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## Poland

### **INSIGHT: What's Inside Poland's New Innovation Box?**



BY PIOTR WYRWA

It is almost certain that, from January 2019, a new tax incentive for entrepreneurs obtaining income from intellectual property rights will be implemented.

The tax incentive (“Innovation Box”), is part of a number of comprehensive changes aimed at supporting the innovations of entities investing in Poland.

Most amendments introducing numerous changes to income taxes will definitely not be met enthusiastically by taxpayers, as their aim is to fight “aggressive” tax optimization and impose additional administrative obligations. However, the Innovation Box is an exception.

It is worth recalling the fact that corporate income tax (“CIT”) payers are already entitled to apply for an R&D tax credit—allowing double deduction for tax purposes of certain qualifying costs incurred in relation to a taxpayer’s R&D activities.

While the existing R&D tax credit refers to the cost side of a taxpayer’s activities, the planned Innovation Box, introduced on September 25, 2018, concerns particular income earned as a result of a taxpayer’s R&D activities.

**Four Times Lower CIT** So, what’s inside the box? The planned tax incentive gives an opportunity to apply a lowered 5 percent CIT rate in respect of certain types of incomes generated. The tax benefit that may be

*Piotr Wyrwa is a Tax Supervisor at RSM Poland*

achieved is prominent because the “standard” CIT rate in Poland is almost four times higher (i.e. 19 percent).

**Catalog of Intellectual Property Rights Covered by Innovation Box** The favorable CIT rate will apply only to certain types of income, rendered by the so-called qualifying intellectual property rights. In this respect, the Innovation Box scheme provides a closed catalog of IP rights eligible for the tax incentive discussed. According to that catalog, discussed tax credit will apply to:

- patents;
- extensions of patent protection;
- protected utility models;
- registered industrial designs;
- registered topographies of integrated circuits;
- extensions of patent protection for medicinal products and plant protection products;
  - registered medicinal and veterinary products admitted to trading;
  - registered new varieties of plants and animal breeds; and
  - rights to computer programs.

Those rights fall into the Innovation Box only if they are subject to a certain legal protection. This protection has to result from separate provisions or ratified international agreements to which the Republic of Poland is a party and other international agreements to which the European Union is a party.

What the above means is that to be able to benefit from the Innovation Box, one needs not only the support of a tax adviser but also a lawyer familiar with intellectual property law (or patent attorney). There might be yet another consequence of the obligation to legally protect the IP rights.

Favorable taxation might serve as an impetus for obtaining legal protection for innovations which have not been so far patented by investors.

The above-listed IP rights should be obtained by a taxpayer in a specific way. As a rule, these rights must arise as a result of the R&D activity conducted by a taxpayer. However, IP right do not have to be created from scratch by a taxpayer. They may also be developed or improved by a taxpayer as part of their own R&D activity.

Entrepreneurs will be able to apply the tax credit throughout the duration of the legal protection of the IP right. However, the IP rights that are subject to the registration procedure may provide taxpayers with the benefits of the Innovation Box scheme from the moment of submitting an application for registration to a competent authority.

Such flexibility is met with universal acclaim by investors. Still, if the registration procedure is unfavorable for a CIT-payer (i.e. no IP right protection provided) he/she is obligated to pay the outstanding tax. This tax will be calculated as a difference between the "standard" CIT rate and the "lowered" CIT rate.

**What Income May Benefit from Innovation Box?** IP rights should generate certain types of incomes in order to be covered by the Innovation Box.

Primarily, this applies to fees and royalties received under a license agreement. Furthermore, income generated from the sale of the qualifying IP right is covered by the discussed tax credit. This also applies to the situation when qualified IP rights are embedded in the sale price of products or services.

Last but not least, the compensation received by a taxpayer for the infringement of rights resulting from the qualified IP right may also be taxed in accordance to the favorable regime (assuming that this compensation is received as a result of a court proceeding or arbitration).

**Limitation of Favorable Taxation—Nexus Approach** Not all income generated by certain IP rights falls into the Innovation Box regime.

The draft of Act provides the concept of "qualified income amount." This amount corresponds to the amount calculated as the income obtained from the qualifying IP right multiplied by the ratio established in accordance with the following formula:

$$x = (a+b) \cdot 1.3 / (a+b+c+d)$$

where:

"a" stands for an R&D activity related to the qualifying IP right, carried out directly by a taxpayer;

"b" stands for the acquisition of R&D results related to the qualifying IP right from an unrelated entity, other than those mentioned in point d);

"c" stands for the acquisition of R&D results related to the qualifying IP right from a related entity, other than those mentioned in point d);

"d" stands for the acquisition of the qualifying IP right by a CIT-payer.

In the case where the value of the "x" is greater than 1, it is assumed that the value is 1.

Through analyzing the indicator "x", we can arrive at the following conclusion: the more R&D activity is performed by a CIT-payer by himself or is outsourced to unrelated entities, the higher amount of tax credit that could be claimed under the Innovation Box scheme.

The above corresponds to the Organization for Economic Co-operation and Development recommendations indicated in BEPS Action 5: Agreement on Modified Nexus Approach for IP Regimes.

The "Nexus Approach" imposes an obligation to ensure that IP regimes introduce a relationship between the costs incurred, intellectual property rights and the income generated from these rights. In accordance with the Nexus Approach, the benefits of a tax relief depend on the scope of R&D activities undertaken by the taxpayer.

In other words, the tax advantage is possible if there is a connection between the income qualifying for relief and expenses incurred in order to obtain it.

**Additional Documentation Requirements** Those entrepreneurs who want to take advantage of the proposed tax credit will be obliged to keep detailed accounting records. Based on data indicated in those records, taxpayers should be able to distinguish each qualifying IP right and determine revenues, tax-deductible costs, and income (loss) attributable to each of the qualifying IP rights.

Furthermore, in certain cases, an alternative method may be available to taxpayers who earn income from more than one qualified IP right and it is not possible to determine the income and costs related to each of the qualifying IP rights.

Under this approach, it may be possible to determine the income applicable to all qualifying IP. Similarly, it may be possible to track income and costs to the same type of products or services, or the same group of products or services, in which the qualifying IP asset was used.

**Planning Points** Companies operating in the field of innovations and new technologies should become familiar with the current Innovation Box proposal.

According to government plans, the new tax incentive will be launched from early 2019. Nevertheless, analysis of IP rights qualified for the Innovation Box may also apply to rights developed in the past years. The predicted provisions are not limited to rights arising from 2019. Thus, they should apply to all the qualified incomes, regardless of when the IP right protection was obtained.

Piotr Wyrwa is a Tax Supervisor at RSM Poland.