain circumstances national R&D tax incentives could constitute State Aid. Thus, when assessing an R&D tax incentives that constitutes State Aid (within the meaning of Article 87) the Commission will look at: whether it applies to one or more R&D category; whether it relates solely to certain eligible R&D costs listed in the framework; and the aid intensity of the R&D tax incentive.

Good design features for R&D tax treatment and incentives: Member States' best practice are currently disseminated via CREST expert reports. These reports provide an overview and analysis of the various R&D tax incentives and reflect the diversity of situations in the countries concerned (general tax policy, industrial structure, private sector R&D performance etc). There is no single answer as to how R&D tax incentives should be designed, implemented or evaluated. Nevertheless, based on expert analysis of the various schemes a number of guiding principles can be defined. They include, for example, the need for tax incentives:

- to reach more firms and to minimise market distortions;
- to include all current expenses and consider certain types of R&D related capital expenditure;
- to focus on ascertaining the direct additionality of tax incentives and their behavioural additionality ;
- to consider evaluation criteria and data from the design stage;
- to test whether tax incentives have met their specific objectives;
- to test whether their delivery/administration mechanism was efficient; and
- to assess what their wider societal effects may be.

More detail regarding their generic design and implementation principles are set out in Annex to the report.

Orientations for measures of common interest and mutual benefit: A number of other specific tax issues can be applied consistently, on top of the basic design principles, outlined above. Some of these issues are research-related aspects of the general taxation system whilst others concern R&D issues of common interest. The common aim of the initiatives discussed under this section is to ensure that tax policy contributes more to achieving a knowledge-based economy by establishing a consistent framework conducive to more investment in R&D and improving the functioning of the internal market. The initiatives analysed under this heading include: supporting large-scale trans-national R&D projects; targeting Young Innovative Enterprises; promoting philanthropic funding or research; the cross-border mobility of researchers; facilitating cross-border outsourcing of R&D; R&D's relationship with VAT; and R&D treatment in the common consolidated tax base.

Conclusions: The Commission acknowledges the recent trend in many Member States to provide more favourable tax treatment for R&D and welcomes these efforts to raise R&D business expenditure. The growing diversity of R&D tax incentives risks further fragmenting the European corporate fiscal landscape and could lead to their less than optimal cross-border use. As a result, a certain degree of co-ordination is needed in order to foster the effective use of R&D tax incentives across the EU and in order to improve trans-national research co-operation.