

German Act on Tax Incentives for R&D (FZuIG)

An opportunity for Germany as innovation hub



Introduction



Following various calls from German industry and politics over the past years, the German Act on Tax Incentives for Research and Development (“Forschungszulagengesetz - FZulG”) became effective on 1 January 2020. Under this act, entitled companies and entrepreneurs may apply for subsidies of up to 25% of their eligible R&D activities. The maximum amount of subsidy was originally limited at EUR 500,000 but was increased to a maximum of EUR 1,000,000 per year under the German COVID-19 measures. This extension of maximum subsidy, which shall be valid until 30 June 2026, makes it even more worth to check whether the preconditions for eligible R&D activities are met.

The FZulG aims to establish and strengthen Germany as a preferred location for innovation as well as technology hot spot and may create a high-value opportunity not only for established small and medium-sized enterprises but also for the start-up business. For international corporate groups the FZulG may result in material tax savings and therefore requires respective tactical decisions at a rather early stage how this subsidy can fit with the overall R&D strategy and how the group can benefit most effectively by also taking into account applicable R&D tax regimes and subsidies across other jurisdictions.

Expenditure for R&D in Germany has significantly increased over the past years up to an over-all amount of EUR 104.7 billion as per 2018 which is equal to approx. 3.13% of the German GDP. The portion of R&D costs spent by entities within the sector of Technology, Media and Telecommunications (TMT) amounts to approx. EUR 24 billion. At least 23% - 54% of the entities are carrying out R&D activities on a continuous basis which demonstrates the high importance of R&D incentives in particular for the TMT sector.

Who is entitled under the FZuIG



The FZuIG provides for a rather broad scope of entitled persons. Basically, anyone who is subject to unlimited or limited tax liability in Germany and generates profit income from either trade business, agriculture and forestry or self-employment is principally entitled for tax benefit under the FZuIG. Hence, foreign companies or international groups may benefit from the subsidy as well. The FZuIG does not require a specific legal form, which means that any company or business established under foreign or domestic law, from sole entrepreneurs to corporations, can principally apply for the subsidy. In case of a partnership, the subsidy can only be applied once at the level of the partnership itself but not at the level of the single partners. The FZuIG does, however, explicitly exclude those companies or businesses from the benefit which are deemed to be in financial difficulties.

Eligible R&D activities

Basically, R&D activities are eligible for subsidy under the FZuIG if they have been initiated after January 1st, 2020 and which are attributable to at least one of the following categories:¹

Fundamental research

Experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any direct commercial application or use in view.

Industrial Research

Planned research or critical investigation aimed at the acquisition of new knowledge and skills for developing new products, processes or services or for bringing about a significant improvement in existing products, processes or services. It comprises the creation of components parts of complex systems, and may include the construction of prototypes in a laboratory environment or in an environment with simulated inter-faces to existing systems as well as of pilot lines, when necessary for the industrial research and notably for generic technology validation.

Experimental Development

Acquiring, combining, shaping and using existing scientific, technological, business and other relevant knowledge and skills with the aim of developing new or improved products, processes or services. This may also include, for example, activities aiming at the conceptual definition, planning and documentation of new products, processes or services. Experimental development may comprise prototyping, demonstrating, piloting, testing and validation of new or improved products, processes or services in environments representative of real life operating conditions where the primary objective is to make further technical improvements on products, processes or services that are not substantially set. This may include the development of a commercially usable prototype or pilot which is necessarily the final commercial product and which is too expensive to produce for it to be used only for demonstration and validation purposes. Experimental development does not include routine or periodic changes made to existing products, production lines, manufacturing processes, services and other operations in progress, even if those changes may represent improvements.

¹According to the COMMISSION REGULATION (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

Eligible R&D activities

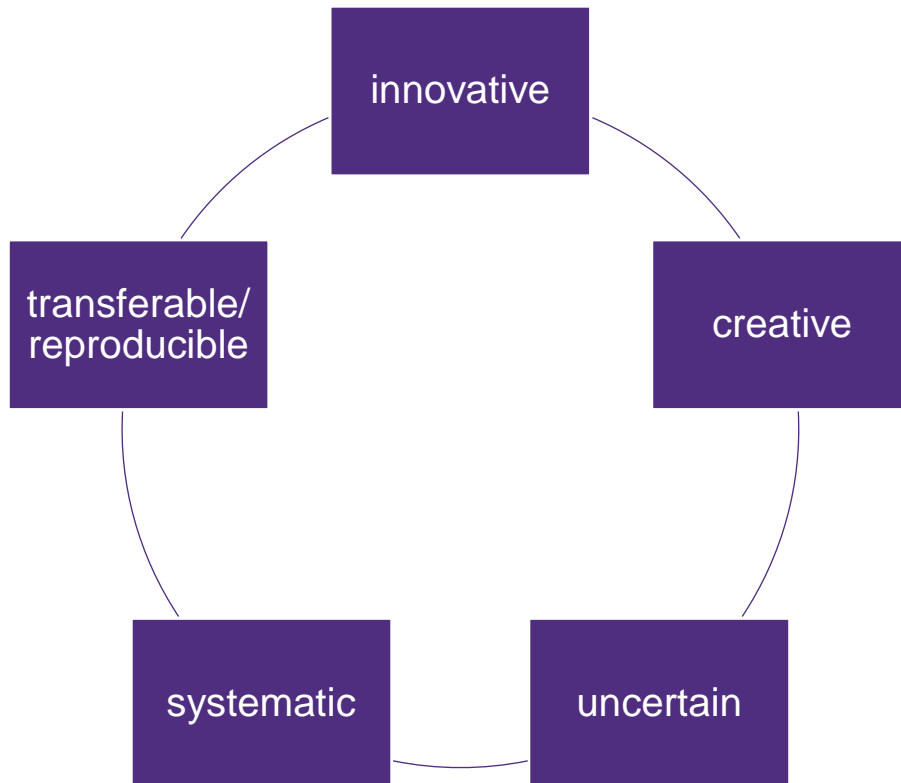


Within the above eligible categories, it is irrelevant to which field of research the activity is to be attributed, as long as it falls within the generic term research and development. This means that the respective activity requires a precisely defined task of an economic, scientific or technical nature with clearly defined objectives along with the steps to be taken to achieve them, including objective guidelines to verify whether the objectives have been achieved.

For eligibility under the FZulG it is further required that the R&D activity

- aims to gain new scientific insights (“innovative”),
- is based on original, non-obvious concepts and hypotheses (“creative”),
- is uncertain as regards to the outcome (“uncertain”),
- is based on a budget and follows a certain plan (“systematic”) and
- leads to a result which may be reproduced (“transferable / reproducible”).

Key criteria of eligible R&D activity



Taking into account the above, eligible R&D activities in terms of the FZuIG are projects that basically aim at the new development or significant improvement of products, processes or services whose functionalities, parameters or features significantly exceed those from already existing products, processes or services. The activity can be regarded as R&D if the completion of the project involves scientific and / or technical progress or if scientific uncertainty has been eliminated.

This may include new developments or significant improvements relate to new services made possible by digitization, for example in the areas of production, logistics, payment or machine control. This also includes new developments in the field of financial or actuarial methods for risk assessment or research into the development of new algorithms, as well as the development or significant improvement of software components, artificial intelligence, operating systems or programming languages.

Key criteria of eligible R&D activity

Non-eligible activities

The mere use of already known products, processes or procedures is generally not eligible for subsidy under the FZuG. This in particular applies to recurring and routine changes to existing products and processes as well as (quality) controls. Furthermore, the development of management systems and developments in which the solution approaches are based on business (non-technological) concepts are non-eligible.

Examples for non-eligible activities are as follows:

- Market research;
- Market development, i.e. activities related to the development and manufacture of market-readiness and smooth functioning of a certain product or process;
- Client acquisition;
- Development of production manuals and quality assurance guidelines;
- Support, sales, customer training / testing;
- Certain administrative and legal patent and licensing work which is not directly related to R&D projects.

In case that the above preconditions for an eligible R&D activity are met, it is principally irrelevant whether the activity is carried out directly by the company itself, in cooperation with other companies or in form of a contract research by a contractor.

In particular the latter may create a high-value and opportunity for small and medium sized enterprises or start-up businesses as they often do not have the capacities to perform the R&D activities by themselves.

How to assess eligible R&D expense

The basis of assessment for R&D subsidy under the FZuIG is calculated on the basis of a company's eligible expenses in the R&D area. Eligible expenses are

- The direct costs incurred for wages that are in principle subject to wage tax as well as the employer's expenses for securing the employee's future, provided that the employees are involved in eligible R&D activities;
- Payments to partners or shareholders of a company, provided that these payments are generally subject to wage tax deduction. This may in particular be beneficial for start-up businesses which usually employ only a few individuals in the R&D area;
- In addition, own contributions by an individual entrepreneur in the field of R&D may also be eligible for subsidy. Such own contributions are estimated at a flat rate of EUR 40 per proven working hour with a maximum of 40 working hours per week.
- For contract research, 60 % of the remuneration paid to the contractor is eligible for subsidy.

As regards to the assessment base it is essential to ensure that the applicant has verifiable documentation regarding the personnel carrying out the relevant R&D activities. In particular, the working hours spent should be clearly documented in a verifiable manner (pls. refer to the below application process under step 2). General or proportional cost allocations to the R&D department shall not be considered as sufficient.

How to assess eligible R&D expense

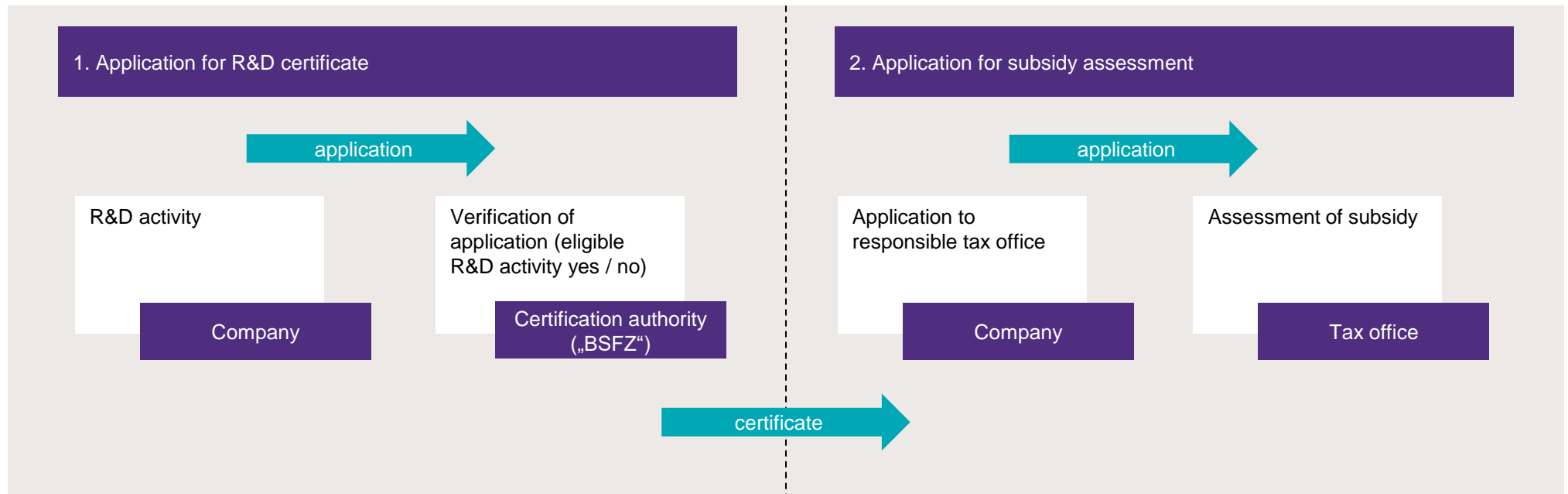
Moreover, it should be noted that those eligible expenses which are included in the assessment basis for the R&D subsidy under the FZuIG shall not be included twice in the context of other grants or governmental subsidies.

The capped amount of R&D expense at kEUR 940 may remain available for utilization as assessment base within the application for other grants or governmental subsidies, if any.

Example for determination of eligible expense & subsidy	
Employee 1	
- 1,760 working hours per year (220 days / 8h)	
- thereof 880h for R&D project (acc. to internal documentation)	
- EUR 120,000 annual gross wage	
Employee 2	
- 1,760 working hours per year (220 days / 8h)	
- thereof 1,760h for R&D project (acc. to internal evaluation)	
- EUR 80.000 annual gross wage	
Employee 3 (administrative staff)	
- 1,760 working hours per year (220 days / 8h)	
- responsible for organisation / planning / settlement of R&D projects	
Expense for contractual research	
- EUR 8,000,000	
Determination of eligible R&D expense	
	EUR
Employee 1	60,000
Employee 2	80,000
Employee 3	0
Expense for contractual research (60%)	4,800,000
Sum	4,940,000
Cap to maximum amount	-940,000
Eligible R&D expense	4,000,000
thereof 25% subsidy	1,000,000

How to apply for the subsidy

The application process for the subsidy under the FZuIG follows a two steps approach. The process is divided into the application for a R&D certificate (1.) followed by an application for the subsidy at the responsible German tax office (2.).



How to apply for the subsidy - Step 1: Application for R&D certificate

The application for R&D certificate has to be done with the respective certification authority (“Bescheinigungsstelle Forschungszulage - BSFZ”). The BSFZ is responsible for validation whether the preconditions of eligible R&D activity are met.

The application for certificate can be filed prior, during or even after the execution of a certain R&D project. Basically, the application has to be filed electronically via the website of the BSFZ (<https://www.bescheinigungsforschungszulage.de/>). However, for a transitional period it is re-quired to additionally submit the application and relevant information in paper form including a legally binding signature from the applicant.

If the verification by the BSFZ comes to the result that the preconditions for an eligible R&D activity are met, a respective R&D certificate is issued. The certificate will be issued separately for each R&D project even though it is possible to combine several R&D projects into one ap-plication.

The R&D certificate shall be issued not later than 3 months after the application has been filed.

The application process as well as the issuance of respective R&D certificate are free of charge for the applicant.

How to apply for the subsidy - Step 1: Application for R&D certificate

5 Steps to R&D certificate²:



Overview on relevant information for application process

The application for R&D certificate with the BSFZ shall include the following information:

- Specific information on the R&D activity or project for which a certificate is applied for, in particular including
 - a meaningful and comprehensible description of the relevant R&D project;
 - information on whether the R&D activity is performed directly by the company itself, in cooperation with other companies or in form of a contract research by a contractor;
 - the expected timeline, personnel and financial scope of the R&D activity;
- The applicant's name (firm), address and contact information;
- Tax identification number and responsible tax office;
- Registration number of the commercial register, if applicable;
- Information on related entities of the applicant, if applicable.

²According to the BSFZ (<https://www.bescheinigung-forschungszulage.de/>).

How to apply for the subsidy - Step 2: Application at the local tax office

The assessment of subsidy under the FZuIG must be applied for electronically (via ELSTER) at the end of the business year in which the respective R&D activity was performed at the re-sponsible local tax office, i.e. for eligible R&D activities within fiscal year 2020 the application can be filed from January 1st, 2021 onwards.

The application for subsidy assessment needs to be accompanied by the issued R&D certificate (see step 1).

Long term R&D projects

In case of long-term or multi-year R&D projects it is principally not necessary to submit the certificate every year unless there are material changes in the underlying facts and circumstance of the R&D project which may require an updated validation of eligibility by the BSFZ.

Verification of eligible R&D expense

The eligible R&D expenses must be described in sufficient detail to allow for a verification by the tax office and assessment of the subsidy. In this regard the German Ministry of Finance has issued a sample template for a time sheet in order to monitor and document the working hours spent with regard to a certain R&D activity. The applicants are principally free to utilize the provided template.

Deadline for application

The application for subsidy assessment at the responsible tax office can be filed 4 years after the relevant fiscal year of eligible R&D expense at the latest.

How does the FZulG fit within the international context of R&D regimes

The FZulG can create considerable tax advantages for all companies carrying out activities in the R&D sector of up to EUR 1,000,000 per year. Potentially eligible companies should consider early on, whether and how they can benefit from the subsidy. These considerations can begin with the tax liability in Germany and continue up to the specific contractual design of the R&D activities. This is especially relevant for international corporate groups that may benefit from the subsidies by transferring R&D activities to eligible subsidiaries.

An advantage of the FZulG in comparison to foreign R&D incentives schemes is that funding can be applied for in Germany as early as the development stage itself and not only in the course of exploiting the R&D efforts via license income. Please find below an exemplary overview of R&D incentive scheme in the UK:

United Kingdom

Small and medium sized enterprises R&D relief

SME R&D relief allows eligible companies to:

- deduct an extra 130% of their qualifying costs from their yearly profit, as well as the normal 100% deduction, to make a total 230% deduction
- claim a tax credit if the company is loss making, worth up to 14.5% of the surrenderable loss

Eligible companies are SME with:

- less than 500 staff, a turnover of EUR 100 million or a balance sheet total under EUR 86 million

Qualifying costs for SME R&D relief are directly allocable personnel costs, license fees for software, material costs, and 65% of the expense for contractual research.

Research and Development Expenditure Credit

Large companies can claim a Research and Development Expenditure Credit (RDEC) for working on R&D projects.

The RDEC is a tax credit, which is 13% (since 1 April 2020) of the qualifying R&D expenditure.

The qualifying R&D expenditure is equal to the qualifying costs under the SME R&D relief.

How does the FZuIG fit within the international context of R&D regimes

Due to the broad international network of Grant Thornton member firms and availability of foreign tax experts, Warth & Klein Grant Thornton can further assist with the set-up and design of a most optimal R&D strategy by taking into account the tax advantages from FZuIG and further foreign R&D incentive schemes as well.



How can Warth & Klein Grant Thornton help

- Analysis whether the preconditions for an eligible R&D project or activity in terms of the FZuIG are met
- Support the determination and documentation of eligible R&D expense
- Support the applications at the BSFZ and the local tax office



Warth & Klein Grant Thornton

© 2021 Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft

Warth & Klein Grant Thornton AG is a memberfirm of Grant Thornton International Ltd (Grant Thornton International).

References to "Grant Thornton" are to Grant Thornton International or one of its member firms. Grant Thornton International and the member firms are not a worldwide partnership. Every member firm renders its services autonomously and independently of Grant Thornton International or other member firms.

Berlin

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Cicerostraße 2
10709 Berlin
T +49 30 890482 0
F +49 30 890482 100

**Warth & Klein Grant Thornton
Rechtsanwalts-gesellschaft mbH**
Cicerostraße 2
10709 Berlin
T +49 30 890482 0
F +49 30 890482 100

Dresden

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Schubertstraße 41
01307 Dresden
T +49 351 31821 0
F +49 351 31821 635

Duesseldorf

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Johannstraße 39
40476 Düsseldorf
T +49 211 9524 0
F +49 211 9524 200

**Warth & Klein Grant Thornton
Rechtsanwalts-gesellschaft mbH**
Johannstraße 39
40476 Düsseldorf
T +49 211 9524 0
F +49 211 9524 200

Frankfurt a.M.

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Ulmenstraße 37-39
60325 Frankfurt a. M.
T +49 69 905598 0
F +49 69 905598 677

Hamburg

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Kleiner Burstah 12
20457 Hamburg
T +49 40 4321862 0
F +49 40 4321862 49

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Jungfernstieg 7
20354 Hamburg
T + 49 40 32088 1200
F + 49 40 32088 1222

**Warth & Klein Grant Thornton
Rechtsanwalts-gesellschaft mbH**
Jungfernstieg 7
20354 Hamburg
T + 49 40 32088 1200
F + 49 40 32088 1222

Leipzig

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Humboldtstraße 25
04105 Leipzig
T +49 341 59083 0
F +49 341 59083 733

Munich

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Ganghoferstraße 31
80339 München
T +49 89 36849 0
F +49 89 36849 4299

**Warth & Klein Grant Thornton
Rechtsanwalts-gesellschaft mbH**
Ganghoferstraße 31
80339 München
T +49 89 36849 0
F +49 89 36849 4299

Lower Rhine

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Eindhovener Straße 37
41751 Viersen
T +49 2162 91811 0
F +49 2162 91811 60

Rostock

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Am Vögenteich 26
18055 Rostock
T +49 381 3756 6300
F +49 381 3756 6315

Stuttgart

**Warth & Klein Grant Thornton GmbH & Co. KG
Wirtschaftsprüfungsgesellschaft**
Jahnstraße 6
70597 Stuttgart
T +49 711 16871 0
F +49 711 16871 40

Wiesbaden

**Warth & Klein Grant Thornton AG
Wirtschaftsprüfungsgesellschaft**
Hagenauer Straße 59
65203 Wiesbaden
T +49 611 18890 0
F +49 611 260133