

## German Federal Council approves Research Allowance Act

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On 29 November 2019, the German Federal Council (Bundesrat) approved the *Research Allowance Act (Forschungszulagengesetz)* which was passed by the German Federal Parliament (Bundestag) on 7 November 2019 and will enter into effect on 1 January 2020.

As of 2020, Germany will for the first time offer a tax credit (called "research allowance" or "Forschungszulage") for certain R&D projects. The Government expects the new law to strengthen innovation among German businesses and contribute to the Government's plan of raising R&D expenditures to 3.5 % of GDP by 2025. The new tax incentive will be made available to a broad range of R&D activities and will complement the highly-developed German public cash grant-based R&D funding programs.

Companies, regardless of size and industry sector, will be able to receive up to €500,000 per year for R&D projects starting from 1 January 2020. The amount will be credited against tax liability or paid in cash if the tax credit exceeds the tax liability. Thus, it is very relevant for start-ups and young companies in the build-up phase.

Funding is open for three types of R&D projects: A company's own R&D projects, cooperative projects, e.g., with universities, and contract research. Contract research is funded at the level of the customer and is only possible if the R&D contractor is based in the EU/EEA.

The eligibility of contract research was the most disputed point within the grand coalition in Berlin: The government draft in May still foresaw the R&D contractor as beneficiary. During the discussions in committees and with industry, however, it became evident that the eligibility would be passed on to the customer in order to specifically benefit the German "Mittelstand." Further, the European Commission insisted on the shift: accepting contract R&D only at the level of the ordering party (customer). Contract research assumes, according to the so-far-available guidance, an R&D project-specific contract.

Eligible R&D activities need to be classified either as basic research, industrial research or experimental development (as per the R&D definition in the EU general block exemption regulation). Pure product development, in the context of "simple" routine R&D, is not eligible. Companies will need to apply for a certificate by a certifying body (outside the finance administration) confirming that the conducted activities qualify as R&D, based on the EU definition. Details regarding the application process (e.g., determination of the certifying body) are currently defined by decree by the Federal Ministry of Education and Research and are expected to come into force by the end of this year.

The funding will be provided on direct R&D personnel costs plus employer's social security contributions, at a rate of 25% of eligible costs. For contract research, the 25% funding is provided on 60% of the contract value. The maximum funding threshold of €500,000 per company and year applies to the whole corporate group as defined in Art. 15 AktG.

This new instrument in the German R&D funding landscape offers interesting opportunities for companies, as it permits an ex-post application for funding and improved predictability due to legal entitlement to the R&D tax credit.

Businesses that already have R&D activities in Germany or are considering establishing R&D in Germany, need to investigate which of their activities are potentially eligible and clarify what the definition of R&D activities means in their business practice, which of their activities are eligible for funding and how they can be documented. Due to the close starting date and the documentation requirements for the new R&D tax credit, it is important to swiftly implement related processes to ensure a smooth application process as of 2020.

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