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AS OF 1 JANUARY 2016 TAX CREDIT FOR RESEARCH AND DEVELOPMENT ACTIVITY REPLACING THE REPEALED NEW TECHNOLOGY TAX CREDIT

Tax Alert

Dear Sirs,

On 1 January 2016 the Law of 25 September 2015 on changes to some regulations connected with supporting innovation (hereinafter called: the "Law") became valid. The Law introduces significant changes in the scope of eligible deductions from Income Tax. The provisions regulating the principles of deductions falling within the scope of the so-called new technology tax credit were repealed. In their place new tax credit concerning the research and development activity was introduced.

How should research and development activity be understood?

According to the new provisions the operational costs, also called 'eligible expenses', incurred by the taxpayer for the research and development activity shall be deducted from the taxable income.

When is the taxpayer entitled to apply the tax credit?

- In the case of his/her independent development of new products, new production processes or new services (whereas this does not apply to the introduction of routine, standard changes) and in the case of development of significant improvements to the aforementioned;
- In the case of creation of new applications of the already existing products;
- In the case of development of new technologies, including software;
- In the case of acquisition and use of know-how of other entities for the purpose of planning of the production processes.

The definitions of the activities deemed to be the research and development activities are included in the Law.

- Definition of the research and development activities: creative activities comprising the scientific research or development works undertaken on a regular basis for the purpose of the increase of the know-how resources and for the purpose of the new applications of the know-how resources.

Furthermore, the Law also includes detailed definitions of the scientific research (basic research, applied research, industrial research) and development works.

To determine whether the taxpayer is entitled to apply this tax credit or not, the purpose of the activities is to be accounted for but not the actual result of these activities. Therefore, the actual activities documented with respective documentation are of vital importance. It may sometimes occur that despite carrying out the research and development works intended for the development of new products, such products shall eventually fail to be produced. If the taxpayer applies the said tax credit, he/she is not required to obtain an opinion of a scientific unit confirming the nature of the taxpayer's activities.

The provisions do not require that the entrepreneurs should incur additional costs e.g. the creation of new work places (the entrepreneur may engage the already employed staff in the research and development activity) or the creation of a new internal unit/department intended for this purpose exclusively (e.g. research and development department).

The tax credit may be applied irrespectively of the fact whether the costs incurred were paid to the supplier or not.

Eligible expenses

The scope of eligible expenses is much wider here than in case of the repealed new technology tax credit.

- Costs of remunerations and premiums: remuneration of an employee employed on the basis of an employment contract for the purpose of carrying out the research and development activity including the premiums financed by the payer of these premiums (this also applies to the service relationship, home based work and cooperative work relationship);
- Costs of materials and raw materials: purchases of materials and raw materials directly related to the undertaken research and development activity;
- Costs of services: expenses incurred for the payment for expert's opinions, opinions, consultancy services and similar services as well as those incurred for the purchase of results of scientific research, rendered or performed on a contractual basis by the scientific unit;
- Costs related to the use of research instruments; the application of the tax credit is dependent on the use of the instruments not based on any contract concluded with an entity related to the taxpayer;
- Depreciation and amortisation write-offs: recognised as operational costs - depreciation and amortisation write-offs applied for the undertaken research and development activity, except for passenger cars and facilities, buildings and premises being separate ownership. This, for instance concerns: machinery, new invention patents, software licences, know-how.

Deduction principles

Due to incurring the above listed costs and expenses, the taxpayer may enjoy the tax benefits at two stages:

Stage 1: recognition of the full amount of the expense/cost into the tax deductible costs;

Stage 2: additionally deduction of these costs/expenses from the taxable basis, with the reservation that the deduction may not exceed 30%, 20% or 10% of their amount, depending on their type and status of the entity applying the deduction.

Statutory limitations of deductions

- 30% - concerns the costs related to the payment of remuneration to persons working on innovative projects;
- 20% (in case of large enterprises 10%) - concerns the costs of purchasing raw materials and materials, expert's opinions, consultancy services, results of scientific research, use of research instruments against a fee and depreciation and amortisation write offs, if the taxpayer is a micro-enterprise, small or medium enterprise in the meaning of the provisions of the Act on Freedom of Business Activity.

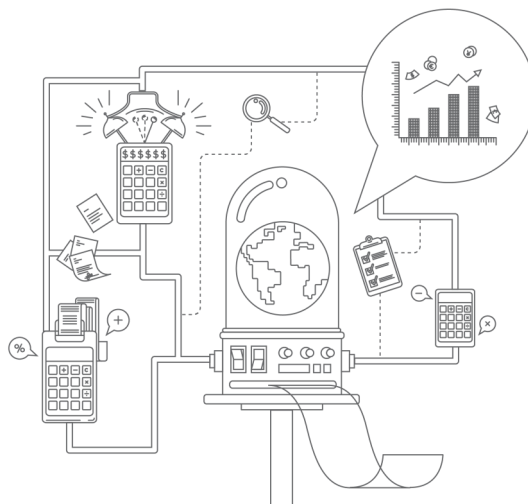
For example:

A taxpayer, who is a medium enterprise, employed three employees for the purpose of designing a new product. The total cost incurred by the employer due to such employment is 30,000.00 PLN/month

(remuneration and premiums :) 3 x 10.000 PLN). For the same purpose, the taxpayer purchased the consultancy services to the value of 30,000.00 PLN and materials and raw materials necessary for the manufacturing of the prototype to the value of 60,000 PLN.

In 2016 the taxpayer allocated for the research and development activity the total of: 450,000.00 PLN.

- costs related to employment: 360,000.00 PLN (12 x 30,000.00 PLN);
- consultancy services: 30,000.00 PLN;
- materials and raw materials: 60,000.00 PLN.



Costs of the research and development activities:

Stage 1: The taxpayer recognises 450,000.00 PLN as the operational costs in the year;

Stage 2: Next, he/she deducts the following from the taxable basis subject to the income tax: 126,000.00 PLN.

- 30% of the costs related to remuneration that is 108,000.00 PLN (360,000.00 PLN x 30%);
- 20% of the costs related to consultancy services that is 6,000.00 PLN (30,000.00 PLN x 20%);
- 20% of the costs related to materials and raw materials that is 12,000.00 PLN (60,000.00 PLN x 20%).

Tax calculation:

- at the assumption that in 2016, the income of the taxpayer shall amount to 1,000,000.00 PLN;
- operational costs shall amount to 700,000.00 PLN (in this 450,000.00 PLN allocated to the research and development activity);
- taxable income shall amount to 300,000.00 PLN;
- the taxable basis, having accounted for the tax credit for research and development activity, shall amount to: 174,000.00 PLN (300,000.00 PLN – 126,000.00 PLN);
- The due tax, after the application of the tax credit, shall amount to: 33,060.00 PLN (174,000.00 PLN x 19%).

The benefits obtained

If the aforementioned costs and expenses were not recognised (due to inadvertence or lack of knowledge) as the costs and expenses incurred for the research and development activities, the due tax would amount to 57,000.00 PLN.

Thus, in this case, the tax benefit is 23,940 PLN - this is the amount by which the tax payable by the taxpayer was reduced.

Examples of reservations and duties related to the deduction

The eligible costs shall be subject to deduction if they were not reimbursed to the taxpayer in any other form. The taxpayers, who in the fiscal year, carried out business activity in the special economic zone on the basis of a licence, may not apply the new tax credit.

The taxpayers carrying out research and development activity, who intend to apply the deductions for innovations, are obliged to keep separate records of the costs of the research and development activity.

In case of basic research, the eligible costs incurred for the research are subject to deduction only if the research is carried out on contractual basis or on the basis of an agreement with a scientific unit in the

meaning of the Law of 30 April 2010 on the principles of financing science. Whereas, in case of applied research and industrial research (more focussed on practice) this condition does not apply.

Additionally, it must be pointed out that the new tax credit has no effect upon the calculation of VAT.

Check if your enterprise may apply the tax credit

Accounting for the best interest of your entity we recommend that your entity should carry out an analysis of the business activity performed and take respective steps in order to qualify for the application of the new tax credit. For that purpose, we have developed tools dedicated for you, which, on one hand, shall enable you to identify the eligible costs, which might translate into respective savings in your entity, and which, on the other hand, shall minimise the risk related to the application of the above described tax credit.

Should you wish to discuss the above mentioned amendments in detail, feel free to contact us:



Piotr LISS
Tax Partner
Tax advisor (10240)

RSM Poland
Droga Dębińska 3b
61-555 Poznań, Poland

www.rsmpland.pl
office@rsmpland.pl

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