

FEATURED PERSPECTIVE

The Secrets to the Success of the Dutch Innovation Box

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In this article, the authors examine the conclusions and findings of a recent report on the Dutch innovation box, which provides for an effective corporate income tax rate of only 5 percent on the profits from self-produced, qualifying intellectual property.

The Dutch Ministry of Finance requested a study on the effects of the Dutch innovation box, which provides for an effective corporate income tax rate of only 5 percent on the profits from self-produced, qualifying intellectual property. On February 19 Dutch State Secretary of Finance Eric Wiebes, presented to the Dutch parliament the most important observations from a recent evaluation report.¹

The Dutch innovation box has two main objectives: enhancing the business climate in the Netherlands to attract innovative, high-end companies, and stimulating research and development expenditures. The report

concludes that both objectives have been met, essentially declaring the Dutch innovation box a success.

This article discusses the letter and provides some observations on the report's conclusions and findings, which are of interest, given the international debate on IP boxes.

Enhancing Business Climate

The report concludes that the innovation box contributes to the overall business climate for (foreign) investors and causes an increase of R&D activities. However, when the Dutch innovation box was introduced in 2007 (under the name "patent box"), only France and Hungary had patent box regimes in place. The report notes that many more jurisdictions now have similar regimes.

Because the Dutch innovation box must compete with more European IP box regimes, it might be less effective at attracting new foreign investments than when it was introduced. However, abolishing the innovation box would mean the Netherlands would become less attractive to (foreign) investors, compared with other countries.

Tables 1, 2, and 3 provide a brief overview of differences in patent box regimes in Europe. The overview shows the Netherlands allows relatively many types of income in the innovation box with a relatively low tax rate.

Stimulating R&D Expenditures

The report states that the innovation box and related R&D incentives stimulate R&D expenditures in the Netherlands. For every euro lost in tax revenue as a result of the innovation box, an additional €0.54 in R&D expenditures are produced. Therefore, more R&D activities have been performed because of the

¹Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch).

Table 1. Types of Qualifying Income for Different European Patent Box Regimes

	Nether-lands	Portu-gal	Belgium	Spain	Malta	U.K.	France	Cyprus	Hun-gary	Nidwalden (Switzerland)	Luxem-bourg	Liech-tenstein
Royalties	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Capital gains	✓	✓		✓*		✓	✓*	✓	✓*	✓	✓	✓
Sales	✓		✓			✓					✓*	✓
Notional royalties	✓		✓			✓					✓*	✓

Source: Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch); and Lisa Evers et al., "Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations," 22(3) *Int'l Tax & Public Fin.* 502-530 (June 2015).

* Conditions/exceptions apply (simplified by authors).

Table 2. Types of Qualifying Intellectual Property for Different European Patent Box Regimes

	Nether-lands	Portu-gal	Bel-gium	Spain	Malta	U.K.	France	Cyprus	Hun-gary	Nidwalden (Switzerland)	Luxem-bourg	Liech-tenstein
Patents	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Supplementary protection certificates	✓**		✓			✓	✓				✓	
Software	✓*				✓			✓	✓	✓	✓	✓
Other copyrights					✓			✓	✓	✓		✓
Trademarks					✓			✓	✓	✓	✓	✓
Designs and models		✓*		✓*				✓	✓*	✓	✓	✓
Utility models											✓	✓
Secret formulas and processes	✓*			✓				✓*	✓	✓		
Know-how								✓	✓	✓		

Source: Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch); and Lisa Evers et al., "Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations," 22(3) *Int'l Tax & Public Fin.* 502-530 (June 2015).

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** Added by authors.

benefit. The government could implement rules regulating the reinvestment of the tax savings; for example, requiring investing the savings in additional R&D activities.

Using the Innovation Box

It seems that large enterprises are overly represented among users of the Dutch innovation box. Approximately 80 percent of the tax savings go to large enterprises, while those enterprises account for only 59 percent of the total R&D expenditures in the Netherlands. That might be partly explained by the fact that small and medium-size enterprises benefit from a lower tax rate because the first €200,000 of profits are subject to a 20 percent corporate income tax instead of the 25 percent imposed over that amount. SMEs thus benefit

less from the innovation box. That is different for other tax incentives for innovation, which SMEs use more often (see Table 4).

The innovation box has been used for different types of innovative activities. As shown in Figure 1, the focus of almost three-quarters of all users was on product innovation, with the remainder on process and services innovation.

One topic of discussion with the tax authorities is what part of a company's total profits should be attributed to the relevant IP that will benefit from the reduced tax rate of the innovation box. One method is the per-asset method, applied in approximately 9 percent of the cases examined in the report. That method is often easy to use when selling the self-developed IP. In 25 percent of the cases, the cost-plus method, often used if R&D is not a core function of the company

Table 3. European Patent Box Regimes (2014)

	Year of Implementation	Patent Box Tax Rate	Corporate Income Tax Rate	Treatment of Current R&D Expenditures	Treatment of Production Costs
Malta	2010	0%	35%	Nondeductible	Patent box does not apply to patent box income if R&D expenditures were deducted
Cyprus	2012	2.5%	12.5%	Net	Capitalization of production costs
Liechtenstein	2011	2.5%	12.5%	Net	Compensation
The Netherlands	2007	5%	25%	Net	Compensation
Luxembourg	2008	5.84%	29.22%	Net	Capitalization of production costs
Belgium	2007	6.8%	33.99%	Gross	No compensation
Nidwalden (Switzerland)	2011	8.8%	12.66%	Net	No compensation
Hungary	2003	9.5%	19%	Gross	No compensation
United Kingdom	2013	10%	21%	Net	Allocated to patent income
Spain	2008	12%	30%	Net	No compensation
Portugal	2014	15%	30%	Gross	Capitalization of production costs
France	2000	16.76%	35.41%	Net	No compensation

Source: Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch); and Lisa Evers et al., "Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations," 22(3) *Int'l Tax & Public Fin.* 502-530 (June 2015).

Table 4. SMEs' Share in Tax Incentives and R&D Expenditures

	WBSO/RDA Budget (2014)	Innovation Box Benefits	Total Tax Incentives Related to Innovation	Total R&D Expenditures (2013)
Total (in € millions)	1,035	742	1,777	7,095
Share of SMEs	67%	17%	46%	41%

Source: Letter from State Secretary of Finance Eric Wiebes to Dutch parliament (Feb. 19, 2016).

involved, was used. If the R&D is a core function, the specific allocation or peeling method is used. In that method, the earnings before interest and taxes (EBIT) will be allocated to the specific functions in the company (peeling the EBIT, so to speak), leaving the residual profits to the R&D (see Figure 2).

Entry Ticket

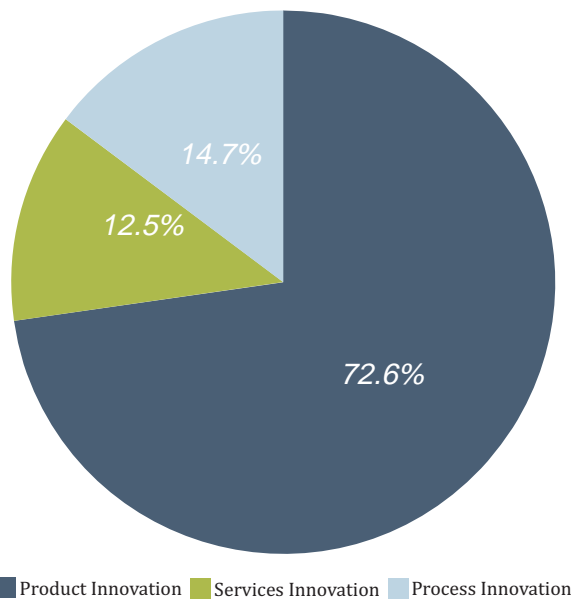
To benefit from the Dutch innovation box, taxpayers must have either a patent (including plant breeder's rights) or an R&D certificate. In addition to providing access to the innovation box, the R&D certificate provides reduced wage tax benefits. In short, the R&D

certificate was available for four types of projects in the evaluation period (2010-2012):

- a) development of new technical products, processes, or software;
- b) technical scientific research;
- c) an analysis of the technical feasibility of the company's own R&D project; and
- d) technical research intended to improve physical production process or software used by the company.

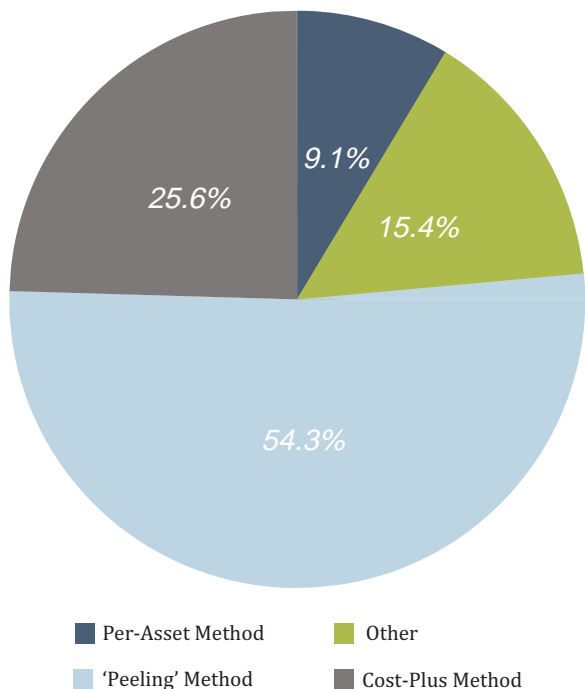
As of January 1, 2016, the R&D certificate is no longer available for the types of products mentioned in items c) and d).

Figure 1. Innovation-Related Activities by Innovation Box Users



Source: Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch).

Figure 2. Calculation Methods — Innovation Box

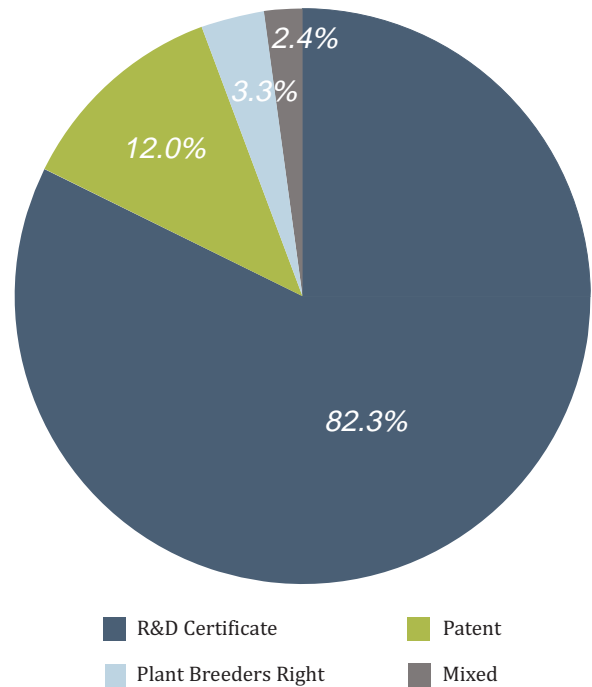


Source: Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch).

A Dutch company can apply for an R&D certificate only if it organizes and implements the R&D activities itself, the technological development is new to that organization, there are technical bottlenecks in the development, and the R&D work will take place in the future.

Remarkably, 82.3 percent of taxpayers benefiting from the innovation box predominantly use an R&D certificate as a "ticket" into the box, and only 12 percent predominantly use patents (see Figure 3).

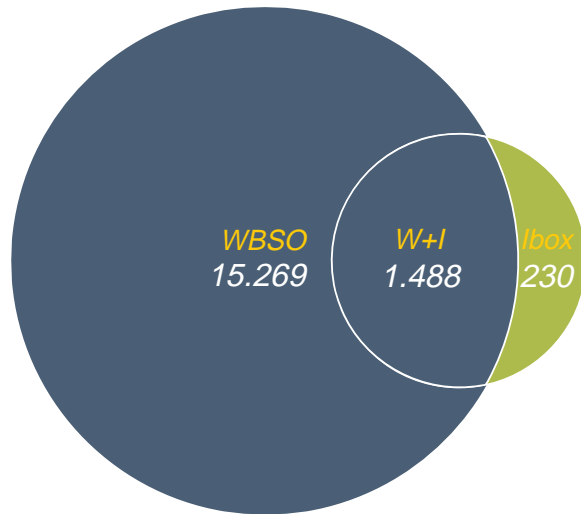
Figure 3. Basis for Innovation Box as Percentage of Total (2010-2012)



Source: Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch).

The report also explains the size of the use of R&D certificates as a way into the innovation box. The researchers interviewed taxpayers benefiting from the innovation box, with 58 percent of respondents saying they used the R&D certificate because it covers activities for which no patent can be obtained. Thirty-one percent said patents are not a desirable means of protecting IP (for example, because the knowledge concerned would become public or the application process is too expensive). Approximately 80 percent of respondents, regardless of the size of their respective companies, expect the tax savings stemming from use of the innovation box will decline if the R&D certificate would no longer grant access to the box (see Figure 4).

Figure 4. Interaction Between the Use of Innovation Box and R&D Certificates With Entrepreneurial Groups



Source: Dialogic/UNU-Merit, "Evaluation Innovationbox 2010-2012" (2015) (in Dutch); and Dialogic research based on 2012 data from the Dutch Central Bureau for Statistics (2015).

The interaction between the use of R&D certificates and the innovation box is depicted in the above overview. A small number of companies uses only the innovation box and a somewhat larger group combines the innovation box with R&D certificates. The 230 companies that use only the innovation box are mostly smaller companies (53 percent have 0-5 full-time equivalent employees). Most taxpayers, however, use only R&D certificates.

Future Implications

Because the R&D certificate is widely used by taxpayers as a ticket to the innovation box and because some taxpayers cannot or do not want to obtain a patent (which would be the alternative), the report recommends maintaining the R&D certificate as a ticket to the box as much as possible. We agree, because we fail to see why R&D resulting in a patent would be eligible for the innovation box and R&D from an R&D certificate would not. It could be claimed that the R&D certificate focuses more on the actual R&D work and effort put into the IP than the patent does (which mainly considers the output).

However, in action 5 of its base erosion and profit-shifting project, the OECD agreed that certificates similar to the R&D certificate can grant innovation box access only to companies that are part of a group with a maximum global groupwide turnover of €50 million that do not themselves earn more than €7.5 million annually in gross revenues from all IP assets (using a five-year average for both calculations). Because larger companies also use the R&D certificate as a ticket to the innovation box, the box will likely become less available for those companies.

We are pleased that for at least some entities the R&D certificate will still provide access to the innovation box. In our view, however, action 5 should not have limited the use to SMEs. Wiebes acknowledged that the BEPS rules have that limitation, saying he intends to hold a consultation in the second quarter of 2016 to discuss the implementation of the agreements following from the BEPS project regarding the innovation box.

Patents and software would still be eligible for the innovation box under the BEPS agreements, for both large and smaller companies. In the Netherlands, the innovation box is open only to corporate entities. It may well be that the new proposals will include the same benefits for private individuals with an innovative enterprise. That may further boost the application of the innovation box and R&D-related activity.

A second recommendation made in the report is to regulate the spending of tax savings related to the innovation box. For example, taxpayers could be required to reinvest the savings in R&D-related activities. The report points out, however, that measures will be difficult to implement, because the innovation box is tied to R&D proceeds rather than costs.

Other recommendations relate to reducing complexity of and enhancing the administration of the use of the innovation box. Although the tax authorities are accessible and helpful and information is generally well stored, there are more improvements that can be achieved. We welcome amendments in that direction.

On September 20 — budget day — at the latest, the Dutch government will announce its proposals to amend the innovation box. The Dutch Association of Tax Advisors (de Nederlandse Orde van Belastingadviseurs) has already commented on this topic. In a March 15 letter, the association suggested that it would be better to have clarity before budget day. It said it is in favor of announcing the Dutch position before June 30, when BEPS action 5 enters into force. We agree with the advisers. ◆