

German Research Allowance Act

How to benefit from tax incentives for research and development

UPDATE German Growth Opportunities Act 2024



Tax-free state research allowance – you too can benefit from R&D funding

Since January 1, 2020, research companies can benefit from state allowances.

On March 27, 2024, the German Growth Opportunities Act was promulgated. The amended Research Allowance Act (FZulG) came into force one day after the promulgation, which significantly expands the tax-free research allowance and thus results in a number of improvements for research companies. These adjustments have only been in force since March 28, 2024 and have not been effective since January 1, 2024, as originally intended.

We have summarized for you the legal situation's development illustrating how and under what conditions you can benefit from the research allowance for the various financial years since July 1, 2020.

Benefit from the state research allowance now

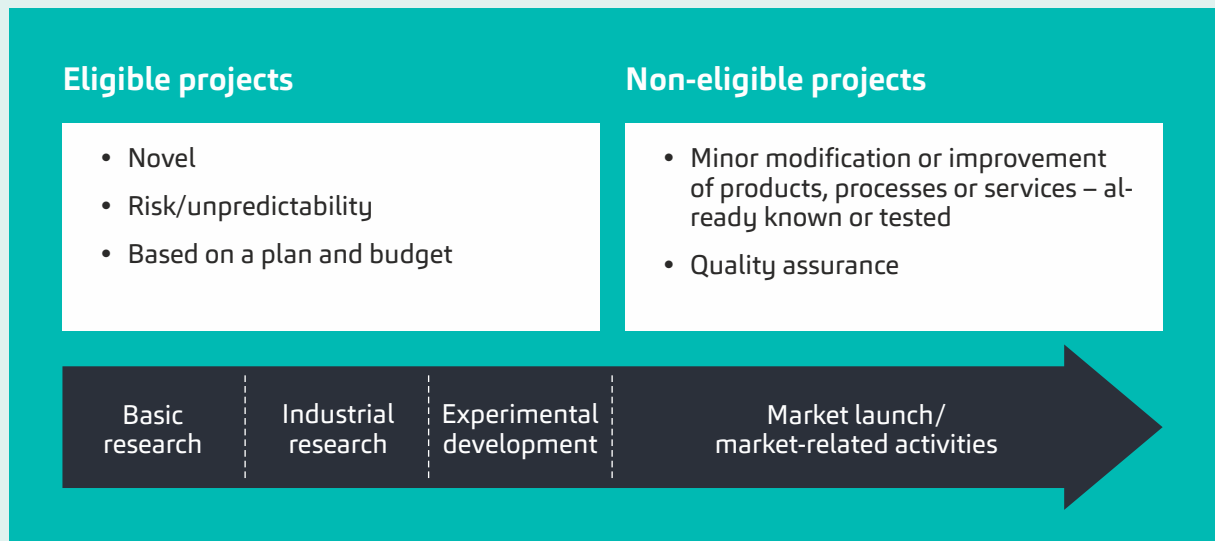
Who is eligible?

Generally, all research companies which or whose shareholders are subject to unlimited or limited corporate income or income tax liability, i.e., which are not tax-exempt, receive the allowance. All taxpayers with the following income are eligible:

- Income from agriculture and forestry Art. 13 German Income Tax Act (EStG)
- Income from trade or business Art. 15 EStG
- Income from self-employment Art. 18 EStG

In the case of co-entrepreneurships pursuant to Art. 15 (1) sentence 1 no. 2 EStG (e.g., commercial partnerships such as GmbH & Co. KG), the co-entrepreneurship replaces the taxpayer as the beneficiary.

Classification as an R&D project: What is funded?



The allowance is awarded to all companies, regardless of their size, legal form and economic activity.

Sole proprietorships performing in-house research and/or contract research, as well as collaborations between a beneficiary and at least one other company, can also benefit. Cooperations with scientific institutions are eligible for the allowance as well.

Please note that public institutions, to the extent they conduct in-house research as part of the cooperation, are often tax-exempt and are therefore not entitled to a research allowance.

What is funded?

The Act provides for tax incentives for R&D in the areas of basic research, industrial research and experimental development. The definitions are derived directly from the corresponding EU state aid regulations (Art. 2 No. 84 to 86 GBER).

Funding is available for R&D activities starting or being contracted after the Act came into force on January 1, 2020.

The Growth Opportunities Act's new provisions apply from March 28, 2024.

The allowance is awarded to all companies, regardless of their size, legal form and economic activity.

How is the research allowance calculated?

With regard to the research allowance's assessment basis, one must distinguish between in-house and contract research.

In-house research

As part of the in-house research, companies receive grants for 100 % of the **wages and salaries subject to payroll tax** for employees working on eligible projects. In addition, any expenses incurred by the employer to secure the employee's future (in accordance with Art. 3 No. 62 EStG) qualify as eligible expenses.

For the first time, eligible expenses also include part of the acquisition and production costs of depreciable movable fixed assets, to the extent these (i) were acquired or produced after the Act's new provisions came into force, (ii) are used in the eligible research and development project exclusively for the company's own purposes, and (iii) are necessary for the research and development project's implementation.

Contract research

In case of contract research, the client now receives a flat-rate allowance for 70 % instead of the previous 60% of expenses. However, the contractor, i.e., the entrepreneur conducting research on behalf of a third party (e.g., contract research institutes, so-called Contract of Clinical Research Organization) is not funded.

SME factor

Companies qualifying as small and medium-sized enterprises within the meaning of the SME definition in Annex I of the General Block Exemption Regulation can also apply for a 10 % increase in the research allowance.

Assessment basis

The company's eligible expenses incurred in the financial year serve as assessment basis. The following upper limits apply to the assessment basis:

- Eligible expenses incurred after January 1, 2020 and before July 1, 2020: EUR 2 million.
- Eligible expenses incurred after June 30, 2020 and before March 28, 2024: EUR 4 million.
- Eligible expenses incurred since March 28, 2024: EUR 10 million.

The maximum assessment base's time limit has been abolished: It will apply until further notice instead of only until June 30, 2026 as before. Affiliated companies can only make use of the above-mentioned upper limits once.

The total amount of state aid granted for an R&D project, including the research allowance under the FZulG, is limited to EUR 15 million per company and R&D project.

Sole proprietorships/co-entrepreneurs

A sole proprietorship's/co-shareholder's personal contributions in a subsidized R&D project are increased from EUR 40 to EUR 70 per working hour (max. 40 hours per week) and taken into account as eligible expenditure.

Liquidity advantage

Granting the research allowance creates additional liquidity advantages, especially for medium-sized and large companies with high eligible expenses, but only after the end of the financial year. As illustrated by the following table (legal situation from March 28, 2024), the amount of the liquidity advantage also depends on whether the company conducts in-house or contract research.



Sample calculation

	In-house research	Contract research
Expenses	Personnel expenses/ amortization + depreciation	Contract volume
Amount of expenses in EUR	10,000,000	10,000,000
Assessment basis in EUR	10,000,000 (100% of personnel expenses / part of amortization + depreciation)	7,000,000 (up to 70 % of contract volume)
Funding rate in relation to total expenses	25.0 %	17.5 %
Refund amount tax office upon filing of tax return per year in EUR (example)	2,500,000	1,750,000
Increase by SME factor 10 % in EUR	1,000,000	700,000
Increased refund amount tax office per year in EUR (example)	3,500,000	2,450,000

How is the research allowance granted?

The research allowance, to which there is a legal claim, is only granted upon application. The application procedure comprises two stages.



1. Application for a certificate from the Research Allowance Certification Office (BSFZ)

- Project costing (checking eligibility for funding, optimizing the funding rate)
- Preparation of project application and work plan
- Project recording in the IMS (GoBD*-compliant hours recording, appropriate depreciation authorization, creation of new project employees, recording of necessary movable assets, recording of orders and invoices, project progress documentation, etc.)
- Creation of BSFZ portal account; Elster certificate required
- Filing
- Answering queries from the assessor (BSFZ)

* German principles for the proper keeping and storage of books, records and documents in electronic form



2. Application for assessment of the research allowance at the tax office

- Preparation of the tax office application based on the project documentation
- Filing of the application and the BSFZ certificate to the tax office via Elster-Online

Before an application for funding can be filed with the competent tax office, the research company must first obtain a certificate for the research project from the Certification Office for Research Allowances (BSFZ). During such first stage, the BSFZ checks whether the project qualifies as eligible for funding and falls under one of the research categories. The correct presentation of the research project is very important at this stage. Digital process and project management as well as technical expertise are particularly important in this phase of the procedure. Therefore, Baker Tilly works at this interface of technology, tax and law with innoscripta GmbH, which has many years of experience in the aforementioned R&D area.

At the second stage, the application for the research allowance must be filed electronically with the competent tax office together with the BSFZ certificate. The application can only be submitted after the end of the fiscal year in which the eligible expenses were incurred.

The assessed amount will be credited or refunded as an advance payment against the tax in the next initial income or corporate income tax assessment (irrespective of the assessment period), if applicable, on a pro rata basis for individual co-entrepreneurs. If the tax return for an initial assessment is still outstanding, the tax office automatically adjusts the advance payments for income or corporate income tax. The fact that the advance payments are reduced in line with the assessed research allowance provides companies with an additional liquidity advantage. The reimbursement option illustrates that the allowance is intended to have the same effect for all companies regardless of their respective earnings situation, i.e., it is also paid in the event of a loss.

The research allowance has a correspondingly tax-neutral effect, i.e., it does not qualify as taxable income.

When is the research allowance excluded?

If the company is in financial difficulties within the meaning of Art. 2 (18) (a) and (b) of the GBER at the end of the financial year in which the eligible expenses are incurred, the granting of a research allowance is excluded.

Generally, the research allowance can be cumulated with other grants. Cumulation is excluded if and to the extent the eligible expenses are already part of the assessment basis for other subsidies, aids or grants from EU funds. However, if higher (as yet unsubsidized) personnel costs or fees for contract R&D are incurred in addition to other grants, such costs can be subsidized with the research allowance. Cumulation is not prohibited in relation to Covid-19 aid, e.g., in relation to the flat-rate approach to personnel costs in the case of interim aid, as this approach has a different funding objective than the research allowance.

The application for a research allowance can be filed within four years from the end of the year for which the entitlement to the research allowance arose. Therefore, **action is required for the research allowance relating to 2020**. For this financial year, an application for the research allowance must be filed with the tax office in 2024, otherwise the claim will lapse.

The expansion of tax incentives for research is intended to strengthen Germany as a business and research location. It is an attractive instrument for promoting research, particularly for innovative companies, with the following advantages:

No research allowance for companies that are in financial difficulties at the end of the financial year in which the eligible expenses are incurred



Advantages of the research allowance at a glance

25-35.0 %

(with SME factor)

of personnel costs for internal R&D employees and depreciation for necessary assets

17.5-24.5 %

(with SME factor)

of external R&D (contract research) costs

EUR 2.5-3.5 million

(with SME factor)

per fiscal year



Benefits

Projects

- Eligibility for funding for both individual companies' projects and collaborative projects
- Both external and intragroup contract R&D

Administration

- No application required before the start of the project, long (four-year) period for (subsequent) application
- Less administrative effort for application procedure and documentation

Tax benefits

- Attractive funding amount of EUR 3.5 million for SMEs and of EUR 2.5 million for large companies
- Subsidy amount not taxable (not subject to income or corporate income tax)
- Additional liquidity advantage by reduction of income or corporate income tax advance payments



Effect

- Broad impact, especially for SMEs, due to open-technology funding
- High probability of success and predictability due to existing legal claim

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At the interface of technology, tax and law, Baker Tilly works successfully with innoscripta GmbH, an international software company with a focus on cloud-based research and development software, which has many years of experience in the field of R&D.



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