



Autoridad Independiente
de Responsabilidad Fiscal

Spending Review 2019/2020

Tax Benefits

Deduction for RD&I in Corporate Income Tax

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Introduction and objectives

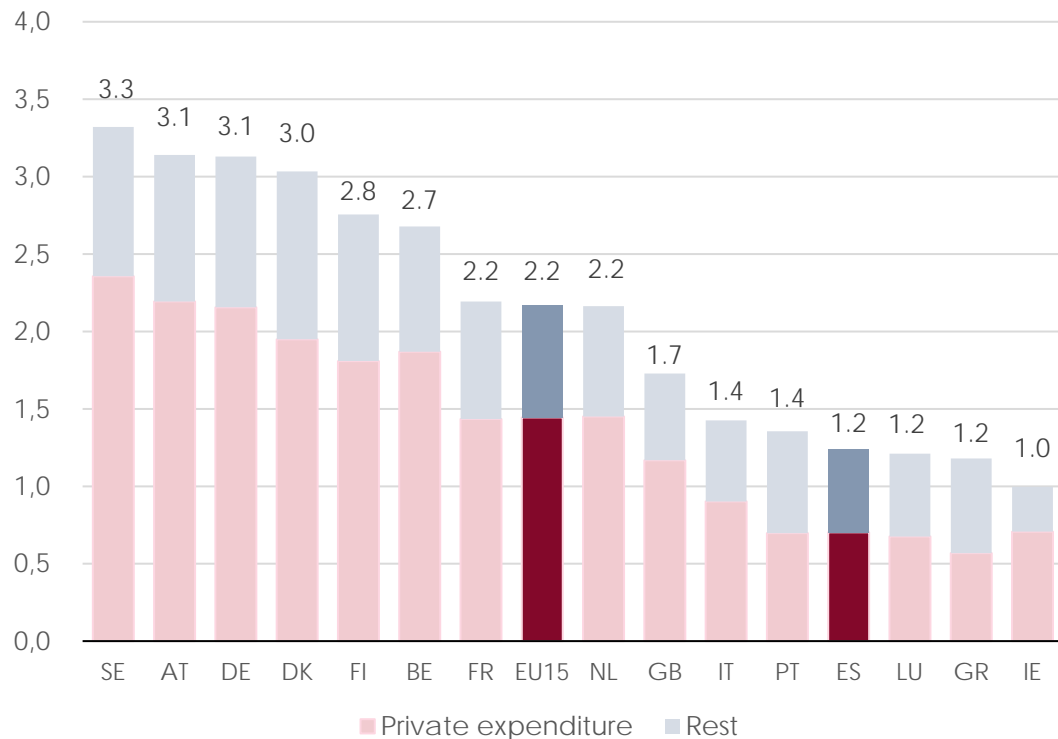
Tax Benefit for RD&I

Tax incentive to encourage private sector RD&I investment through a deduction in the corporate income tax payable.

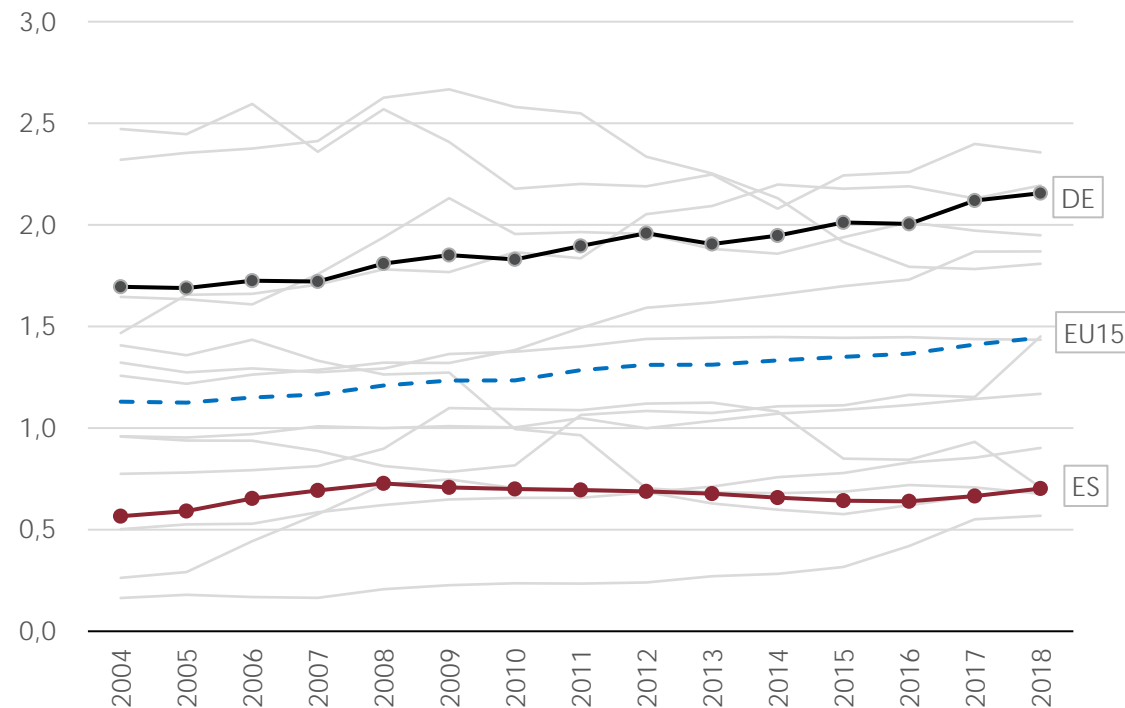
- **Spain has a level of RD&I investment below the EU average**
- **The effective annual tax cost of the tax benefit amounts to €300m although the accrued cost exceeds €1.1bn (approximately €800m of tax credits are generated in favour of companies that are deductible in the following 18 years)**
- **The limits and regulatory requirements for application of the tax benefit undermine the incentive's effectiveness**
- **The incentive in Spain stands out in international terms for its theoretical generosity, although its use in practice is limited**
- **The evaluation identifies a positive effect of the incentive on RD&I investment although it reveals a wide gap between the potential and actual effectiveness of the tax benefit**

This study aims to evaluate whether the tax benefit fulfils the objective of encouraging private sector investment in RD&I

RD&I EXPENDITURE (% GDP)



EVOLUTION OF PRIVATE RD&I EXPENDITURE (% GDP)

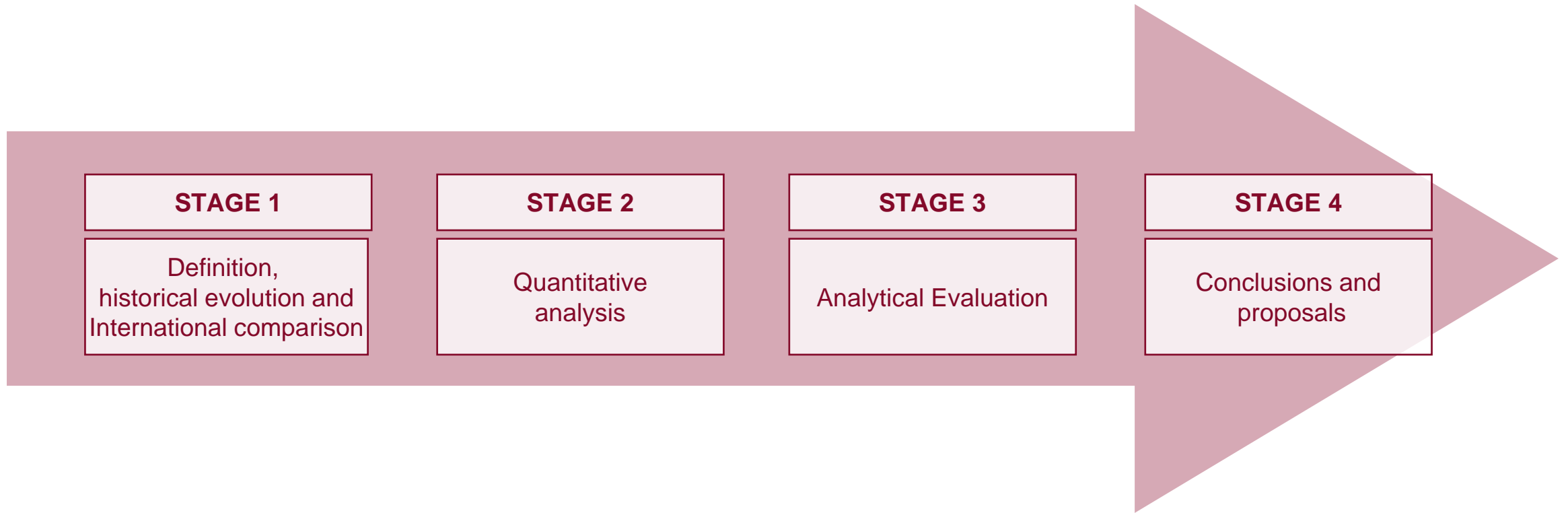


Source: Technology and RD&I Statistics (OECD)

This report does not evaluate the efficiency of RD&I spending in terms of the final product (patents, intellectual property, trademarks...) and it does not analyse the reduction in income from certain intangible assets (Patent box)

2 Methodology and sources of information

Evaluation methodology



Results based on microdata: first study that cross-checks anonymised survey information with corporate income tax returns



Business Innovation Survey

30,000 Companies
Time period: 2010-2017 (227,000 obs)
RD&I expenditure
(composition of expenditure, characteristics of companies, employment, sector, business group, foreign capital, etc.)



Corporate Income Tax Returns

Forms 200 and 220:
Deductions accrued and applied
Tax Rate
Taxable income
Turnover
Volume of assets

Analytical evaluation methodologies adapted to RD&I incentives

1. Impact or counterfactual analysis

Uses changes in private RD&I spending as a result of regulatory modifications of the tax incentive

Results are limited to the effects of a specific regulatory change

Guceri and Liu (2018); Agrawal, Rosell and Simcoe (2020)

2. Elasticities analysis

Analyses the causal relationship between private spending and the cost in RD&I that is affected by the tax benefit

The results are more general without being limited to a specific regulatory change

Rao (2016); OECD (2020)

The study uses the second methodological approach as a result of the absence of significant regulatory changes in the time period under analysis (2010-2017)

3 Evaluation, conclusions and proposals

Deduction for RD&I in Corporate Income Tax

	DEFINITION	Deduction in the tax payable of 25% of the research and development expenditure and of 12% in innovation with limits
	COST (€m)	€1,114 million deduction accrued (deduction applied in the year: €328m)
EVALUATION	OBJECTIVE	To encourage private investment in RD&I
	OBJECTIVE FULFILMENT	
	PROPOSALS	

Regulatory definition

MAIN REGULATORY ASPECTS OF THE TAX BENEFIT FOR RD&I IN CIT

Objective scope and categories	Deduction percentage	Limits ⁽¹⁾
<u>Deduction in the tax payable:</u> <u>Research and development (R&D) activities:</u>		Maximum limit:
For expenses for performing these activities	25% Excess over the average of the previous 2 years: 42%	- In general, limit = 25% x Reduced Tax Due (Spanish acronym - CIM = total tax due - deductions for international double taxation - allowances)
For staff costs corresponding to qualified researchers exclusively assigned to these activities	42%	-If the RD&I deduction > 10% x CIM, limit = 50% x CIM
For investments in property, plant and equipment and intangible assets, excluding land and buildings, which are exclusively used for these activities.	8%	The sums not deducted, as a result of insufficient tax payable or the limits being exceeded, may be applied in the following 18 years
<u>Deduction in the tax payable:</u> <u>Technological innovation (TI) activities</u>		
For expenses for performing these activities	12%	

Regulatory definition

MAIN REGULATORY ASPECTS OF THE TAX BENEFIT FOR RD&I IN CIT (2)

Objective scope and categories	Deduction percentage	Limits ⁽¹⁾
<p><u>Optional regime</u></p>	<p><u>Option A:</u> Payment of non-deducted sums may be requested if there is insufficient tax payable</p> <hr/> <p><u>Option B:</u> The deduction limits may be exceeded if there is positive tax payable</p> <hr/> <p>Both cases: a 20% discount will be applied on the amount of the deduction</p>	<p>- Maximum limits:</p> <p>a) TI: €1m / year</p> <p>b) Overall for RD&I: €3m / year</p> <p>and €5m / year if R&D expenditure exceeds 10% of net turnover.</p>
<p><u>Unrestricted depreciation</u></p> <p>Unrestricted depreciation in the tax on assets used for RD&I activities with the exception of buildings, which have accelerated depreciation of 10 years.</p>		

The status of tax-deductible expenditure requires taxpayers to provide a recent report issued by the Ministry of Science and Innovation

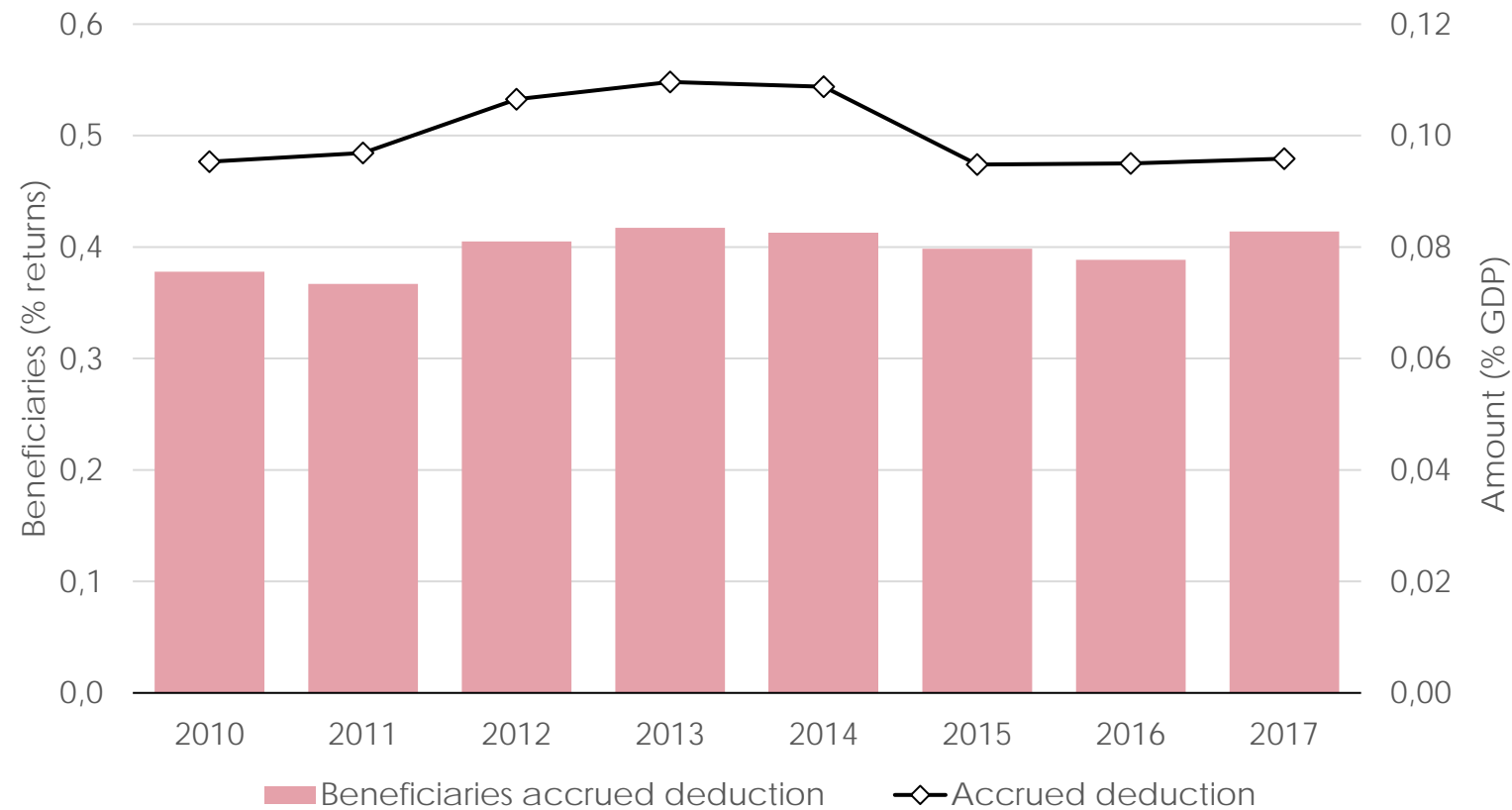
Historical evolution: multiple modifications based on the aim of strengthening the deduction and improving its effectiveness, but with little budgetary impact

Regulatory changes of the tax benefits for RD&I In Corporate Income Tax

Year	Items and measures	Deduction percentage	Limits	Years to apply outstanding deductions
1979	-	-	-	-
2000	X	X	X	X
2002	X	X	X	X
2004	X	X	X	-
2007	X	X	-	-
2008	X	X	-	-
2011	-	X	X	-
2012	-	-	X	X
2013	X	X	X	-
2014	-	-	X	-

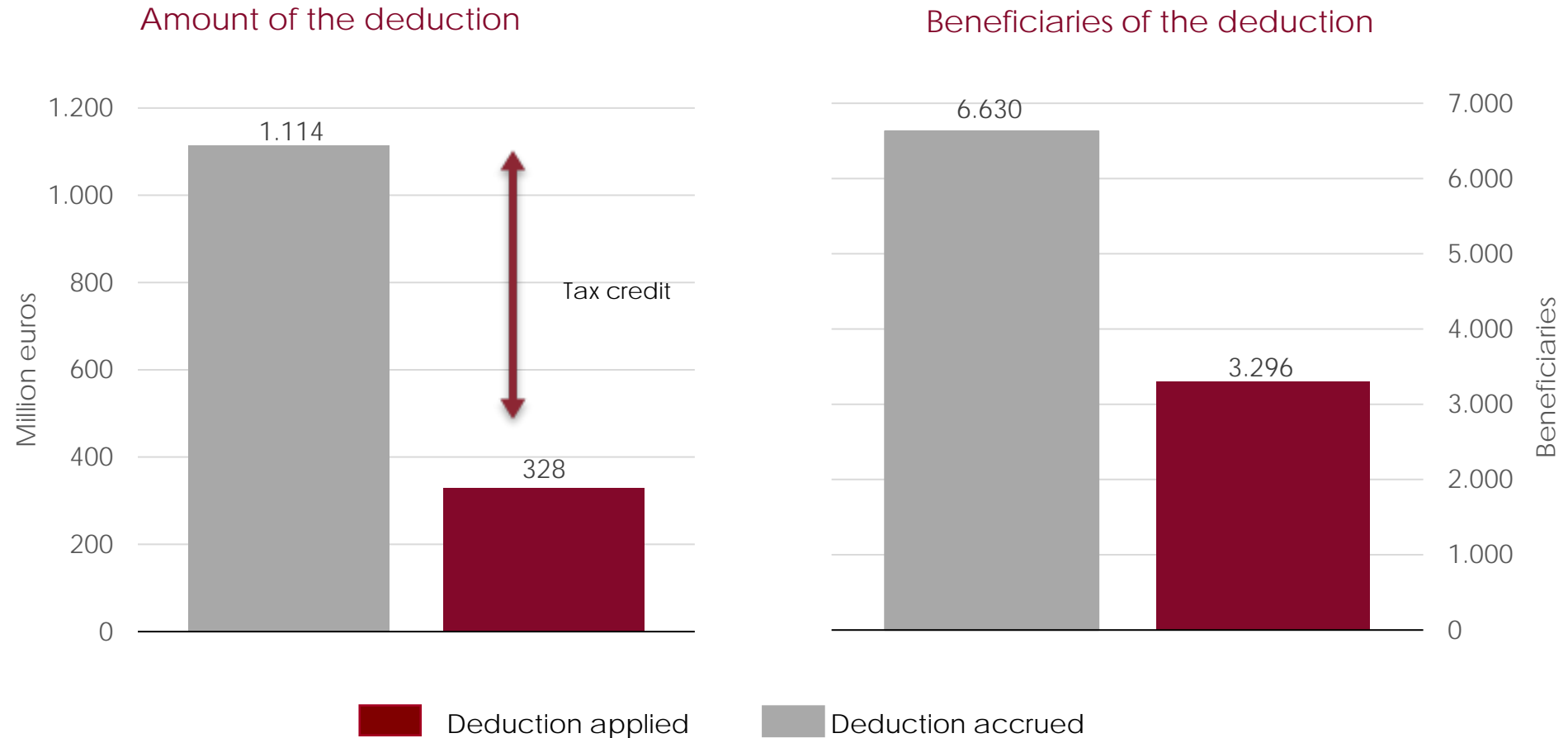
Historical evolution: Stable behaviour of the amount of the deduction and the number of beneficiaries

HISTORICAL EVOLUTION OF THE AMOUNT AND BENEFICIARIES OF THE DEDUCTION ACCRUED IN RD&I IN CIT (IN % GDP AND % OF RETURNS)



SOURCE: Corporate Income Tax Microdata 2010-2017 AEAT (State Tax Administration Agency).

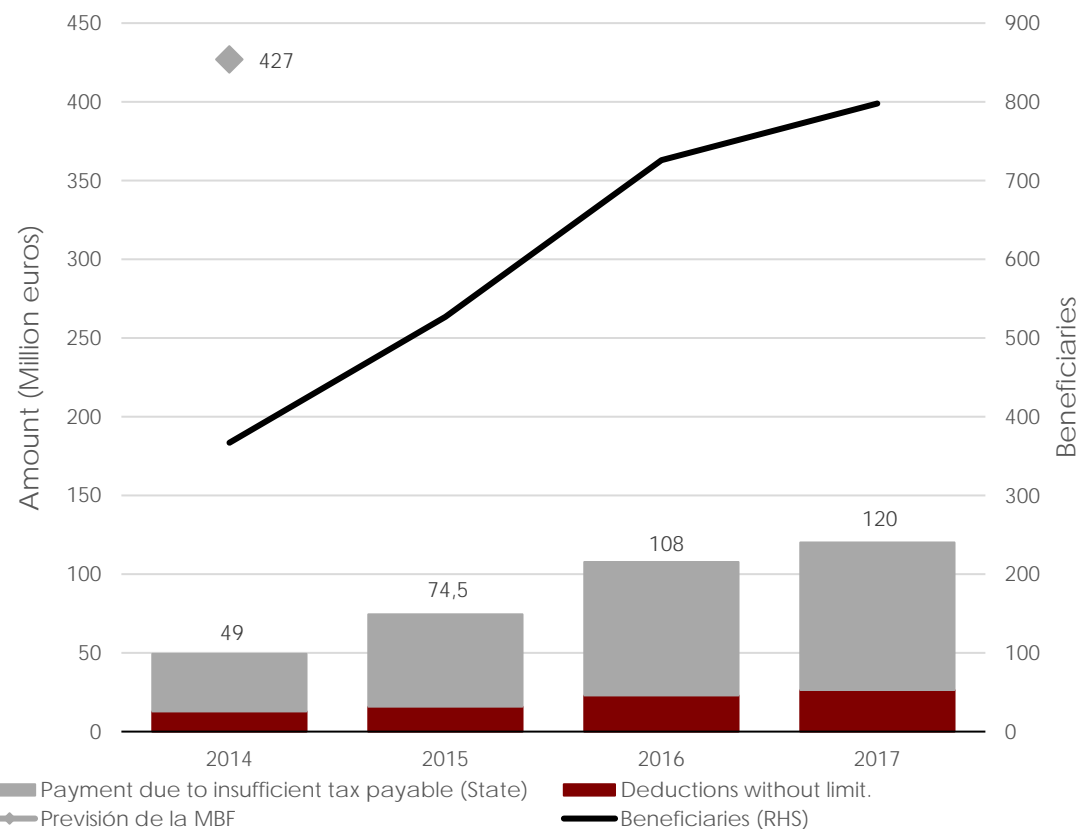
Quantification: Significant differences between the amount of deduction applied and the amount accrued that show the gap between the incentive's actual and potential effectiveness



SOURCE: Corporate Income Tax Microdata 2010-2017 AEAT.

An optional regime allowing the application of less stringent limits and payment of the deduction due to insufficient tax payable was introduced in 2014, but its success has been limited

EVOLUTION OF AMOUNT AND BENEFICIARIES OF OPTIONAL REGIME



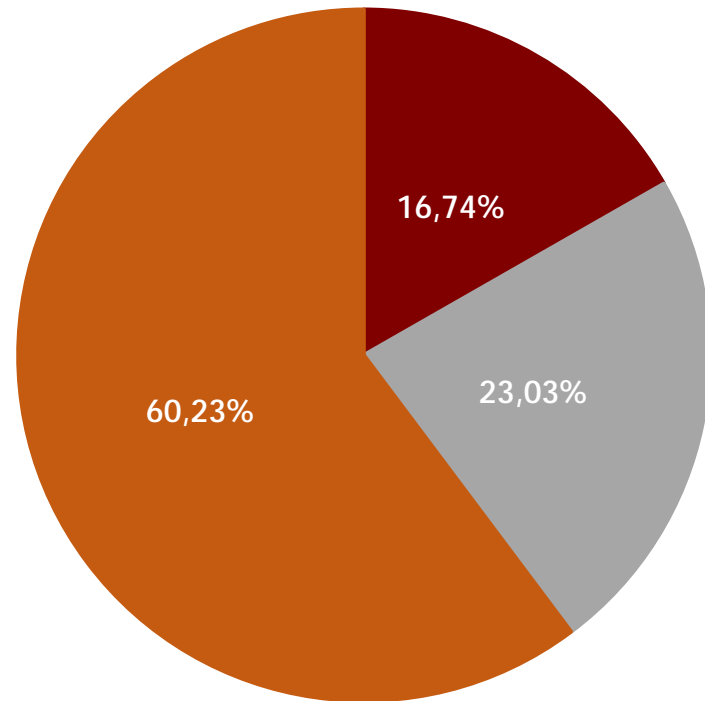
Requesting requirements (regulated in Article 39.2 of the Corporate Income Tax Act):

- Obligation to maintain the overall average workforce, or staff assigned to RD&I activities, for 24 months
- Allocating the amount of the reimbursed deduction to RD&I expenses
- Requesting payment in the tax year following that in which the right to the deduction is generated (not in the same year)
- By making the request, companies accept a 20% reduction in the amount of the deduction

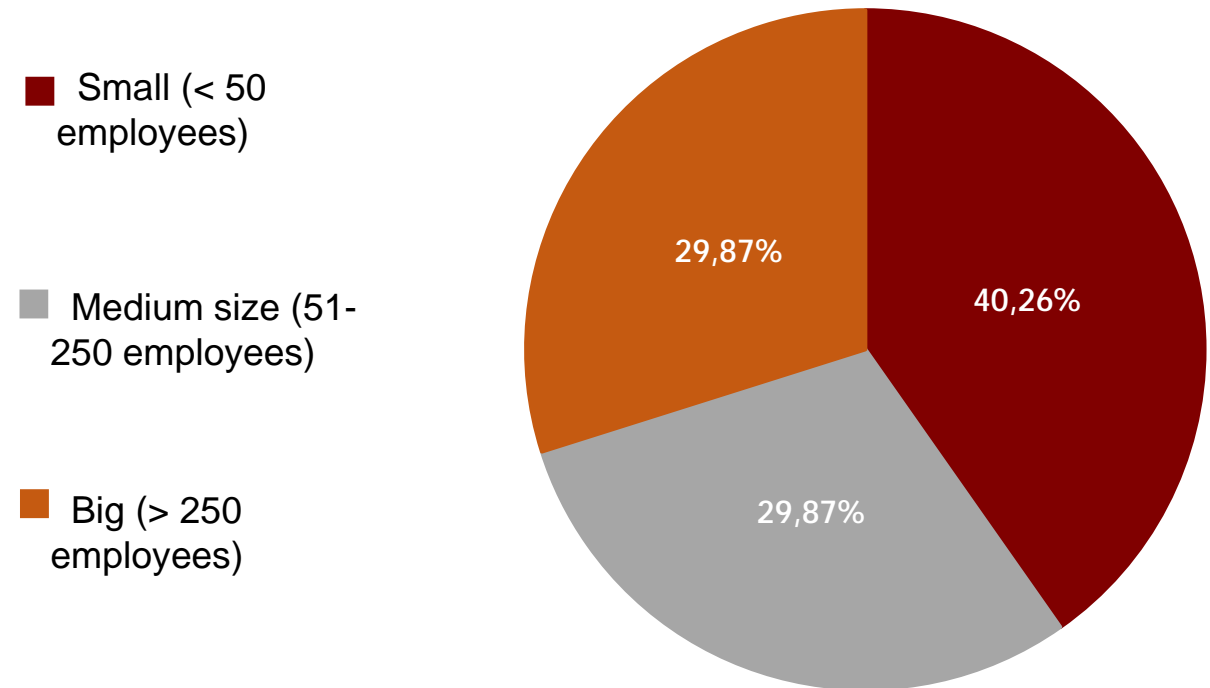
SOURCE: Corporate Income Tax Microdata 2010-2017 AEAT.

Greater use of the tax benefit by large companies. The optional regime is used more by SMEs

GENERAL DEDUCTION DUE TO COMPANY SIZE (€1.114 BILLION)

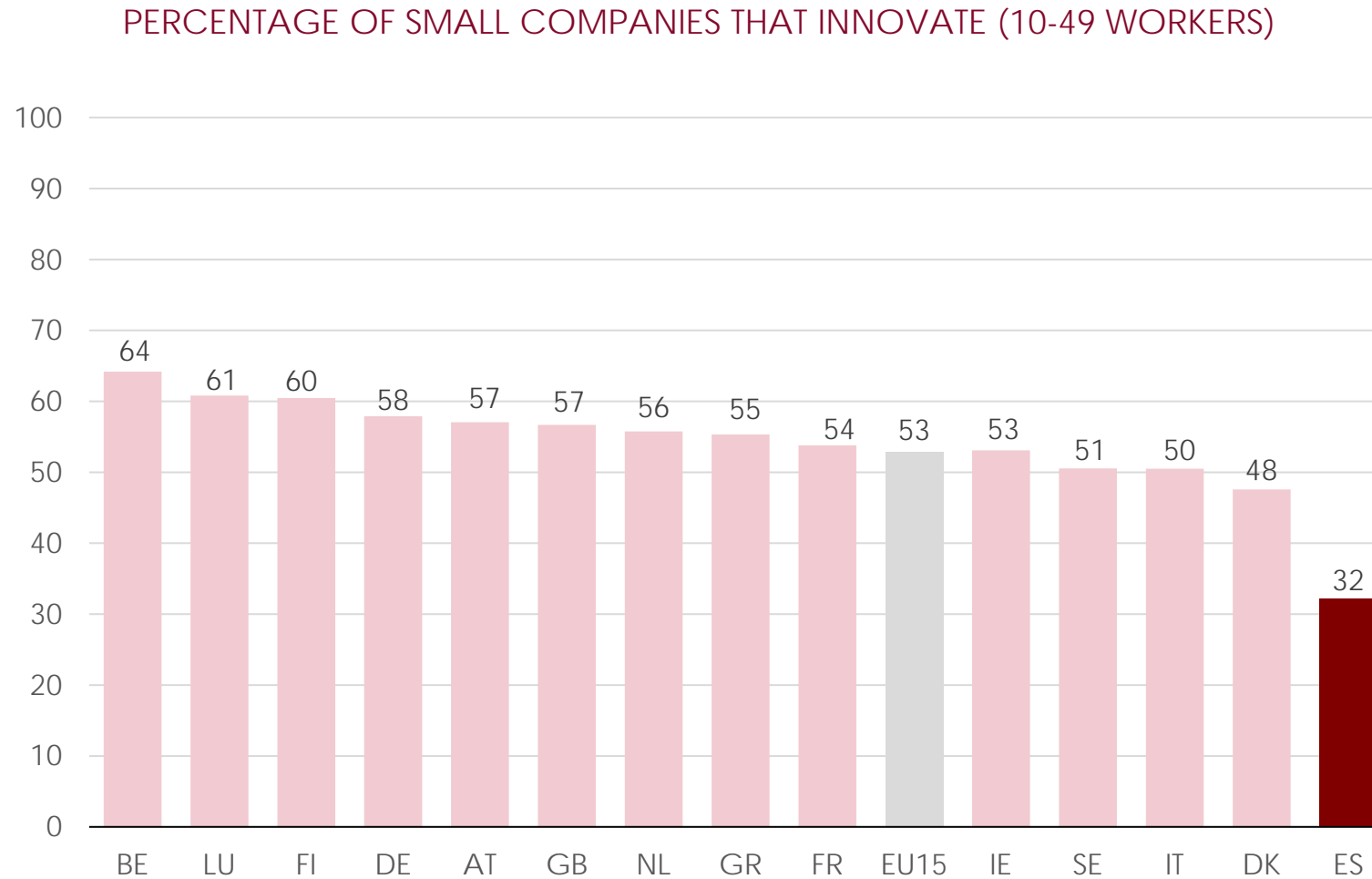


OPTIONAL REGIME DEDUCTION BY COMPANY SIZE (€120M)



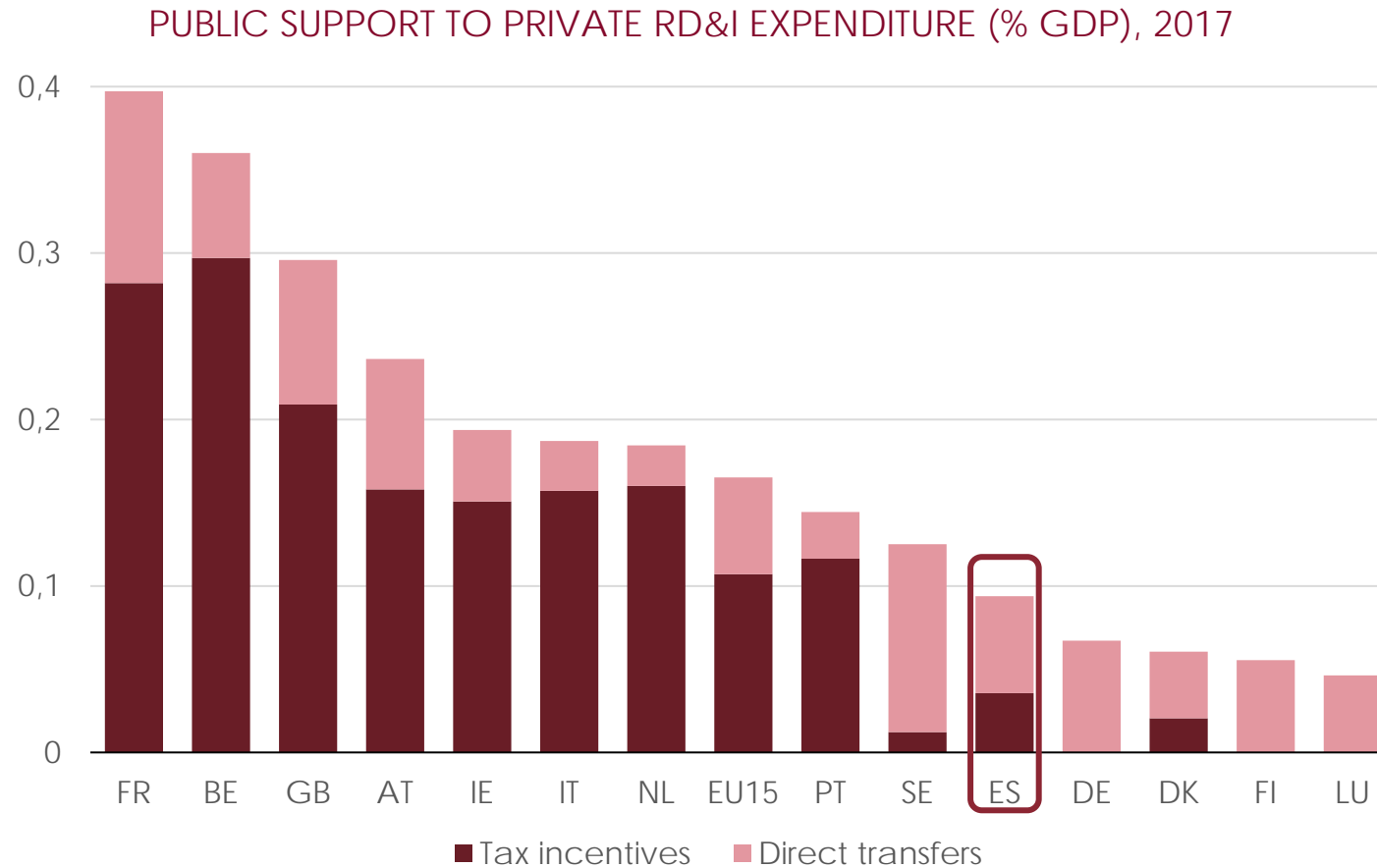
Source: Prepared by the author based on the merger of the Company Innovation Survey (INE) with Corporate Income Tax microdata (AEAT)

Despite the optional regime, which is more widely used by SMEs, Spain remains the country where the lowest number of small companies innovate



Source: 2019 Innovation Survey (CIS-Eurostat)

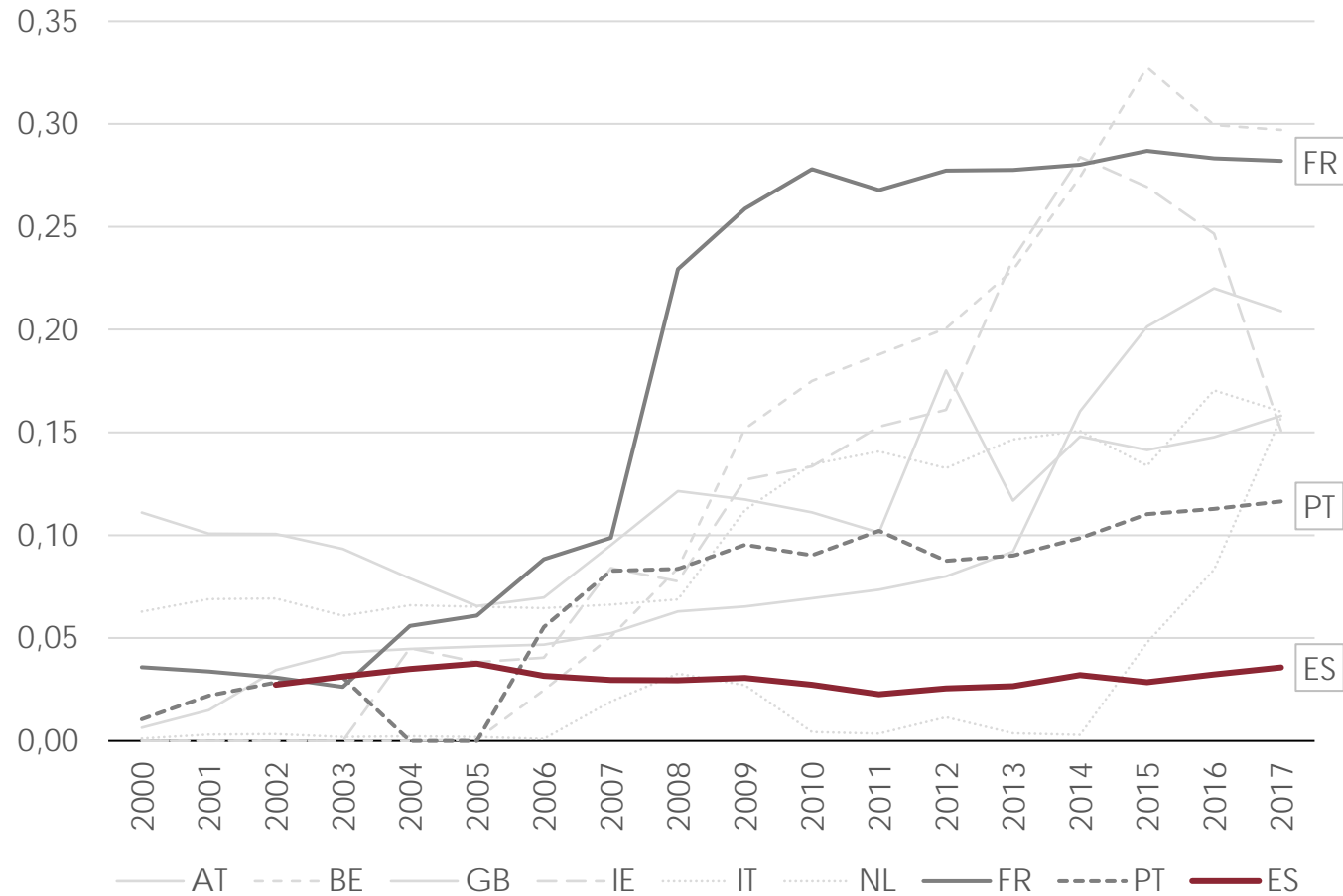
International comparison: Most countries grant favourable tax treatment to RD&I...



Source: RD&I Tax Incentive Database (OECD)

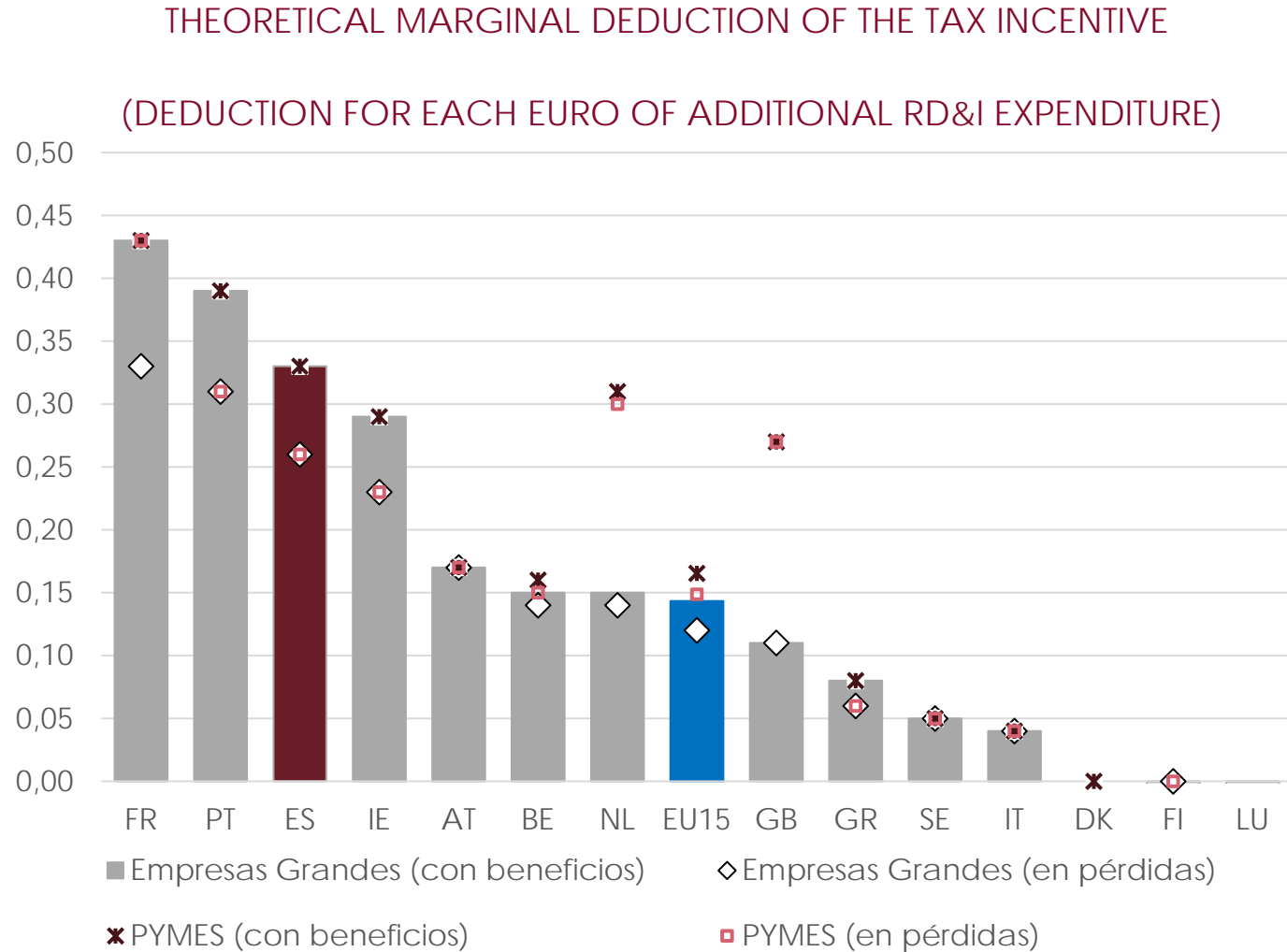
... which has improved over the last decade in most economies, with the exception of Spain

EVOLUTION OF THE AMOUNT OF THE TAX BENEFITS FOR CORPORATE RD&I (% OF GDP)



Source: RD&I Tax Incentive Database (OECD)

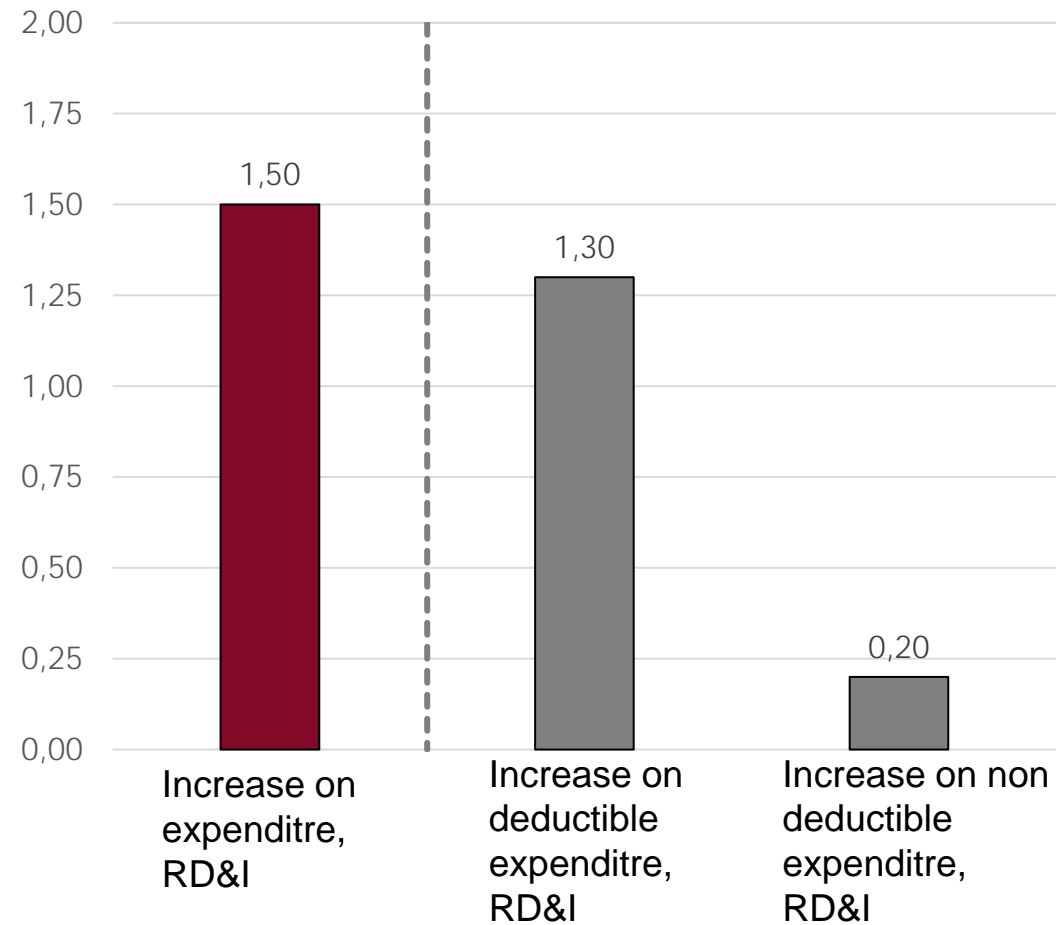
In particular, France, Portugal, Spain and Ireland stand out for the theoretical generosity of the tax benefit, although it is lower in practice in the case of Spain



Source: RD&I Tax Incentive Database. RD&I B Index (OECD)

Results of evaluation: For every euro of tax incentive, private RD&I expenditure rises by 1.5 euros

INCREASE IN PRIVATE RD&I EXPENDITURE PER EURO OF TAX BENEFIT (IN EUROS)



Source: Prepared by the author based on the merger of the Company Innovation Survey (INE) with Corporate Income Tax microdata (AEAT)

Results of evaluation: For every point of increase in the tax incentive (e.g. from 25% to 26%), private RD&I expenditure rises by €110m and entails a tax cost of €73m

EFFECT OF A 1-POINT INCREASE IN THE DEDUCTION ON COMPANIES' PRIVATE RD&I EXPENDITURE
AND ON TAX COLLECTION (€M)



Source: Prepared by the author based on the merger of the Company Innovation Survey (INE) with Corporate Income Tax microdata (AEAT)

Proposals

EVALUATION	OBJECTIVE	To encourage private investment in RD&I
	OBJECTIVE FULFILMENT	<p>The tax benefit DOES achieve the objective of encouraging investment in RD&I, which rises by €1.5 for every euro that the government allocates to the tax incentive. The evaluation also reveals the existence of a wide gap between the tax benefit's potential and actual effectiveness as a result of the existing maximum limits.</p> <p>The optional regime established in 2014, which mainly favours SMEs, allows the limits to be exceeded or the deduction to be obtained in the form of a reimbursable deduction, but it has not proved to be as effective as expected since a series of administrative requirements must be fulfilled for its application, which limits the appeal of the instrument.</p>
	PROPOSALS	

Proposals

	OBJECTIVE	
	OBJECTIVE FULFILMENT	
EVALUATION	PROPOSALS	<ul style="list-style-type: none"> • Removing some of the requirements to benefit from the optional regime and thus gradually bring the potential effectiveness closer to the actual effectiveness of the tax benefit. In particular: <ul style="list-style-type: none"> ○ Removing the obligation to maintain the overall average workforce or, alternatively, the staff assigned to RD&I activities for 24 months in order to benefit from the optional regime (Article 39.2b of the Corporate Income Tax Act). ○ Allowing the request for the reimbursable deduction of the optional regime to be made in the same financial year as the right to the deduction is generated (Article 39.2b of the Corporate Income Tax Act). • Setting up a quick and semi-automatic RD&I accreditation mechanism for companies whose RD&I investment does not exceed a certain threshold. • Publishing the list of legal persons benefiting from the tax incentive to match the published information to that required for programmes of transfers and direct subsidies for RD&I and therefore improve transparency.

Proposals

EVALUATION	OBJECTIVE	
	OBJECTIVE FULFILMENT	
	PROPOSALS	<ul style="list-style-type: none"> • Increasing the requirements for beneficiary companies to report on the characteristics and composition of the spending on RD&I and the results of the innovation so as to be able to perform a better evaluation of the tax incentive's effectiveness. • Analysing the tax benefit together with the policies of direct transfers and subsidies within the overall policy of support for RD&I.

