# International R&D Tax Incentives

**The following is a summary of R&D tax incentives offered by select competitor-nations that help explain why foreign-based R&D spending has grown faster than U.S.-based R&D spending. Today, the average company that claims the U.S. R&D credit only realizes a credit rate of 6%. In addition, the United States requires that the deduction for R&D expenses be reduced by the amount of any R&D credit, which drives the effective rate even lower.**

**In 2003, U.S. majority-owned affiliates invested $22.3 billion in R&D in foreign countries, up from $15.0 billion invested in 1998 – a 49% jump. By comparison, spending on R&D in the United States by U.S. parent companies rose more slowly (by 23%) over this period, from $114.2 billion to $140.1 billion.**

| Country | R&D Tax Incentive | Comment |
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| **Australia** | • Allows a 125% deduction for R&D expenses<br>• *Plus* a 175% premium tax deduction for R&D expenditures exceeding the prior 3-year. average spending.<br>• Effective from 2008, foreign-owned R&D activities undertaken in Australia may also attract a 175% premium tax deduction. | The 125% deduction is the equivalent of 7.5 cents in the dollar after tax benefit. The premium 175% amount equates to 22.5 cents in the dollar after tax benefit.<br>In discussing its R&D-friendly environment, the Australian government's website (investaustralia.com) concludes that with the 125% tax deduction, 175% premium tax deduction, and the introduction of the new 175% premium tax deduction for foreign-owned R&D, **"It's little surprise then, that many companies from around the world are choosing to locate their R&D facilities in Australia."** The government also points out that "50% of the most innovative companies in Australia are foreign-based." |
| **Canada** | • Offers a permanent 20% flat (i.e., first-dollar) R&D tax credit.<br>• *Also*, many provincial governments offer various incentives (e.g., refundable credits) for R&D activities conducted in their provinces. | In 2003, U.S. subsidiaries spent $2.5 billion on R&D in Canada, which has mounted an aggressive marketing campaign, including television and print advertisements, to lure more U.S. companies to locate R&D operations north of the border. Ontario print ad discusses "R&D tax credits, among the most generous in the industrialized world" and "a cost structure which KPMG confirms as lower than the U.S. and Europe"; the ad concludes, "you'll see why R&D in Ontario is clearly worth investigating." |
| **China** | • A R&D center qualified as a State-encouraged high and new technology enterprise can enjoy a 15% reduced tax rate, instead of the 25% corporate income tax rate, and potentially a tax holiday of "2-year tax exemption and 3-year 50% deduction" if located in the prescribed areas.<br>• A 50% "super deduction" is allowed in addition to the actual expense deduction for R&D expenses that are not required to be capitalized as intangible assets.<br>• In addition, there are indirect tax incentives to the R&D center, for example, business tax exemption and duty-free importation of equipment and spare parts, etc. | On 3/16/07, China adopted a new *Enterprise Income Tax Law* that eliminated many of the incentives applicable exclusively to foreign-investment enterprises. The new law was adopted in part out of a desire for equal taxation of all enterprises and to remove incentives applicable only to foreign investment. **Still, the new law includes incentives to encourage activity that stimulates economic growth, such as research and development.** (*Fundamental Enterprise Income Tax Reform in China: Motivations and Major Changes,* Jinyan Li, Comparative Research in Law and Political Economy paper 33/2007) |
| **France** | • A 30% credit for qualifying R&D expenses for the year of up to €100M and 5% of those R&D expenses in excess of €100M.<br>• The 30% rate is raised up to 50% and 40% for the first and second years, respectively, following a five-year period during which the enterprise has not benefited from the R&D Tax Credit mechanism.<br>• The total amount of the R&D Tax Credit is not capped anymore. | As part of the *French Finance Act for 2008*, approved 12/18/07, the R&D limitation of roughly US$23 million was eliminated and the previous two-pronged credit consisting of a variation and volume component was abandoned in favor of a 30% volume component. "Practically, **all taxpayers engaged in R&D should benefit from these changes**, with a proportionally bigger tax benefit for taxpayers incurring stable or declining R&D expenses." (*International Tax Review,* February 2008) |

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| **India** | • A 15-year phased income tax holiday and a complete exemption from indirect tax implications for export of services (including R&D) from a Special Economic Zone. The complete exemption may continue indefinitely as long as certain requirements are met.<br>• Deduction for scientific expenditure or in-house R&D equal to 1.5 times the expenses so incurred. The deduction is restricted to entities approved by the Department of Scientific and Industrial Research (DSIR) and is limited to selected industries (e.g., biotechnology, electronic equipment, etc.).<br>• Special other benefits such as accelerated tax deductions, allowability of prior period expenses and weighted deductions are also available, depending upon the facts. | "More than 100 global companies … have established R&D centers in India in the past 5 years, and more are coming. … As I see it from my perch in India's science and technology leadership, **if India plays its cards right, it can become by 2020 the world's number-one knowledge production center,"** Raghunath Mashelkar, Director General, Council for Scientific & Industrial Research, India, in *Science Magazine*. |
| **Ireland** | • Offers a 20% R&D tax credit on incremental expenditures calculated with reference to base year of 2003. This is in addition to any existing deduction or tax depreciation. This results in an effective benefit of up to 32.5% based on Ireland's low 12.5% corporate income tax rate.<br>• Capital expenditure on scientific research may also qualify for a separate 100% initial allowance. | According to IDA Ireland, the government agency with responsibility for the promotion of direct investment by foreign companies into Ireland, **"Many leading global companies have found Ireland to be an excellent location for knowledge-based activities.** … Nearly half of all IDA supported companies now have some expenditure on R&D and 7,300 people are engaged in this activity." |
| **Japan** | • A corporation may claim two credits, generally equal to 5% of certain incremental R&D expenditures in a year and 8% to 10% of total R&D expenditures in a year, subject to a limitation of 20% of the corporate tax due for the year. The excess can be carried forward only for 1 year. A 5% credit is a sunset provision and is not available for tax years beginning on or after April 1, 2008.<br>• The 2008 tax reform is currently pending. A proposal to change the rule to the following has been made, however, the Diet has not passed the reform yet:<br>(1) 8% to 10% of total R&D expenditures in a year, up to 20% of the corporate tax due; and<br>(2) Either (a) or (b) (elective)<br>(a) 5% of incremental R&D expenditures, up to 10% of the corporate tax due;<br>(b) If the current R&D expenditures exceed 10% of the average sales, a certain % of such excess amount, up to 10% of the corporate tax due (The % is computed by the following formula: (current R&D expenses / average sales x 10%) x 0.2%).<br>The total of (1) and (2) can be claimed as a credit. Note that the 10% limitation under (2) is separate from (1) and therefore, the total credit can be up to 30% of the corporate tax due. | Japanese Finance Minister Fukushiro Nukaga said in January 2008 that reforms acted upon in 2008 would focus on R&D among other issues, in an effort to provide a sustained economic recovery in the face of rising oil prices, troubled foreign economies, and an aging population (*Bureau of National Affairs)*. |
| **South Korea** | • A 100% deduction for R&D expenses is allowed.<br>• Tax credit would be 40% of incremental R&D expenses for the current year exceeding the average of the R&D expenses incurred during the previous 4 years.<br>• For Small and Medium Enterprise (SME), more benefit may be available. | South Korea has moved aggressively to attract foreign R&D center, offering income tax exemption for foreign companies locating their R&D center in Foreign Investment Zones ("FIZs") or in Free Economic Zones ("FEZs").<br>i) FIZs: a 100% exemption or first 5 years and a 50% for 2 years – minimum 2 million investment<br>ii) FEZs: a 100% exemption for first 3 years and a 50% for 2 years – minimum 1 million into free economic zone + 10 full time research staff |

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| **Singapore** | • "R&D and Intellectual Property Management Hub Scheme" offers U.S. companies a 5-year tax holiday for foreign sourced royalty or interest income earned with respect to Singapore-based R&D.<br>• The 2008 Budget proposed that companies that carry out R&D activities in Singapore or outsource their R&D activities to an R&D organization in Singapore will qualify for a tax deduction of 150% of the amount of R&D expenses incurred in the tax year ending in 2008 to 2012. There is no need for the R&D activities to be connected to the Singapore entity's current trade or business to get the deduction. This proposal is expected to be enacted in late 2008.<br>• Another 2008 Budget proposal is for companies with chargeable income (i.e., taxable income after depreciation allowances and applicable tax exemption) to be granted an R&D tax allowance for each year from tax year ending in 2008 to 2012, at a prescribed rate of up to 50% of the first S$300,000 (approx. US$218,000 as of April 3, 2008) of the company's chargeable income. Likewise, this proposal is expected to be enacted in late 2008. | According to Singapore's Economic Development Board website, **"Singapore does not just welcome business ideas; it actively seeks and nurtures them.** We play host to any shape and size of enterprise and innovation – startups with little more than the germ of an idea; global corporations with large R&D teams and complex production operations." |
| **United Kingdom** | • Allows a 125% deduction for R&D expenditures incurred by large companies prior to April 1, 2008, and 130% for expenditures incurred after April 1, 2008. | The UK leads the world in attracting R&D investment by U.S. affiliates – U.S. subsidiaries spent more than **$4 billion on UK-based R&D** in 2003. The 130% deduction alone is the equivalent of a flat 8.4% R&D tax credit. |
| **United States** | • Allows a maximum 10% incremental credit (a nominal 20% credit) for qualified R&D expenditures in excess of a calculated base amount.<br>• The Alternative Simplified Credit ("ASC") provides companies with a credit of 12% of R&D expenditures that exceed 50% of average R&D expenditures over the prior three years.<br>• An Alternative Incremental Research Credit formula is also available. The AIRC computation combines a three tiered fixed-base percentage with a reduced three-tiered credit percentage.<br>• The business deduction for R&D expenses must be reduced by the amount of any R&D credit. | **The U.S. R&D credit expired on December 31, 2007.** In 2006, Congress enacted into law a seamless extension of the R&D tax credit from January 1, 2006, through December 31, 2007. Included in the law was language to strengthen the credit with a new credit formula called the Alternative Simplified Credit that became effective January 1, 2007 through December 31, 2007. |

Source: Ernst & Young, April 2008