

Research and Development tax incentives around the world

Global R&D Tax News

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Welcome

Welcome to the first quarterly issue of PwC's Global R&D Tax News

Keeping up with the constant flow of developments surrounding R&D tax incentives worldwide can be a real challenge for multinational companies. As a result, PwC's Global R&D Incentives Group is excited to bring you a new publication that will offer in-depth analysis of R&D tax regime changes around the world. The Global R&D Incentives Group is made up of R&D specialists from over 25 countries who collaborate to assist clients in examining their global R&D outlay in order to augment their return on investments.

In this issue, we start with an outline of considerations for businesses taking advantage of R&D tax incentives in multiple jurisdictions. PwC's Belgium team lists the major categories of incentives in its "toolbox" of considerations based on spending, assets, and income.

One example would be a situation where a Belgian company could contract out part of its R&D in relation to patents to a French affiliate under contract research arrangements that would qualify for the French R&D tax credit, capitalize the contract research fee, and qualify for the Belgian patent income deduction. By utilizing the toolbox approach, companies can develop an efficient approach to claiming related incentives.

The first issue of our Tax News also highlights R&D tax developments in six countries:

- **Australia**—Proposed R&D tax credit program changes include refundable and non-refundable offsets as well as different definitions that may enable businesses to take advantage of R&D tax credits
- **Canada**—Draft third-party payment changes and new limits proposed on the length of project description narratives
- **France**—Significant opportunities under the Finance Act of 2011 for companies involved in the manufacturing in France of products containing patented or patentable technologies

- **Ireland**—New changes introduced, including the ability of companies to monetize R&D tax credits and claim repayment of excess tax credits over a three-year cycle
- **United Kingdom**—Reform of the UK corporation tax includes introduction of a patent box regime
- **United States**—Highlights of benefits for businesses to claim R&D tax credits for internal-use software

I hope you find this issue both interesting and informative. If you have any thoughts or comments on any of the topics covered, please contact me.

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Taking advantage of R&D tax incentives in multiple jurisdictions

Introduction

Tax incentives for R&D are instruments used by governments to increase R&D activities. From the point of view of companies, R&D incentives are an effective way to reduce the cost associated with innovation.

R&D tax incentives provided by governments vary widely in their form and design features. These range from tax deferral to special tax deductions to reduce the tax base or to tax credits to reduce the tax liability.

In this analysis, we will classify R&D tax incentives by calculation basis and show that this is relevant to optimise the use of R&D tax incentives within a jurisdiction as well as in cross-border situations.

The tax planning toolbox

In terms of calculation basis, we can identify three types of R&D tax incentives:

1. Spending-based R&D tax incentives are calculated by reference to qualifying R&D expenses incurred by the company.

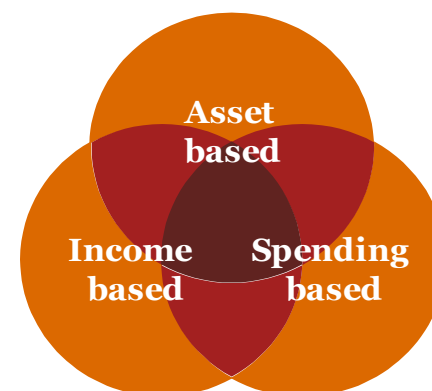
Example: The French R&D tax credit (“Crédit d’impôt recherche”) is a tax credit ranging between 30% and 40% of the qualifying R&D expenses (including costs of research personnel and depreciation).

2. Asset-based R&D tax incentives are calculated as a percentage on the value of the assets used for R&D purposes.

Example: The Belgian R&D investment deduction is an extra deduction from the tax base of 13,5% or 20,5% of qualifying R&D assets, including buildings, equipment, patents, and capitalized R&D expenses.

3. Income-based R&D tax incentives are calculated as a percentage of qualifying income.

Examples: The Luxembourg IP regime, the Dutch innovation box, and the Belgian patent income deduction are each calculated on the basis of the income derived from qualifying IP (including patents).



Taking advantage of R&D tax incentives in multiple jurisdictions continued

Combining different types of R&D tax incentives

As companies become more aware of tax planning opportunities related to R&D activities, the question arises whether different categories of incentives can be combined. Indeed, the connection between the entity that conducts the R&D in practice and the entity that owns the resulting IP is disappearing as a result of contract research structures, cost sharing models, and joint venture arrangements.

Using the toolbox in practice

Certain IP structures are designed to benefit from the combined application of asset-based, spending-based, and income-based R&D tax incentives in order to decrease the overall group tax burden.

Such “ideal combination” could, e.g., be achieved in a situation where a Belgian R&D and IP company would contract out part of the R&D in relation to patents to a French affiliate under a contract research arrangement:

1. The R&D spending by the French contract researcher would qualify for the French R&D tax credit (subject to conditions);

2. To the extent that the contract research fee can be capitalized by the Belgian IP principal as an asset on its balance sheet, the Belgian R&D investment deduction could apply (subject to conditions).
3. The patent income realized would qualify for the Belgian patent income deduction (subject to conditions).

Conclusion

As a tax-efficient R&D model is the basis for a company’s growth, companies should screen existing R&D structures and new R&D projects to assess opportunities to combine different types of R&D tax incentives.

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Country Highlights—Australia

Proposed R&D Tax Credit Program awaits Parliamentary action

Support of research and development in Australia is undergoing major change after a period of review spanning several years. The Australian Federal Government has proposed an R&D Tax Credit system to replace the existing R&D Tax Concession. The new tax credit, if enacted, will change the mechanism by which the Government supports business-related R&D. This came about after more than two years of consultation with stakeholders in industry and Government.

The new tax credit proposal was passed by the House of Representatives without amendment on 22 November 2010 and subsequently was introduced into the Senate. However, no debate has occurred due to the Senate adjourning in late November for summer recess.

It is expected that several aspects of the credit will be discussed and debated before the proposal is adopted in final form, including consideration of a deferred start date of 1 July 2011.

Key aspects of New R&D Tax Credit

Below is a high-level summary of the new program as contained in the bill pertaining to the new tax credit currently before Parliament:

- A 45-percent refundable R&D tax offset will be available for companies with a grouped turnover of less than \$20 million. This is equivalent to a 15 cents on the dollar benefit (or a 45 cents refund per dollar of R&D spend if the company is in tax losses).

- A 40-percent non-refundable R&D tax offset will be available for companies with a grouped turnover of more than \$20 million. This is equivalent to 10 cents on the dollar benefit.
- There will be a requirement to distinguish between core and supporting R&D activities in registration documentation.
- The definition of core R&D has been changed, and no longer refers to the existing terms of innovation or high levels of technical risk. Under the proposed changes, core R&D activities:
 - must be “experimental activities whose outcome cannot be known or determined in advance,” and
 - are to be determined by “applying a systematic progression of work that is based on principles of established science.”

Country Highlights—Australia *continued*

- Supporting R&D activities are “activities directly related to core activities.”
- Activities on an “exclusions list” cannot be core R&D activities, and can only be included if they are undertaken for the dominant purpose of supporting core R&D activities.
- Support activities related to the production of goods or services can only be included as supporting R&D activities if they are undertaken for the dominant purpose of supporting core R&D activities.
- Software R&D is only excluded from the program if it is developed for the dominant purpose of use for internal business administration.
- For MNC’s, Australian R&D activities that are paid for by the offshore group member which owns the IP will be supported.
- Feedstock rules, which are intended to apply in the same way as the current feedstock provisions, apply.
- Where R&D cannot be undertaken in Australia, and the overseas R&D expenditure is less than the Australian R&D expenditure on core activities, then R&D expenditure performed outside Australia may be claimed.

Whilst the legislation is still before Parliament and may change before final adoption, it is likely that the new R&D Tax Credit program may operate for income years commencing on or after 1 July 2011. However, this start date has not yet been confirmed by the Government. Despite the uncertainty surrounding some aspects of the new program, it will be significantly different from the existing R&D Tax Concession. Accordingly, companies will need to assess the application of the new provisions and the impact on their R&D activities being undertaken in Australia.

At present, the current R&D Tax Concession program continues to operate, offering benefits to claimants at an elevated 125% tax deduction level and above. For further information, please contact your appropriate Australian R&D Tax contact.

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Country Highlights—Canada

Canadian Filing Requirements and Third-Party Payments; Changes to SR&ED Project Description Length Limits

The purpose and contents of the Canada Revenue Agency's (CRA) draft policy documents that deal with filing requirements and third-party payments.

Changes to limits on the length of project description narratives, which have been relaxed somewhat.

CRA Policy Updates

To support its policy review in respect of Scientific Research and Experimental Development (SR&ED) claim filing requirements and third-party payments, the CRA is conducting public consultations and seeking feedback. This report provides an overview and summarizes the key points that you—as a claimant—should keep in mind to maximize the benefits of the SR&ED program.

The draft policies do not incorporate material changes. Rather, they have been prepared:

- to consolidate numerous relevant CRA publications into two documents; and
- to clarify the CRA's position.

SR&ED filing requirements policy—draft

The SR&ED filing requirements policy:

- Specifies the prescribed forms (T661, T2SCH 31, T2038, etc.) and prescribed information necessary to file an SR&ED claim successfully.
- Lists additional prescribed forms required to supplement forms T661 and T2SCH31 in various situations. For example, Form T1263 is required if third-party payments are involved.
- Outlines the filing due dates and reporting deadlines for corporations, individuals, and trusts.

- Explains what happens in various filing scenarios, e.g., when a tax return is filed with Form T661 but without Schedule T2SCH31.
- Lists the forms necessary to claim provincial SR&ED credits.

The CRA requires prescribed forms and information to be filed before the reporting deadlines. The Income Tax Act provides no mechanism for extending these deadlines. A taxpayer is not allowed more time after the deadline to provide any missing prescribed information.

For taxpayers, the key implication is to file early; PwC recommends doing so at least 90 days before the deadline. This allows time for submitting any additional or missing prescribed information the CRA may request. Otherwise, the CRA may reject the claim.

Country Highlights—Canada *continued*

Third-party payments policy—draft

The third-party payments policy:

- Identifies the entities (approved research institutes, universities, etc.) to which third-party payments can be made.
- Explains the criteria that must be met so payments to these entities can be considered eligible.
- Outlines the differences between third-party payments and contract payments for SR&ED performed on behalf of a claimant.
- Addresses specific situations that may be encountered, such as contributions-in-kind and issues facing farm producers and agricultural associations.

Under the policy, to include third-party payments in a claim it is critical that:

- the claimant complete Form T1263, “Third-Party Payments for SR&ED,” for every third-party payment made;
- the claimant generally should not be in control of the work performed, because if so, the work may be a contract payment, not a third-party payment; and
- the payments be for the prosecution of SR&ED in Canada and relate to the claimant’s business, and that the claimant is entitled to exploit the results of the SR&ED.

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Country Highlights—France

The use of patented or patentable technologies in manufacturing: an opportunity for tax optimization

The recently finalized Finance Act 2011 presents significant opportunities for companies involved in the manufacturing in France of products containing patented or patentable technologies. The new provisions, effective from 1 January 2011, enable those companies which own such technologies and incorporate theirs into goods that are manufactured in France to benefit from a reduced effective rate of tax.

Previously, the reduced 15% tax rate applicable to royalty income from the licensing of patents or patentable inventions was “neutralised” in the event that such an arrangement existed between two connected French companies. If the licensor company benefitted from a 15% tax rate, the licensee company would only be entitled to claim a reduced tax deduction for amounts paid under the licence (i.e., 15/33% of the amounts paid). Therefore, to truly benefit from this provision in a group context, it was necessary for the licensee company to be an overseas company.

Article 126 of the Finance Act removes this capping of the tax deduction for licensee companies where the licensing arrangement is between connected French companies.

These new provisions apply equally to existing licensing arrangements as well to new agreements. It follows, therefore, that in the case of a licensing arrangement between connected French companies, the licensor will benefit from a reduced 15% tax rate on royalty income, while the licensee company will benefit from a tax deduction at 33%.

The new rules can create opportunities for those French manufacturing companies that own the technology that they use. If manufacturing companies in the group enter into licensing arrangements for patented or patentable technologies with other group companies, this will result in a reduced 15% tax rate on that portion of the global earnings corresponding to the value of that technology.

In order for a licensee company to benefit from full deductibility for royalties paid, the new rules require that the licensee company “effectively exploits” the rights available to it. The concept of “effective exploitation” is defined in particular by reference to the Code of Intellectual Property (art. L. 613-11). In practice, this should not be a particularly difficult condition to satisfy.

Restructuring operations to benefit from the new provisions will require input from transfer pricing specialists, as well as corporate and IP lawyers.

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Country Highlights—Ireland

Ireland's R&D tax credit regime update

Ireland's R&D tax credit regime has positioned Ireland to the forefront of locations to develop, manage, and exploit intellectual property.

In 2010, €500m of Ireland's foreign direct investment projects related to research, development, and innovation activities. Allied to the new IP tax regime introduced in 2009 and Ireland's range of R&D grant incentives, Ireland's enhanced R&D tax credit regime has made Ireland an attractive location for R&D for both indigenous and international investors.

A series of positive R&D tax credit changes have been introduced since 2004, and extensive and welcome amendments recently have been introduced. Essentially, the new regime supplements the existing tax credit scheme and provides for the monetisation of unutilized R&D tax credits in certain circumstances.

In addition, companies have the ability to account for the credit "above the line" in the Profit & Loss account, thereby reducing the unit cost of R&D, which is a key measurement used when considering where to locate R&D projects.

Key features

A 25% tax credit can be offset against corporate taxes for incremental expenditure on qualifying R&D. This tax credit is in addition to the corporate tax deduction (at the 12.5% rate) that is otherwise available for the expenditure, giving an effective tax benefit of 37.5%.

The incentive is aimed predominantly at in-house R&D activity, although expenditure incurred by companies on sub-contracting R&D work to unconnected parties may qualify for a tax credit, up to a

limit of 10% of the qualifying R&D expenditure in any one year. A similar provision exists in relation to R&D work sub-contracted to universities, with the limit set at 5% of the qualifying R&D expenditure in any one year.

Expenditure incurred by companies under 51% common ultimate ownership is aggregated. The resulting credit can be allocated between the trading members of the group in proportions nominated by the taxpaying company.

Country Highlights—Ireland *continued*

What's new?

The most significant of recent R&D credit amendments is the 'monetisation' of the credit, which generates cash.

- Companies have the ability to claim repayment of excess R&D tax credits over a three-year cycle. The repayment is limited to the greater of the corporation tax payable by the company in the preceding ten years or the payroll liabilities (PAYE/PRSI/Levies) for the period in which the relevant R&D expenditure is incurred.

- Companies have the ability to carry back excess R&D tax credits to the prior year, thereby generating cash refunds of tax paid.
- While companies have had the ability to account for the credit 'above the line' in the Profit & Loss account, thereby immediately impacting on the unit cost of R&D, legislation is expected to be introduced shortly to "copper-fasten" this benefit and remove any uncertainty.

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Country Highlights—United Kingdom

In November 2010, the UK Government announced a public consultation on UK Corporation tax reform with the aim of providing the most competitive corporate tax system in the G20. The reform includes consultation on the introduction of a patent box regime and on reforming the UK R&D tax relief regime.

Patent Box

- The proposal is to introduce a preferential regime for profits arising from patents, known as the Patent Box, which will attract a 10% corporation tax rate applicable to profits arising after 1 April 2013 in respect of patents commercialized after 29 November 2010.
- The proposal is to make the Patent Box available for both royalty income and patent income “embedded” in the price of patented products. The Patent Box is likely to apply to net patent income after associated expenses (including pre-commercialization expenses), rather than to gross income.

- While the proposals for a patent box regime are supported in making the UK tax regime more competitive, the concern is that the proposals only apply to patented IP while other IP will not fall within the regime. However, it is likely that given the financial constraints within the economy, the regime will remain limited to patent rights, at least initially.

R&D Tax Reliefs

As part of the consultation, the UK Government has confirmed that it remains committed to continuing the R&D tax credit schemes to encourage innovation in the UK.

In the March 2011 budget, increases in the rates of relief for Small and Medium Sized Enterprises (SMEs) were announced—the enhanced deductions are increasing from 175% to 200% from April 2011 and 225% from April 2012. While the value of the cash-back claims for many loss-making

companies is staying broadly the same, the removal of the employment taxes cap on cash-back claims will benefit some loss-making SMEs. This is all subject to EU approval.

The consultation has focusing on a number of areas to reform the UK regime, including the following:

Structural changes to the relief

There are proposals to change the structure of the reliefs. PwC believes that one way to make the R&D regime more effective in stimulating R&D investment would be to make the incentive a true “credit” that is accounted for within operating costs, rather than in the tax charge. This could address the following limitations of the current regime:

- Recording the relief in the tax line means that the benefit is dependent on the tax profile of the group and that no cash benefit is obtained in a loss-making year (for large companies).

- Often ownership of the project for making R&D tax relief claims sits within finance or tax. It is not possible for the R&D teams to ‘record’ the R&D benefit in the results for which they are responsible.
- The current regime can be disadvantageous for overseas-parented groups, as some territories (such as the United States) calculate tax on foreign earnings with relief for the foreign tax suffered. Currently, a reduction in UK tax resulting from the R&D relief increases the amount of tax payable in the overseas territory because there is less relief for overseas tax suffered.

Accounting for the credit “above the line” could address these issues and is supported by business. A recent survey, undertaken by PwC, showed that 70% of respondents thought this would have a positive impact on UK R&D investment decisions.

Country Highlights—United Kingdom *continued*

- The current headline rate for the large company R&D regime is an 8.4% tax saving on qualifying R&D expenditure. The regime is likely to be more effective if this headline rate were increased to at least 10%. If the credit were accounted for above the line, the headline rate could be increased to as much as 14%, which is taxable and therefore results in an after-tax credit of 10% (at current 28% tax rate). An increase in headline rate of this magnitude is more likely to stimulate R&D investment.

Definition of R&D

- Recently there has been much debate as to whether production activity can be included in R&D claims. The consultation covers whether there should be an exclusion for production activity or whether it would be better to have a statutory definition of production. Another alternative would be to introduce rules similar to those in Canada whereby production costs are allowed after deducting revenues from selling the items produced.
- Currently the UK regime allows claims for internal-use software development. Part of the consultation is considering whether the inclusion of these activities should be limited or even excluded.

Simplification

- An objective of the UK Government is to simplify the UK tax legislation. There are a number of areas whereby the R&D tax legislation could be simplified including:
 - The rules related to externally provided worker expenditure (agency type staff) are complex and often prevent claims for genuine R&D activity due to the structure of the arrangements in place.
 - The UK R&D regime has recently changed to allow for certain supporting activities to be included in the R&D claim. The guidance on this is complex, and the benefits to claimants often are not significant.

- Simplification of the R&D regime for SME's also is required, particularly in relation to subsidized and funded R&D. This can be very complex, and companies can easily be prevented from claiming due to the type of funding received.

The initial consultation phase has now closed. We are expecting a further, more focused consultation to commence in May 2011.

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Country Highlights—United States

Internal-Use Software in the Retail Industry

On December 17, 2010, President Obama signed legislation that includes a two-year extension of the research and development (“R&D”) credit through 2011. This extension of the R&D credit once again allows retailers that have qualifying activities to generate additional cash tax savings and lower their effective tax rate. Unfortunately, some retailers are unaware that certain of their activities may qualify for the credit. One area that easily can be overlooked is “internal use software.”

R&D Credit

The R&D credit in Internal Revenue Code Section 41 is a credit against regular federal income tax. Enacted in 1981 to stimulate R&D in the United States, the credit is for businesses that increase their spending on qualified research activities. Under Section 41, “qualified research” means:

- Research which results in expenditures that are deductible under Section 174;
- Research which is intended to discover information that (1) is technological in nature, and (2) will result in the development of a new or improved business component of the taxpayer; and
- Research which involves a process of experimentation related to a new or improved function, performance, or reliability or quality.

Certain research-related activities will not qualify for the research credit. These include research activities associated with computer software that is developed primarily for internal use by the taxpayer (e.g., computer software to be used internally in general and administrative functions, such as payroll and bookkeeping). All other research activities related to internal-use software are ineligible for the credit, except to the extent permitted by regulations.

Observation: The R&D credit is a General Business Credit. As such, any credit not used in the current tax year is generally carried back one year and carried forward up to 20 years.

Internal-Use Software Requirements

The 2003 final regulations contain the most recent Treasury guidance regarding qualified research expenses. While these regulations clarify certain issues relating to qualified research expenses, they do not include any guidance related to internal-use software (that paragraph is “reserved”). Therefore, until further guidance regarding internal-use software is issued, taxpayers may rely on the 2001 proposed regulations. Alternatively, taxpayers may rely on the older 2001 final regulations (which were “replaced” by the 2003 final regulations).

Country Highlights—United States *continued*

Under the 2001 proposed regulations, software is presumed to be for internal use unless it is developed to be commercially sold, leased, licensed, or otherwise marketed, for separately stated consideration to unrelated third parties. However, under the 2001 proposed regulations, internal-use software may qualify for the R&D credit provided the software meets the general requirements for the credit outlined in Section 41; the software is not otherwise excludable under Section 41(d)(4) (other than subparagraph (E)); and one of the following conditions is met:

- The taxpayer develops software for use in an activity that constitutes “qualified research” (other than the development of the internal-use software itself);

- The taxpayer develops software for use in a production process which meets the general requirements for the credit outlined in Section 41;
- The taxpayer develops software for use in providing computer services to customers; or
- The software satisfies the “high threshold of innovation test.”

Observation: In certain circumstances it may be possible to avoid the “high threshold of innovation test,” under the computer services exception. However, this exception generally only will be available where customers are conducting business with the company primarily for the use of the company’s computer or software technology, not where customers are merely interacting with the company’s software.

The 2001 proposed regulations explain that the “high threshold of innovation test” is met if:

- The software is innovative in that it is intended to be unique or novel and to differ in a significant and inventive way from prior software;
- The software development involves significant economic risk to the taxpayer in that there is substantial uncertainty because of technical risk; and
- The software is not commercially available for use by the taxpayer in that the software cannot be purchased, leased, or licensed and used for the intended purpose without certain modifications.

Under the 2001 final regulations, internal-use software qualifies for the R&D credit in much the same way it does under the 2001 proposed regulations. However,

there are several differences between the 2001 final regulations and the 2001 proposed regulations. Most notably, the 2001 final regulations only require that software result in a reduction in cost, improvement in speed, or other improvement, with respect to the first prong of the “high threshold of innovation test.” On the other hand, there is also a very specific “discovery test”—i.e., a requirement to undertake research to obtain knowledge that exceeds, expands, or refines the common knowledge of skilled professionals in a particular field of science or engineering. The 2001 proposed regulations arguably establish a higher standard with respect to the first prong of the “high threshold of innovation test,” requiring that the software be unique or novel and differ in a significant and inventive way from prior software implementations or methods, but there is no detailed “discovery test.”

Country Highlights—United States *continued*

Observation: Over the last few years there have been a number of court decisions addressing various aspects of the research credit. One of the more notable cases addressed the “discovery test” in the context of internal-use software. In *FedEx Corp. v. United States*, 103 AFTR 2d 2009-2722 (2009), the taxpayer took the position that it could rely on the 2001 final regulations and its more lenient “high threshold of innovation test” without having to also address the “discovery test” found in those same regulations. Ultimately, the U.S. District Court agreed with the taxpayer, concluding that since the 2003 final regulations effectively renounced the “discovery test” outlined in the 2001 final regulations, the IRS could not hold the taxpayer to that standard.

Potentially Qualifying Activities

The R&D credit is not reserved for technology companies and industrial products manufacturers. It is available to many different companies in many different industries, including the retail industry. Similarly, qualifying R&D activities are not confined to designated R&D departments. In some cases, R&D activities may occur within other departments. For example, in the retail industry, the company’s IT department may be involved in the creation of one or more of the following technologies, any one of which may qualify for the R&D credit, depending on the facts and circumstances:

- Website browse, search, and recommendation technology;
- Advertising and affiliate program related technology;
- Digital media download technology;

- Online payment, self-checkout, and other point-of-sale technology;
- Distribution center fulfillment and radio-frequency identification technology; or
- Other similar technology.

In analyzing the activities associated with developing these types of technologies, retailers should consider trying to qualify for the R&D credit under the computer services exception, thereby avoiding the “high threshold of innovation test.” If the computer services exception does not apply, then retailers should consider whether they meet the more lenient “high threshold of innovation test” found in the 2001 final regulations, especially in light of the recent taxpayer-favorable decision in *FedEx Corp.* regarding the “discovery test.”

Tier I Issue

On April 4, 2007, the IRS issued “Industry Director Directive #1 on Research & Experimentation (R&E) Credit Claims,” announcing that research credit claims have been designated as a Tier I issue, meaning that these claims are of strategic importance to the IRS. On January 15, 2009 the IRS issued “Industry Director Directive #2 on Research Credit Claims,” supplementing the guidance provided in the earlier directive and emphasizing concerns that R&D credit claims may “lack adequate documentation,” among other concerns. In response to these concerns, IRS guidance currently mandates the issuance of an Information Document Request (“IDR”) for many R&D credit claims. This IDR is very comprehensive and is focused on a variety of issues. Based on these developments, retailers should make certain they have the proper supporting documentation in order to sustain their R&D credit positions upon audit.

Country Highlights—United States *continued*

Conclusion

Despite current economic conditions, retailers will need to continue focusing on R&D in an effort to ward off competitors, increase their customer base, and improve their bottom line. Retailers can manage the cost and risk associated with their R&D by identifying specific activities that should qualify for the federal R&D credit. In many instances, activities associated with providing computer services to customers or creating “internal use software” may qualify for this credit.

Observation: Retailers should also look for state-specific R&D credit opportunities. In addition, many foreign countries now offer incentives related to various R&D activities, as illustrated in this Tax News issue.

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