

R&D relief

Small steps towards
innovation



ayming



2019 report

KANTAR



Ayning is an international consulting group operating in 15 countries in Europe, Asia and North America. Ayning Polska provides business optimization services, helping achieve better financial results by providing professional consulting in two areas:

- Taxes and Innovations (real estate tax, research and development relief, grants)
- Labor costs (accident insurance contribution, contributions to the State Fund for the Rehabilitation of Disabled Persons (PFRON))

Ayning heads the team in charge of Innovation Reliefs of the Lewiatan Confederation's Tax Council. In the first year since the R&D relief has been active, 80% of the individual legal interpretations of the relief were provided at the request of Ayning. In one year, the Group carries out over 15 000 projects globally regarding the acquisition of EU grants and the R&D relief. The quality of services provided by Ayning Polska is ISO 9001:2015 certified.

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Contents

Introduction	4
5 essential facts on the R&D relief in Poland	6
Benefits of the R&D relief	8
Biggest challenges	12
R&D relief step by step	13
○ Step 1. Identification and mapping of R&D activities	14
○ Step 2. Identification of eligible costs	18
○ Step 3. Eligible costs' accounting	28
○ Step 4. Preparation of the appropriate documentation	30
○ Step 5. Preparing for tax office verification proceedings and audit	32
Case studies	36
○ Settlement of the R&D relief in practice Savings in the 2019 fiscal year	36
○ Mutual complementation of grants and the R&D relief	39
On the study	41
Contact details	42

Introduction

"The research and development relief requires time and promotion, if it is to genuinely contribute to the growth of business innovation in Poland."

One of the objectives of the "Europa 2020" national strategy, which is to be fulfilled by 2020, is that Poland should increase its spending on research and development to a level of 1.7% of the GRP. In 2017, the figure was 1.03% of the GDP, which amounted to 20.06 billion PLN – a mere 0.06% more than in the previous year. Even though the business sector's share of investment into R&D is still growing, this is insufficient for reaching the assumed target. The tax relief on research and development that has been in life since 2016, was intended as a tool to help make this task easier. However, it appears that for the solution to indeed impact the growth of innovation in Poland, it requires time and more extensive promotion.

Starting with the fiscal year 2018, all businesses may for the first time deduct as much as 100% of their eligible costs, meaning that every 1 PLN spent on R&D provides a 2 PLN deduction. In the meantime, according to the Kantar study commissioned by Ayming Polska, only 12% businesses from innovative sectors have used the relief in 2018. This constitutes a mere 3 pp. increase compared to the study conducted in the previous year.

According to the data of the Ministry of Finance from July this year, the relief was used by 951 CIT payers, who deducted a total of 1.7 billion PLN costs incurred on research & development activity, generating 0.3 billion PLN in savings. This figure is nearly three times larger than in the last year, yet companies are still not fully tapping into the potential of the R&D relief. This is partly due to two factors. Firstly, businesses do not understand what constitutes R&D activity, believing that only country-wide innovation qualifies as an innovative activity. Whereas in fact, the relief rewards conducting activities that are innovative in the scale of a given company. The second factor is the lack of any promotion of this tool. The relief has been in place for a short time, thus many companies have not yet heard of it, others lack sufficient tax and technical insight to properly settle it.

To fill this promotional and technical gap, we are providing You with the report that we have developed based on interviews with businesses using the R&D relief and our own experience. The report outlines the benefits and challenges tied to settling the relief, we also share our practical recommendations on how to fully and correctly identify research-development activity within the company. We hope that our publication will help businesses safely benefit from the solution and grow their innovativeness.

Magdalena Burzyńska
Managing Director



"The more advanced the analysis of R&D activity within the organization, the higher the chance for safely claiming the tax benefit."

Businesses in Poland may benefit from the research and development relief since 2016. Now is a good time to examine the functioning of the solution and how businesses assess it.

We commissioned the Kantar research agency to carry out a study with businesses that have claimed the R&D relief at least once. According to this study, a vast majority of the respondents positively assess the relief and continue using this solution. One in two businesses declare that the savings generated thanks to the relief will be used for further investments, whereas nearly one in three declare that they used the savings to increase their research and development spending.

Despite this positive response, many businesses still come across difficulties in the process of settling the relief, especially when it comes to the proper documentation of the R&D process and record-keeping of the worktimes and costs. Interestingly, only a small share of respondents point to difficulties with identifying research & development activity.

Our experience shows that the identification of the R&D activity is the key stage that the sound settlement of the relief depends on. At the same time, we are seeing many businesses carry out that identification exclusively based on financial records, limiting the relief-claiming to only very innovative activities.

In the meantime, using the R&D relief also requires technical analyses. The more advanced the analysis of R&D activity within the organization, the higher the chance for safely claiming the tax benefit. To this end, cooperation is necessary between R&D departments, engineers and production staff. The lack of such cooperation may result in an incomplete or incorrect identification of R&D activity, which in turn translates into incomplete or unjustified deductions.

What else needs to be kept in mind when settling the R&D relief? What are the most frequent errors at each stage of settling the relief and how to avoid them? How to prepare for a verification process done by the revenue office? These and other questions are answered in this publication and have been developed based on the feedback from the businesses and our own experience. With this report, any business intending to claim the R&D relief receives practical tips on how to settle it step by step.

We hope that the guide prepared by our experts will help companies use the research and development relief and will encourage the ones that had not used the tool yet, to consider it. At the same time, we would like to thank all of the businesses that shared their experiences with us.

Agnieszka Hrynkiewicz-Sudnik

Director of the Taxes and Innovations Area





5 essential facts on the R&D relief in Poland



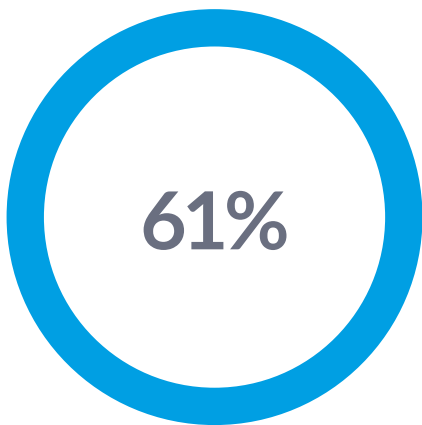
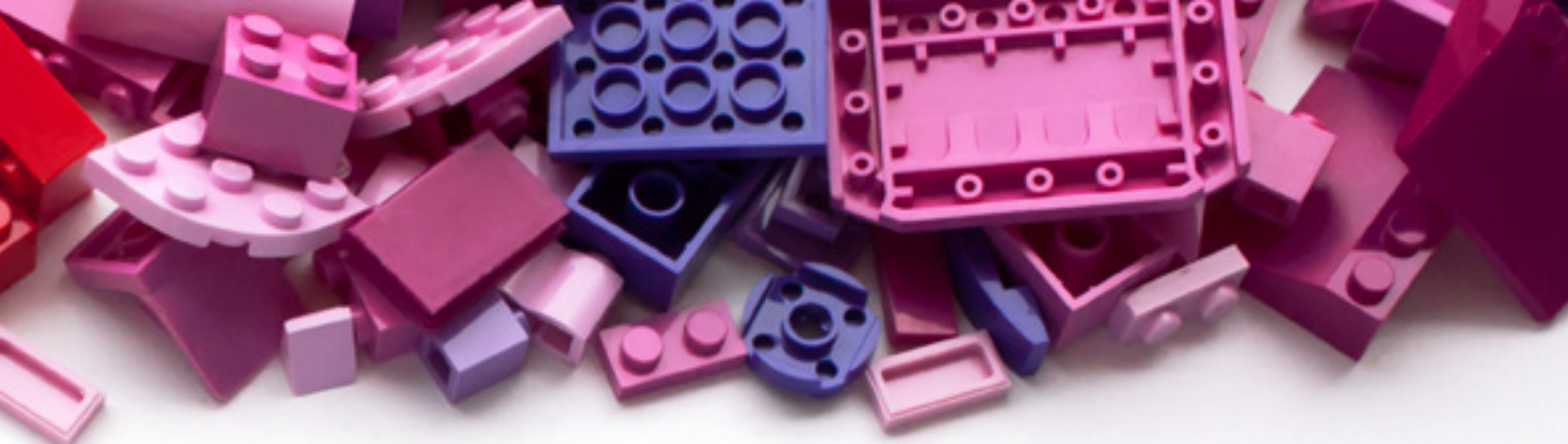
97%

businesses that settle the R&D relief assess its mechanism positively

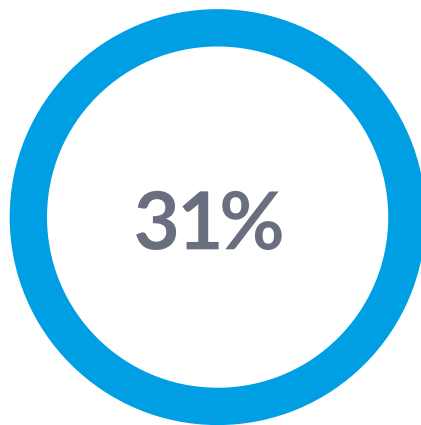


84%

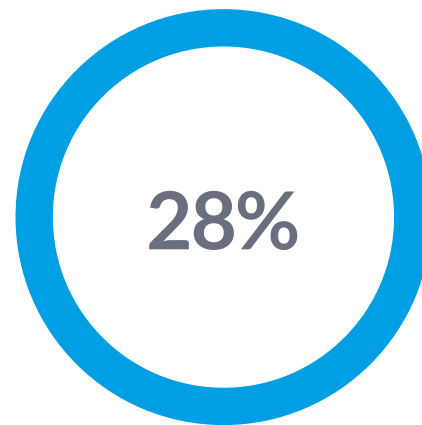
taxpayers continue using the R&D relief



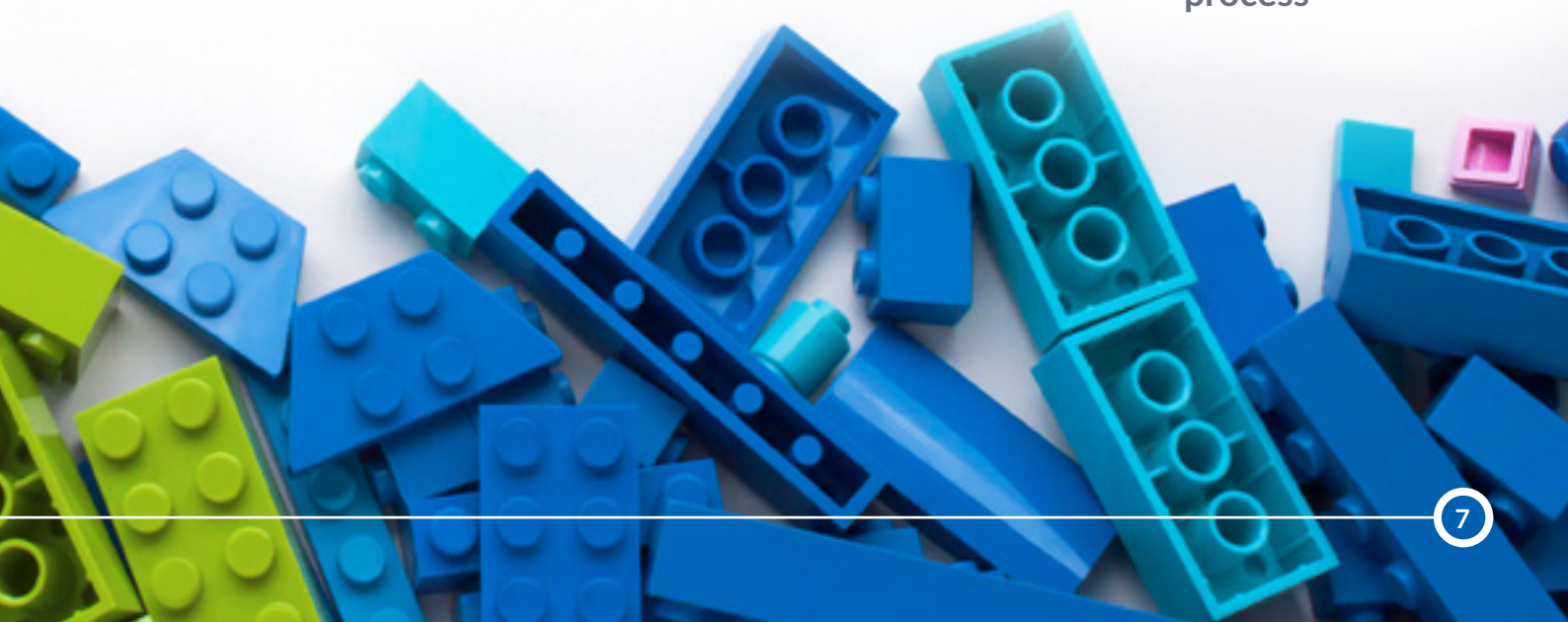
entrepreneurs say that the biggest benefit of the R&D relief are the financial benefits



companies invest the savings generated by the R&D relief into research and development



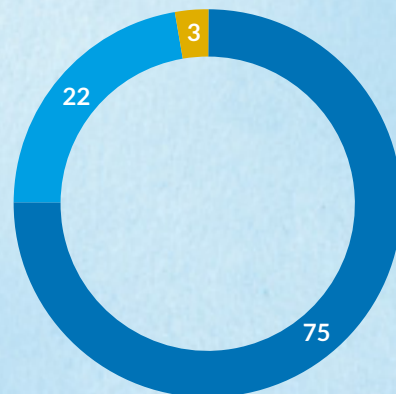
respondents believe that documenting the R&D process is the most difficult aspect of the relief-claiming process



Benefits of the R&D relief

The research and development relief allows CIT and PIT payers to deduct 100% of the eligible costs – twice. Firstly by labelling them as deductibles (100%), then by deducting 100% of the same expense from the tax base. Thanks to this, the company can claim 200% tax benefits from the investments into R&D. In 2019, payers were able to use this tax incentive for the third time. As many as 97% of the companies that used this tool assess it positively.

Assessment of how the R&D relief functions



- 75% very positive
 - 22% rather positive
 - 3% hard to say
- N=30

#1

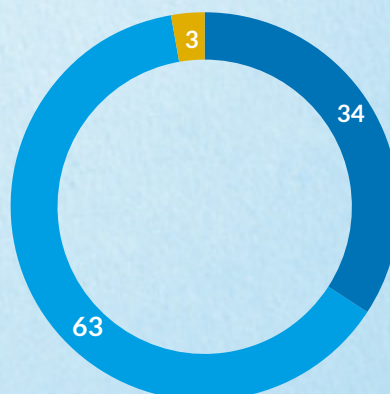
Helps the company build its competitive advantage

97% respondents that use the R&D relief consider innovation important for the competitiveness of their business. The legal landscape is an important factor that stimulates innovation, including the presence of tax incentives, such as the R&D relief or the IP Box.

Under the R&D relief mechanism, the payer may pay less in income tax and can invest the savings generated into i.e. financing more research and development activities. It is worth noting, that the legislator rewards not just advanced innovations, but also innovations on a company-level.

The R&D relief allows the payer to deduct costs of studies and consulting services from academic institutions, which enables the companies to receive support of professional entities with academic backgrounds. This in turn translates into the high quality of the projects carried out, which may contribute to a significant growth of a given company's innovativeness – adds Marek Dalka, Manager of the Innovations, Reliefs and Grants Departments at Ayming Polska.

How important is innovation for the company's competitiveness?



34% key

3% hard to say

63% important, but not key

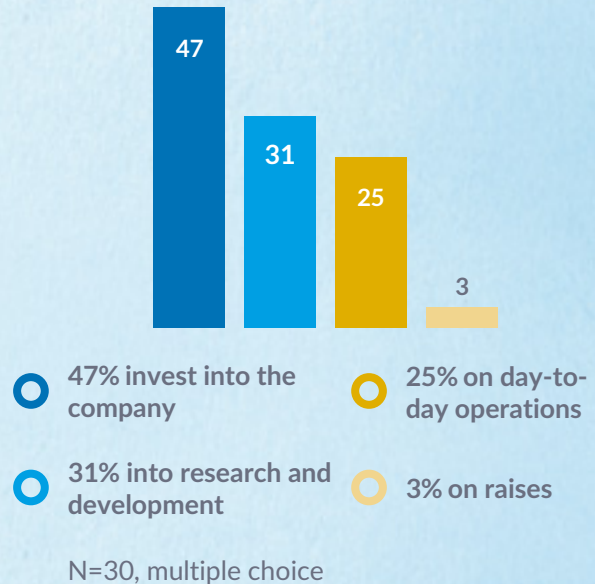
N=30

#2

Acquiring additional resources

Since 2018, all the taxpayers may deduct 100% of the eligible costs of their research and development activities and R&D Centers may deduct as much as 150%. For example, a large company with annual personnel costs of conducting R&D at a level of 1 M PLN and with other eligible costs at 500 K PLN, with a CIT rate of 19% may save 285 K PLN in 2018. The reclaimed funds may be used however the taxpayer chooses. According to the results of the study, nearly half of the businesses spend these savings by investing in the company, whereas one in three companies invests in more R&D.

Purpose of the resources acquired through the R&D relief



#3

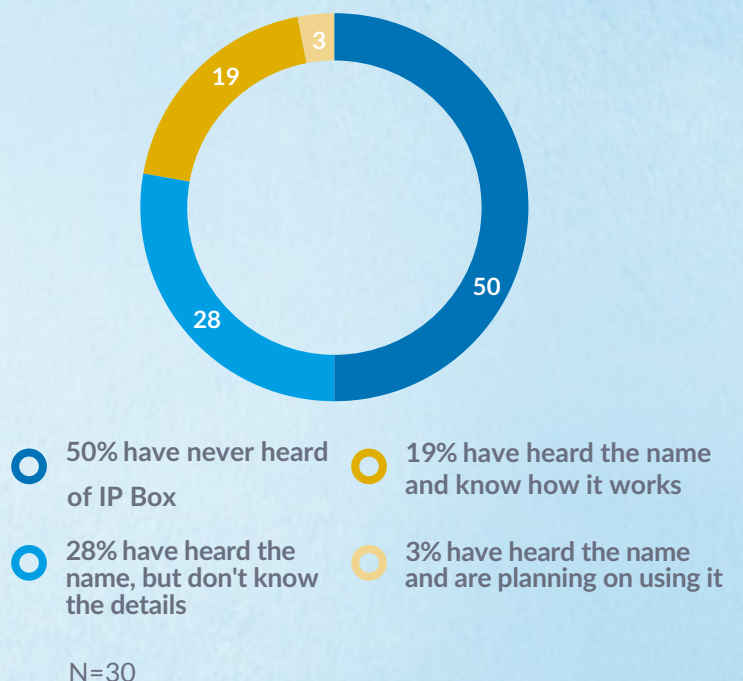
Starting point for using IP Box

Settling the R&D relief may be the starting point for benefiting from the IP Box tax relief that came into life on January 1st, 2019. In the meantime, half of the businesses participating in the study have never heard of IP Box and only 3% are planning to use this new tax incentive in the next year.

IP Box enables using a preferential, 5% CIT/ PIT tax rate on revenue acquired by the payer from commercializing eligible intellectual property rights (i.e. patents, utility models, software copyrights) which need to be created, expanded on or improved through the company's R&D activity.

The R&D relief, as well as the IP Box require conducting analyses of the costs of R&D activity. Therefore, identifying R&D costs of either of these two tax incentives may be a starting point for the business to eventually claim both of them.

Awareness of Innovation Box (IP Box)



#4 Complementary to grants

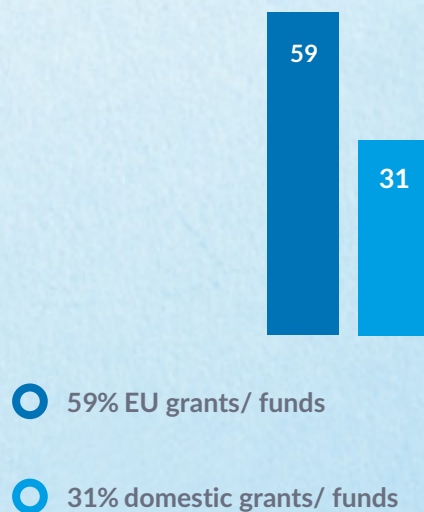
More than half of the businesses that use the research and development relief also benefit from EU funds, whereas nearly one in three companies benefits from domestic funds. Businesses may not deduct R&D activity costs that they had been refunded in the form of grants. However, one has to keep in mind that the so-called own contribution (the portion of the expenses covered by the business) may be deducted as part of the R&D relief.

*An entrepreneur who receives funding for R&D activity from, i.e., the POIR program (Operational Program Smart Growth), may receive funding ranging from 50% to 90% (depending on the company's size and the type of works that the project assumes) and may write off the company's own contribution. As the catalogues of relief-eligible R&D costs and grant-eligible costs don't always overlap, one has to identify the right expenses and the level to which they may be deducted **under** the R&D relief*

– explains Przemysław

Gabrysiak, Project Manager at the Innovations, Reliefs and Grants Departments at Ayming Polska

Other funding sources of innovation in companies using the R&D relief



N=30, multiple choice

#5 Possibility to reclaim amounts going back 5 years

Based on our experience, not all the taxpayers are aware that they may submit an amended tax declaration to deduct the R&D relief for the past years. The relief is claimed for the year in which the eligible costs were incurred, meaning that the time when the R&D project took place is irrelevant. One has to keep in mind that the taxpayer may correct their tax declarations going back five years. If an amended tax declaration is submitted, the entrepreneur receives the amount of tax overpaid within several months. These reclaimed funds may be invested into developing the organization further.

Biggest challenges

According to the study, companies consider the individual stages of settling the R&D relief to be rather easy. 41% studied companies see no difficulties in identifying R&D activity, nearly one in three businesses say that recording-keeping of the costs is easy. **Whereas our experience shows that most of the errors are made on these two stages.**

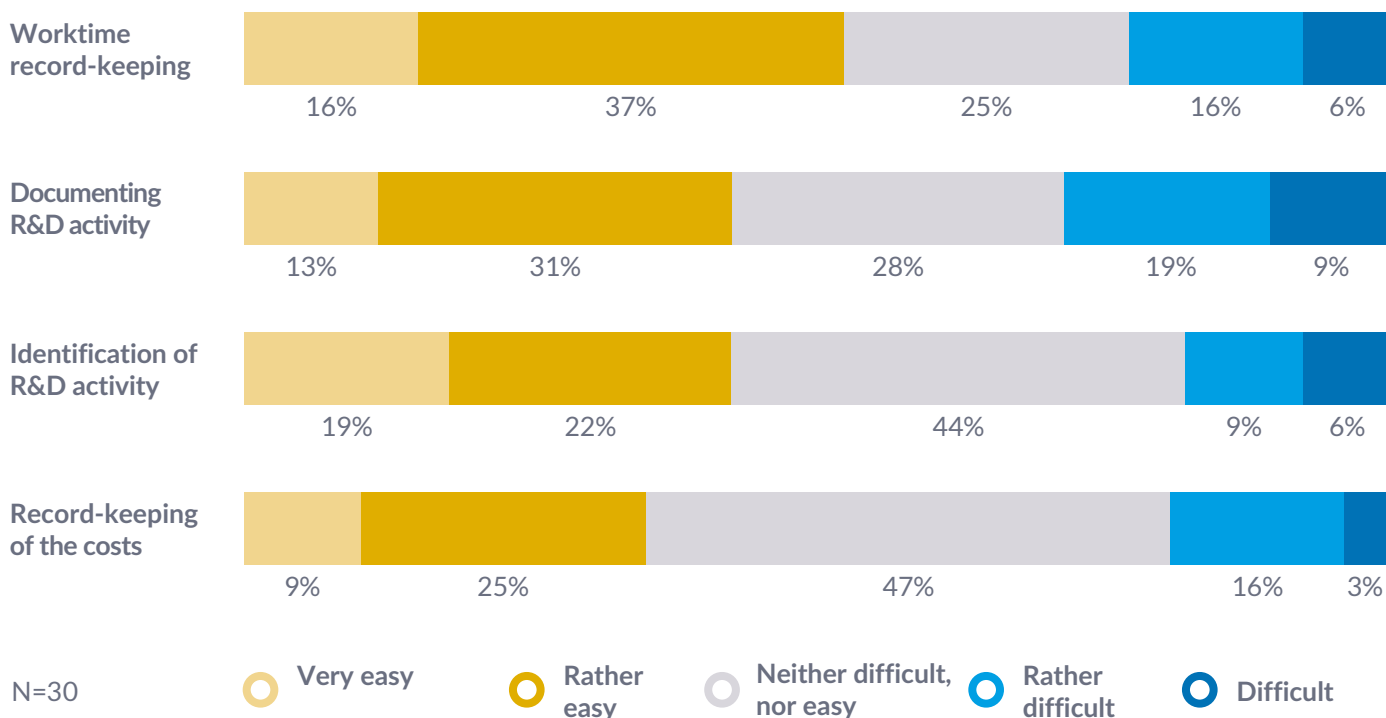
To identify research and development activity, companies most often rely on financial records, completely overlooking the technical analysis. Doing so carries a significant risk

of unjustified tax deductions or writing off only a part of the costs incurred.

On the other hand, when looking at accounting, the challenge for businesses is the lack of detailed guidelines on how to keep the accounting records and the necessity to fulfill the requirements found in the definition of research and development activity.

Once the company receives the deduction, the next challenge lies in verification proceedings or tax audits. The following pages offer a step-by-step guide on how to correctly navigate the whole process of settling the R&D relief.

Difficulty of individual stages of settling the R&D relief



R&D relief step by step

The R&D is presently the most accessible form of support for companies conducting R&D activity and looking for financial resources for new investments.

The relief may be claimed by any company (regardless of the size and profile) that undertakes R&D activities in their daily operations.

This section of the report shows how to go through the whole R&D relief settling process – starting with the identification of R&D activities and ending with the preparation for tax verification proceedings or audits. We share practical examples and case studies, so that companies interested in claiming the R&D relief may learn about its mechanism in an in-depth, yet approachable manner.

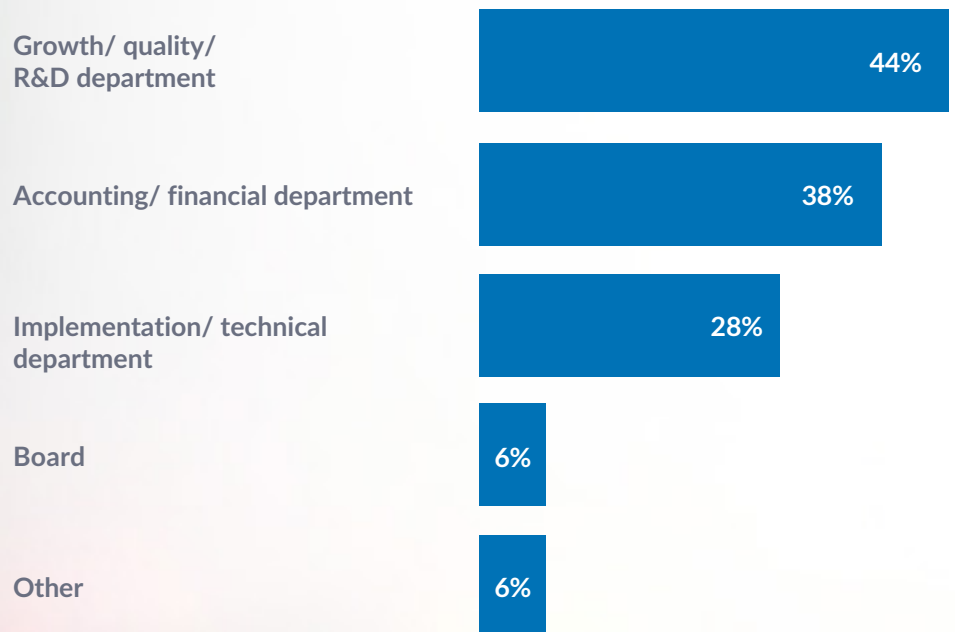


Step 1.

Identifying and mapping R&D activity

In nearly half of the businesses participating in the study, the development department or the R&D department is responsible for identifying R&D activity. For 38% respondents, this task is carried out by the accounting or financial departments, which lack the proper technical insight.

Units that identify the R&D activity in companies in Poland



N=30, multiple choice

A complete and correct settlement of the R&D relief requires not only legal and tax knowledge, but also technical competences. Based on our experience, identifying the areas of R&D activity is the largest challenge for the businesses.

To correctly isolate R&D activity, one needs to first analyze the definitions found in specific laws, among others the Act on the CIT and PIT taxes. Familiarizing oneself with the information provided by the Ministry of Finance, the interpretations issued by the National Treasury Information and court rulings on the matter is recommended.

Following that, it is advisable to analyze the hitherto accumulated documentation on R&D activities. The information included in this documentation should indicate that the works carried out by the companies are in compliance with the statutory definition. According to said statutory definition, R&D activity is creative activity, encompassing scientific studies or development works undertaken systematically to increase the knowledge reserves and using them to create new applications.

At this point of the analysis, it is essential to bring together legal knowledge (awareness of and correct understanding of legal acts) with specialized knowledge (of engineers, IT experts and other persons with technical education) to prepare complete documentation..

According to the experiences of Ayming, most of the irregularities and omissions occur at this stage.





Analyses conducted exclusively by the development department usually completely omit R&D activity conducted within standard projects, i.e. modifying the formulation of the products or introducing enhancements to already existing services or processes. This results in the omission of a large portion of the costs.

On the other hand, accounting and finance departments very frequently identify and qualify under the relief all the R&D activities that are recorded in accounting.

Whereas in fact, the activities that are indeed carried out by the R&D departments do not always meet the criteria of the statutory definition of R&D activity. This may result in settling the wrong costs. In consequence, the business may make unjustified deductions, leading to many issues if the tax authorities choose to verify the soundness of the relief's settlement.

To use an example; one of the entrepreneurs declared that their department conducts exclusively R&D works. A more detailed analysis revealed that only 20% of the employees' worktime is dedicated to R&D activity – comment by engineer Pawel Perzynski, Expert on the R&D Relief in the Innovations, Reliefs and Grants Department at Ayming Polska.

Identifying R&D activity based exclusively on financial documentaiton, without a prior technical analysis, carries a high risk of error.

Most frequent irregularities:

- identification of R&D activity based only on financial documentation, with no prior technical analysis
- no cooperation between R&D departments and accounting when identifying R&D activity
- lack of cooperation between the legal departments and the technical departments when preparing the documentation
- not knowing the statutory definitions or the appropriate laws
- keeping too expansive and complicated records of R&D activity
- qualifying routine and periodical activities under the R&D relief
- incorrect understanding of the innovativeness level of actions eligible for the R&D relief



CASE STUDY

EXAMPLES OF PROJECTS QUALIFIED AS R&D ACTIVITY

CHEMICAL SECTOR COMPANY

- designing and testing a new wallpaper adhesive formulation
- modifying the product formulations to improve durability
- conducting studies on improving the product by extending its applications into such that the company had never offered
- trials of new materials or consumables that would be used for production

INDUSTRIAL PROCESSING SECTOR COMPANY

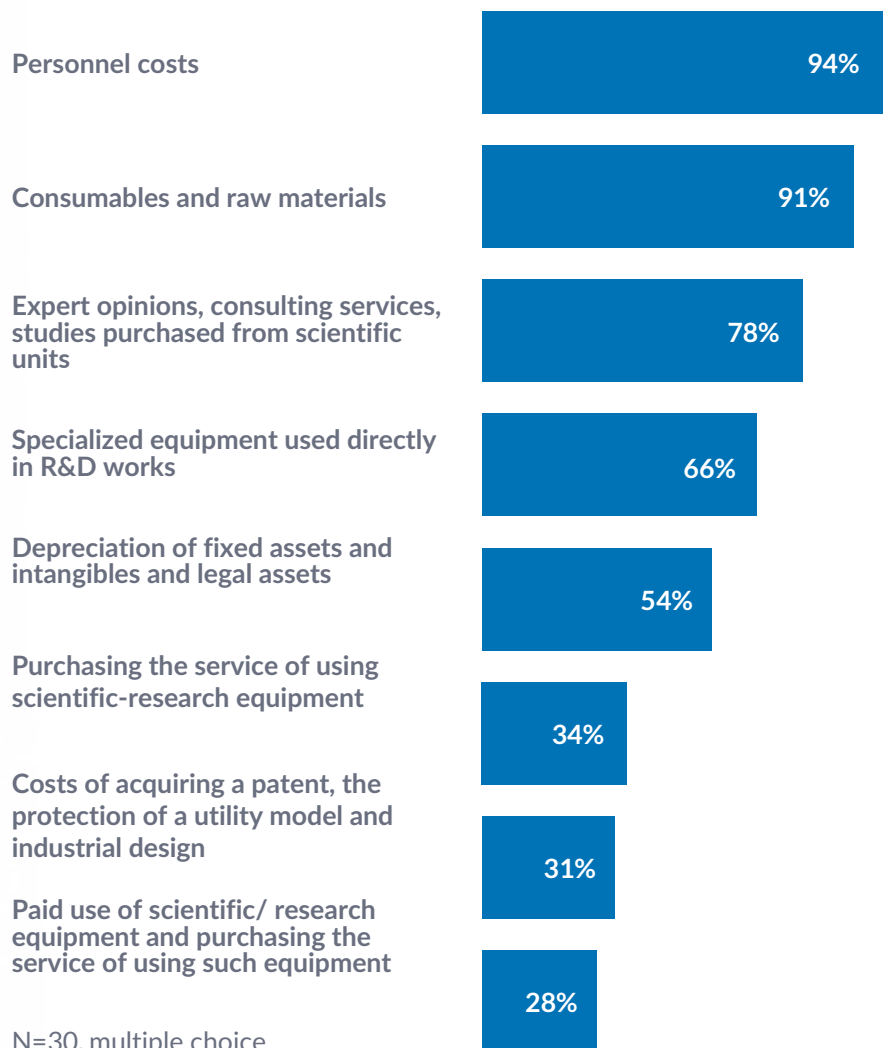
- developing a new product manufacturing technology that lowers water consumption
- developing new quality control techniques resulting in a higher rate of faulty product identifications during the production process
- integrating several production processes into a single, automated one, which, among other things, increase efficiency
- a study on the effects of changing the production process parameters on improving the usability of the products



Step 2. Identification of eligible costs

As many as 94% of the studied businesses submit personnel costs as eligible to the R&D relief. Consumables and raw materials are in second place (91%). Companies least often qualify paid use of scientific and research equipment as eligible under the R&D relief..

Categories of costs of conducting R&D activity



Another important step in the settlement of the R&D relief is matching the identified R&D activity with the costs incurred for its completion. Mapping enables finding all the places where costs are generated, thus making it possible to analyze them on the basis of their eligibility for the R&D relief.

One has to keep in mind that the costs settled under the relief need to comply with the types of eligible costs indicated in the CIT/ PIT law. A thorough analysis enables rejecting the costs that the tax benefit does not apply to.

Types of costs that may be deducted under the R&D relief in 2016-2019

ELIGIBLE COSTS	% VALUE OF ADDITIONAL DEDUCTION IN 2016		% VALUE OF ADDITIONAL DEDUCTION IN 2017		% VALUE OF ADDITIONAL DEDUCTION IN 2018 AND 2019	
	SME	Large businesses	SME	Large businesses	All companies	R&D centers
Personnel costs	30%	30%	50%	50%	100%	150%
Consumables and materials	20%	10%	50%	30%	100%	150%
Expert opinions, consulting services, studies purchased from scientific unit	20%	10%	50%	30%	100%	150%
Paid use of scientific/ research equipment and purchasing the service of using such equipment	20%	10%	50%	30%	100%	150%
Depreciation of fixed assets and intangibles and legal assets	20%	10%	50%	30%	100%	150%
Costs of acquiring a patent, the protection of a utility model and industrial design	-	-	50%	-	100%	100%
Amortization of the results of the company's own development works	-	-	-	-	100%	150%
Specialized equipment used directly in R&D works	-	-	-	-	100%	150%

*Purchasing the service of using science-research equipment was made possible in 2018

Personnel costs

Personnel costs are the amounts paid by the employer in connection with hiring employees based on an employment contract or a civil code collaboration contract and the social insurance contributions paid by the employer. The eligible elements of these costs are the principal remuneration, the remuneration for overtime, bonuses and other costs of employment.

What serves as the basis for calculating personnel costs is the month-to-month record of the worktime spent on R&D activity. The entrepreneur needs to determine the proportion of worktime

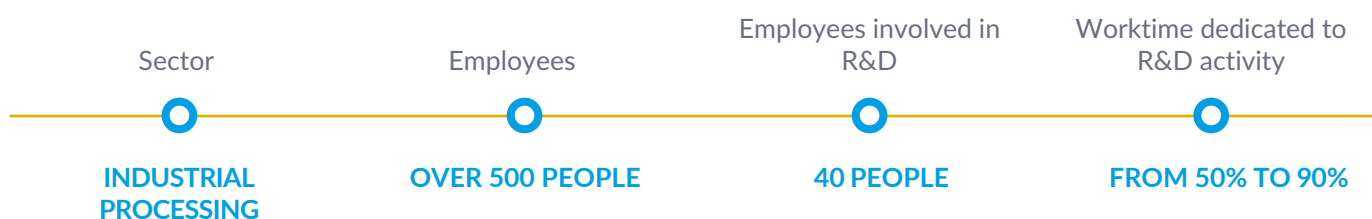
(a numerical or percentage value) spent on actual R&D activity to the total worktime.

A frequently seen error made by companies, particularly the ones with individual R&D units, is the automatic qualification of whole Cost Centers where personnel costs have been accounted as eligible for the relief. Whereas in fact, one has to examine each time, what elements of the remuneration in a given Cost Center are compliant with the CIT/ PIT law provisions – explanation by engineer Karolina Łukasik, Senior Consultant in the Innovations, Reliefs and Grants Department at Ayming Polska

Most frequent irregularities:

- not specifying the proportions between the time spent on actual R&D activity and the total worktime in a given month
- settling the remuneration of persons hired based on B2B contracts
- automatic qualification of whole Cost Centers that had personnel costs as eligible for the relief
- qualifying the contributions to the Labor Fund and the Fund of Guaranteed Employee Benefits for the relief

CASE STUDY



The total annual personnel costs tied to R&D activity in the company was 7 M PLN. After analyzing the specific elements of the costs and calculating the costs based on the records of worktime dedicated to R&D projects, the R&D relief-eligible costs were 3.5 M PLN. After settling the R&D relief, the taxpayer reclaimed 665 K PLN.

665
K PLN

Consumables and raw materials

The legislator included the costs of purchasing consumables and raw materials used directly for R&D activity into this category of costs. In the case of consumables or materials that are not used exclusively for R&D activity, the taxpayer can settle only the part of the costs that are tied to R&D activity. This requires keeping the proper settlement records.

Legal interpretations issued thus far allow for the following:

- using specific consumables or materials taken from the warehouse or as a result of the breakdown of finished ready products used in research and trials,

- qualifying as eligible costs all the consumables and materials, including electrical energy, water, gas, essential for developing a prototype or a pilot batch,
- the purchase of materials and consumables used for creating the prototypes, which are then sold to external clients, qualifying as eligible costs the purchase of
- professional press or literature, when they are directly tied to the R&D activity conducted.

Most frequent irregularities:

- qualifying materials, consumables and costs as eligible, when they were not used directly for R&D activity
- incomplete relief settlement records, which do not show to what level the consumables and materials were used for R&D activity
- identifying costs of semi-finished goods created within the company as consumables and raw materials

CASE STUDY



In 2018, the taxpayer conducted a dozen R&D projects that resulted in the development of prototypes for trials. Throughout this period, the payer incurred expenses such as the purchase of materials essential for developing the prototypes, these being metal and chemical goods. According to the proofs of purchase, the payer spent a total of 400 K PLN for this purpose. Because all of these materials were used exclusively for R&D activity, the payer was able to deduct the total cost within the R&D relief. The taxpayer saved 76 K PLN.



Expert opinions, research services, studies purchased from scientific units

These are the costs of any collaboration conducted during the execution of R&D activities, which need to be incurred as a result of a collaboration agreement with an academic or higher learning institution.

According to the Law on Higher Education and Academics from July 20th, 2018, these institutions include: universities, federations of higher education and learning entities, scientific institutes of the Polish Academy of Sciences, research institutes, operating in compliance with the law from April 30th, 2010 on research institutes, international science institutes created based on separate laws and operating in Poland, the Lukasiewicz Center and institutes operating as part of the Lukasiewicz Research Center, the Polish Academy of Learning, other entities that chiefly conduct scientific activity in an independent and continuous manner.

Based on our experience, taxpayers have many difficulties with the identification of the entity providing the consultation or research services. One has to keep in mind that there is a limited catalogue of institutions, the cooperation with which may be deducted as part of the R&D relief. Therefore, the company should analyze the eligibility of every entity that they cooperate with.

In the case of companies that hold the status of R&D Centers, as described in art. 17 of the law from May 30th, 2008 on some forms of supporting innovative activity, it is possible to settle the costs of cooperation with any external entity for the needs of research and development activity. The interpretations provided thus far allow the purchase of such services provided by R&D centers.

Most frequent irregularities:

- qualifying as eligible the cost of cooperation with entities that are not regarded as a university nor academic center
- purchasing the above-mentioned services based on civil code contracts entered into with university academics

CASE STUDY



As part of the R&D activity in 2018, the taxpayer cooperated with several external entities, among others by ordering laboratory testing of their new products. These entities included a university, a research institute compliant with the provisions of the research institute law and private, certified laboratories. The cost of purchasing the studies was 45 K PLN for studies purchased from the university, 50 K PLN for studies from the research institute and 55 K PLN for studies from the private laboratory. The taxpayer was able to deduct 95 K PLN under the R&D relief for studies purchased from academic units. The savings generated this way amounted to 18 thousand PLN.



Paid use of science-research equipment and purchasing the service of using such equipment

If the taxpayer intends to deduct the cost of renting scientific-research equipment, they need to have qualified staff that is able to use it. The business may use one of two options: either training their employees, or hiring a person with the proper qualifications. Based on our experience, this category of costs is rarely used by companies claiming the R&D relief due to the above mentioned limitations.

Since 2018 it is possible to purchase the service of using scientific-research equipment from a specialized, external entity. The CIT/ PIT law does not limit the purchase of such a service only to academic / science units. The legal interpretations issued thus far allow deducting the cost of contracting an external company with creating 3D print-outs as a paid use of scientific-research equipment.

Most frequent irregularities:

- qualifying a personal computer as science-research equipment
- deducting costs as a result of subcontracting as the purchase of the service of using science-research equipment
- qualifying financial leasing payments as an eligible cost under the R&D relief
- deducting the cost of a contracted study, which does not specify the use of science-research equipment

CASE STUDY



As part of their R&D projects, the entrepreneur contracted a series of analyses and studies to external entities with the proper scientific-research equipment. One of the services was carrying out a computer analysis based on a specialized simulation program with the Finished Elements' Method. As a result, the taxpayer incurred a cost of 200 K PLN. The cost of performing this analysis was not deducted under the R&D relief and therefore there were 150 K eligible costs remaining to be settled. The final amount saved was 28 K PLN.

28.5
K PLN

Depreciation of fixed assets and intangible and legal assets

The taxpayer may also settle as part of the R&D relief the depreciation deductions on fixed assets or intangibles and legal assets. What is important for the qualification of the cost, is assessing the extent to which the fixed assets are indeed used for R&D projects. In the case of equipment dedicated to R&D activity, the depreciation costs may be deducted completely. But when the equipment is also used for other purposes, the depreciation costs should be deducted only to the extent that the equipment was used for R&D activity.

The costs excluded from the R&D relief are those connected to personnel vehicles as well as structures, buildings and premises that constitute a separate property. One exception to this rule are companies that hold the R&D Center status, as they may deduct the above-mentioned costs as part of their research and development activity.

Most frequent irregularities:

- deducting under the R&D relief the costs of personnel vehicles and structures, buildings and premises that constitute separate properties if the taxpayer is not an R&D Center
- deducting the cost of balance-sheet-based depreciation of fixed assets without keeping records of their use for R&D
- deducting the fixed asset depreciation write-offs without holding records that would specify how they are used in R&D activity

CASE STUDY



In 2018, the taxpayer conducted projects eligible for the R&D relief as part of their business activity, specifically the development of new and enhancement of existing specialized software. They were using computer equipment for the R&D activity in question and they were deducting the amortization costs in a given tax year. The records kept by the business made it possible to assess the percentage to which the equipment in question was used for R&D activity. This made it possible to calculate the costs eligible for the R&D relief, which in total amounted to 90 K PLN. The taxpayer saved over 17 thousand PLN.



Cost of acquiring patent, protection of usable model and industrial design

In this category, the following elements are eligible for the R&D relief:

- preparation of application documents and submitting the application, including the costs of translations,
- costs of proceedings of the Patent Office of the Republic of Poland or the appropriate foreign authority, particularly the official fees and the costs of legal and process representation,
- periodical fees, fees for renewals, translations and other activities necessary for issuance or preservation of the protection,
- defeating the charge of not meeting the conditions necessary for receiving patent protection.

It should be stressed that the law lists only three rights of industrial property, that is the patent, the utility model and the industrial design. Therefore, only these three categories may be deducted under the R&D relief. The other rights are not eligible, these being the trademark or the integrated circuit layout. This may sometimes be confusing to businesses.

Most frequent irregularities:

- deducting under the R&D relief a trademark or an integrated circuit layout, as they are excluded from the industrial property law
- large companies deducting the costs of receiving patent protection in the 2017 tax year (at that time, only SMEs had such a possibility)

CASE STUDY



In 2018, the company carried out projects for implementing new products and developed new solutions that had not been previously seen in the sector. Following that, the company chose to apply for a patent protection of the inventions. The costs of acquiring the patent included the fee of the Patent Liaison for preparing application documentation and official fees. In total, the cost was 150 K PLN. In the CIT-BR appendix, the entrepreneur was able to deduct all of these costs, which generated 28.5 K PLN in savings.



Amortization of the outcomes of own development-oriented works

Starting 2018, companies may deduct the cost of development of intangible and legal assets under the R&D relief, provided that the development works comply with art. 16b, paragraph 2, point 3 of the CIT law or art. 22b par. 2, point 2 of the PIT law.

Amortization write-offs on intangible and legal assets developed by the business may be considered eligible costs equal to the proportions of the following costs in the initial value: personnel costs, costs of materials and consumables, costs of purchasing specialized equipment, cooperation with scientific institutions, renting scientific-research equipment, purchasing the service of using such equipment.

The addition of development works to the list of eligible costs, encourages one to consider many past investments, which became deductible in 2018 and constitute amortization write-offs. However, one has to examine the costs that are part of intangible and legal assets. If there are non-eligible elements among these, they need to be excluded from the R&D relief settlement – comment by Karolina Łukasik, Senior Consultant in the Innovations, Reliefs and Grants Department at Ayming Polska.

Most frequent irregularities:

- not excluding the non-eligible elements from amortization write-offs on intangibles and legal assets developed by the company
- deducting amortization write-offs on intangibles and legal assets without having documentation attesting the development of these assets

CASE STUDY



As part of an R&D project, the taxpayer developed intangible and legal assets in 2018. The initial value of said assets was 150 K PLN, including personnel costs, consumables and materials. Starting 2018, the company began the amortization of the intangibles and legal assets by making a monthly write-off of 12.5 K PLN. The tax amortization for 2018 amounted to 75 thousand PLN. Because the value of the intangible and legal assets included only eligible costs, the taxpayer was able to deduct the amortization write-offs in full. Therefore, the savings generated by this group of costs was over 14 K PLN.

14
K PLN

Specialized equipment used directly for R&D activity

In 2018, a new category of eligible costs appeared – the purchase of specialized equipment used for R&D activity which is not a fixed asset. The legislator specified the essential lab equipment elements, such as laboratory vessels and utensils and measurement devices.

Legal interpretations issued thus far allow the possibility to qualify as an eligible cost the purchase of equipment that would be used for other purposes tied to the company's operation after the completion of a given R&D project.

Most frequent irregularities:

- deducting under the R&D relief the cost of purchasing equipment that does not comply with the definition of specialized equipment
- deducting under the R&D relief the cost of purchasing specialized equipment which is not used for R&D activity

CASE STUDY



In 2018, the taxpayer carried out several activities that were qualified as R&D, there were laboratory workers involved in them. Laboratory glass and minor measurement devices needed to be purchased to carry out the projects, items such as templates and lab scales, which were not fixed assets for the entrepreneur, The total cost of purchasing the lab equipment amounted to 50 K PLN. The indicated cost was qualified under the R&D relief in total, which produced savings of 9.5 K PLN.





Step 3.

Accounting of the eligible costs

Taxpayers conducting R&D activity that intend to claim the R&D relief are required to distinguish the eligible costs in their accounting records.

According to the Kantar study, 19% companies using the relief consider this stage problematic.

The income tax and accounting tax laws do not contain detailed guidelines on how to keep these accounting records. It is assumed that it is sufficient to show these costs in a separate, auxiliary record kept for accounting purposes, i.e. on the accounts not included in balance sheets for auxiliary books. It is important for the cost-distinguishing method used to enable identification of the eligible costs in connection with the conducted R&D activity

The accounting records of eligible costs include:

- records of using the eligible costs for the purpose on R&D

The records need to show that the costs were attributed exclusively to R&D activity. One of the most frequently deducted eligible costs are personnel costs, which need to be labelled with particular precision. Worktime records should be declared to the superior by the employee, who indicates how much time they spent on R&D activity. In the case of usage of materials and consumables for R&D projects, their usage records should be tied to the costs of purchase (invoices), whereas if a company uses the average cost method, a verification of algorithms used for this purpose is required.

- records essential for showing that the costs were indeed incurred and are compliant with the legal definitions valid in a given fiscal year.

Such records need to show that the costs have been incurred in a specific settlement period. In the case of services provided by other entities, there needs to be documentation proving the collaboration and the costs incurred. This may apply to expert opinions purchased from academic entities or study or trial services tied to specific equipment

All the costs need to be distinguished in accordance with accounting standards – best in the ledgers or dedicated accounts – explains engineer Paweł Perzyński, R&D relief expert at the Department of Innovations, Reliefs and Grants at Ayming Polska.

Businesses on the relief



We believe that the R&D relief is a simple mechanism. One has to make sure that the isolated eligible costs that meet the statutory criteria are documented and calculated properly and then deducted from the income. This stage is the least laborious and technically easily done. The regulations concerning this stage are clear and spark no doubts.

However, meeting the requirement of isolating the eligible costs in the ledgers was challenging for three reasons. Firstly, there are no regulations that would specify the form of such record-keeping. Provisions that leave the taxpayer with the freedom to choose documentation methods create the risk that the tax authorities would question the soundness of the eligible costs highlighted. Secondly, we needed to train the staff to properly document the events. This applies not just to finance and accounting employees, but also the operations' departments.

Thirdly, we needed to introduce new procedures that enable the identification and evaluation of research and development projects. It becomes necessary to formalize a new type of information circulation, to assess the undertaken actions based on whether they qualify as R&D. We also needed to implement new regulations that would relegate the responsibilities to specific areas of the company.

Another challenge we faced was also developing a system for accounting data records, which would not clash with the system providing financial information for management and statutory reporting.

Emil Orłowski
Head of the Department of Economy,
BOSMALA Institute of Automotive Industry Research
and Development

Most frequent irregularities:

- placing costs that are not deductibles in the auxiliary cost records
- documenting personnel costs in 2018 in annual instead of monthly cycles
- using division methods that do not reflect the actual costs incurred in connection with R&D activity



Step 4. Preparing the proper documentation

Documenting research and development activity is one of the fundamental obligations of the taxpayer intending to use the R&D relief. In the meantime, according to the study, 28% companies using the relief describe the development of this documentation as a difficult stage in the relief settlement process. This could be due to the fact that the legislator does not specify how R&D projects are to be documented, neither do the individual tax interpretations explain how it should be done. It is up for the company to choose how they document their research-development activities. The documentation method depends above all on the internal decisions of the company and the standards the company adheres to with regards to project management, not only with respect to research and development projects.

It is advisable for R&D works to be documented continuously and for them to constitute a professional description of the taxpayer's R&D projects.

If the taxpayer is already keeping records of the projects, these records should be analyzed to verify if they correctly document R&D activity. It happens often that the purpose and scope of the documentation cannot constitute direct proof that the project fulfills the definition of research-development activity. Project documentation is usually kept to study the financial viability of the project or to display the costs incurred for management reasons.

The best method for proper documentation of research-development works is to use the project chart. The chart should describe all of the actions conducted in sufficient detail to assure that there are no doubts during an audit that a given task was essential in the whole research-development process. Before developing such a project chart, it is advisable to analyze the definition of research-development activity.

The most frequently occurring error when filling out the project chart is incorrectly defining the goal – making it very general and without any technical parameters. The level of detail of the descriptions in the project chart depends on the character of the works carried out. The description of the final outcome should correspond with the goal of the project, the research challenges and risks and cannot be detached from previous descriptions in the project chart – **observes Wojciech Popardowski, Project Manager in the Innovations, Reliefs and Grants Department at Ayming Polska.**

It happens during the execution of a research-development project that the results acquired force a change of the initial, technical assumptions. Such changes should also be described in the project chart, together with the indication of how they would translate into continued project fulfillment and achievement of the intended objective.

The project summary needs to estimate the achieved technical parameters, qualitative or functional parameters. To prove the results obtained, the project chart should also contain results of studies and analyses, the research reports developed, prepared assessments or it should at least list their names with an indication of where they are kept.

The final stage of the relief's settlement is the submission of the CIT-BR or PIT-BR declaration. The taxpayer fills out the declaration that is provided on the state administration's platform. The acquired project documentation and accounting records enable a full and correct deduction of all the eligible costs incurred.

Most frequent irregularities

- incorrect definition of the project's goal, which is very general and without technical parameters
- lack of systematic approach in keeping documentation, which results in omissions or an incomplete description of the projects
- not adapting the scope of the documentation to the goals of the project (too detailed or too general)
- not considering changes into the project, which results in its goal and assumed parameters not aligning with the achieved results

CASE STUDY



A MODEL PROJECT CHART SHOULD INCLUDE

- project title
- project duration
- general project description
- description of the goals
- risks of the project
- research challenges
- research stages
- modifications implemented
- description of outcome (positive or negative)
- project summary

Step 5.

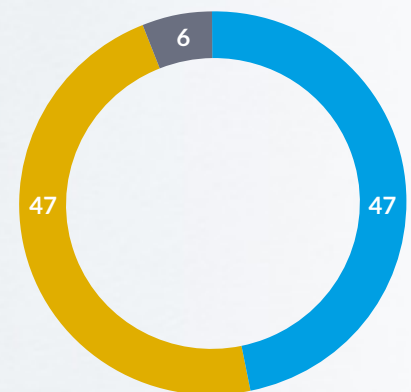
Preparing for verification proceedings and tax audits

According to the study, nearly half of the companies that use the R&D relief have experienced verification proceedings or audits carried out by tax authorities.

Tax office verifying the settlement of the relief:

- 47% companies underwent audits or verification proceedings
- 47% businesses were not verified
- 6% refused to answer

N=30



The settlement of the R&D relief boils down to the taxpayer filling out and submitting a CIT-BR or PIT-BR declaration. An enquiry from the tax authority is to be expected in connection with said submission. The verification of documentation by the tax authorities is standard procedure, which follows from the declaration-based character of the relief's settlement. Every entrepreneur should store documentation strictly tied to the research-development projects and the expenses tied to them throughout a statutory period of five years.

Verification proceedings or tax audits are an opportunity to verify the soundness of the settlements and the documentation acquired. Based on our experience, tax authorities in most cases limit their activity to the verification proceedings of the settlement's soundness, complete tax audits are conducted rarely.

During the verification proceedings, the tax authority usually requests the presentation of the following:

- worktime records of employees participating in R&D works, together with a list of the employees,
- declarations attesting that employee costs submitted for the relief follow from the records sent to the revenue office,
- remuneration chart and proofs of paying the social insurance contributions,
- complete documentation confirming that the projects qualified were R&D projects according to the definition found in the appropriate legal act,
- confirmations of the purchase of materials and consumables, specialized equipment, purchasing services qualifying for the relief (orders, invoices, agreements)

Should the tax office find any irregularities in the documentation presented, in most cases it requires only that the documents be completed. This could be i.e. providing declarations that the costs deducted from the tax base had not been refunded to the payer in any other form and that the payer was not conducting business in a special economic zone based on an appropriate permit. What is also required is the presentation of accounting documents attesting that the costs were distinguished in the accounting records –
explains Michał Barszcz, Project Manager in the Innovations, Reliefs and Grants Department at Ayming Polska.

The tax office may take various steps in the event of finding errors in the CIT-BR or PIT-BR declaration. When the change in the amount of tax due, or the overpaid amount, or amount to be returned, or the surplus tax to be transferred or the loss:

- does not exceed 5000 PLN – the tax office corrects the declaration through appropriate amendments or supplementation. Following that, the entrepreneur receives a certified copy of the CIT-BR or PIT-BR declaration;
- exceeds 5000 PLN - the tax office requests the payer submitting the declaration to correct it and to submit the necessary clarifications. The tax office also points out the reasons why certain information in the declaration had been called into question.

According to the current state of the law, failing to provide an amended declaration or remaining idle in the face of the doubts may result in an audit or other tax proceedings.

The party being verified is required to acquire a complete set of the documentation from the inspected area and they are required to verify said documentation. It is advisable to correct any irregularities identified before the initialization of verification proceedings, whilst providing a justification for the modifications made. The documentation needs to be verified, all the invoices need to be gathered and one has to make sure if the accounting ledgers are being kept according to present-day regulations. The payer should also keep in mind to pay any possible due tax amounts together with late payment interest.

Most frequent irregularities:

- lack of all the invoices, agreements and other documents that would confirm the expenses made on research-development activity
- lack of documentation describing and proving the R&D activity conducted
- incorrectly prepared worktime records of employees involved with R&D
- failing to distinguish the eligible costs in the accounting records in accordance with the accounting act
- R&D relief being claimed by a payer conducting business in a special economic zone after exhausting the zone's aid limit



Businesses on the R&D relief

We've been using the R&D relief since 2016 and we're planning to continue using this tax incentive. We are positive about the whole mechanism, seeing it above all as an opportunity to generate resources needed for continued growth. In our company, the R&D relief has led to the generation of significant savings and allowed us to launch new projects that will help give us a competitive edge in the future.

In 2019, the tax office conducted verification proceedings in our company for fiscal years 2017 and 2018. We received nearly 20 questions that we were able to answer without any problems as we are doing proper record-keeping of the documentation tied to the R&D relief. The only challenge was to send our response within the statutory 7-day deadline, which meant the reorganization of our workflow.

Bartosz Tafliński,
CFO at Anwis



CASE STUDY



QUESTIONS ASKED MOST FREQUENTLY BY THE TAX OFFICE AS PART OF THE VERIFICATION PROCEEDINGS

- What research-development activities were conducted in a given fiscal year?
- What categories of eligible costs were incurred on research-development activity? Please provide a summary statement of the costs
- Has the company kept an isolated record of the R&D activities' costs?
- Have the eligible costs been refunded to the payer in any form?
- Has the payer conducted business in a special economic zone based on a permit?

Case studies

Settling the R&D relief in practice



Employees



250+



Sector



INDUSTRIAL
PROCESSING

Step 1.

Identification and mapping of R&D activity

WHO CARRIES OUT R&D?

The R&D Department and
Tools' Department

WHAT R&D ACTIVITY IS CONDUCTED?

Industrial trials and
development works:

- developing new and enhanced products
- production of tools needed for the activities carried out

Identification of eligible costs

- personnel costs of the employees in the R&D department – remunerations and social insurance contributions of the employees (monthly records of the worktimes spent on conducting R&D projects)
 - personnel costs of Tools' Department employees are not eligible, as they were not settled based on actual worktime records
 - costs of the depreciation of fixed assets used for R&D projects (keeping records showing the use of fixed assets for R&D activity)
 - costs of cooperating with a university as part of R&D projects
 - costs of receiving a patent on innovative solutions developed under R&D projects
- amortization write-offs of the company's developmental works
- related to the eligible materials and consumables

Step 2.

Eligible costs' accounting

Isolating the accounts on which the eligible R&D costs for projects conducted are recorded .

Eligible costs and savings under the R&D relief

NAME OF ELIGIBLE COSTS	ELIGIBLE COST AMOUNT [PLN]	SAVINGS [PLN]
Personnel costs -R&D dep.	550 000	104 500
Amortization write-offs of company's developmental works	11 000	2 090
Cost of fixed assets' depreciation	110 000	20 900
Cost of expert opinions, consulting services, studies	53 500	10 165
Costs of patent acquisition	24 000	4 560
TOTAL	748 500	142 215

Step 3.

Step 4.

Preparing the proper documentation

Preparation of a report from the execution of R&D activities in the form of a project chart, showing among others the goal, course and summary of the works completed.

The company filling out and submitting the CIT-BR application together with the CIT-8 tax declaration that includes the incurred eligible costs amounting to 748 500 PLN.

Step 5.

Preparing for tax office verification proceedings or audits

WHAT INFORMATION / DOCUMENTS DID THE TAX OFFICE REQUIRE?

- descriptions of projects and the eligible costs incurred
- confirmation of the isolation of R&D costs in the accounting records
- declaration assuring that the eligible costs were not refunded in any form to the payer and had not been deducted from the tax base through the income tax

WHAT DOCUMENTS WERE PROVIDED?

- charts for projects conducted in 2018
- summary sheet of the deducted eligible costs, worktime records, proofs in the form of VAT invoices and summary sheets
- printouts from ledger records showing the isolated eligible costs deducted from the tax base
- declaration assuring that the eligible costs were not refunded in any form to the payer and had not been deducted from the tax base through the income tax

Savings in the 2019 fiscal year

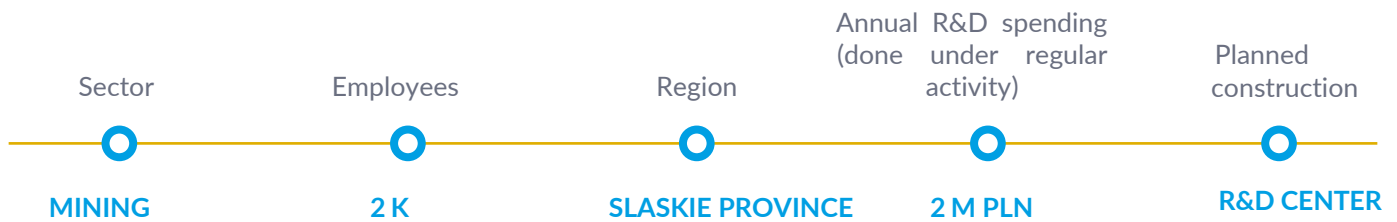


TYPE OF ELIGIBLE COST	ELIGIBLE COSTS' AMOUNT [PLN]	% VALUE OF DEDUCTION	SAVINGS [PLN]
R&D personnel cost	7 500 000	100%	1 425 000
Cost of using research equipment	1 000 000	100%	190 000
Patenting cost	100 000	100%	19 000
Cost of consumables and raw materials	4 000 000	100%	760 000
Cost of cooperation with academic units	500 000	100%	95 000
Amortization	400 000	100%	76 000

Total amount deducted under the R&D relief

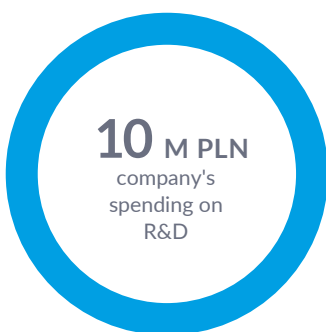
over
2.5
M PLN

The mutual complementation of grants and the R&D relief



Deduction for fiscal year 2018

GRANTS		R&D RELIEF	
INVESTMENT VALUE	GRANT AMOUNT	COSTS ELIGIBLE UNDER R&D RELIEF	AMOUNT DEDUCTED UNDER R&D RELIEF
		2 M PLN	380 K PLN
PO IR 2.1 Investments in R&D infrastructure of business: building an R&D Center (main cost is the purchase of equipment necessary for conducting R&D works, including machines and devices)			
3 M PLN	750 K PLN (25%)	1.5 M PLN	285 K PLN
PO IR 1.1.1 Industrial trials and developmental works conducted by companies: so-called "fast track" (main cost were employee remunerations, subcontracting and raw materials essential for conducting the works)			
5 M PLN	2.5 M PLN (50%)	1.25 M PLN	237.5 K PLN
SAVINGS	3.25 M PLN		0.90 M PLN
SAVINGS AMOUNT TOTAL		4.15 M PLN	





On the study

This report was prepared based on a CATI-method study conducted by Kantar on 30 companies that settled the R&D relief in 2016-2019. The study was conducted from April 30th, to June 19th, 2019.

The companies participating in the study employed over 50 workers and operate in chosen sectors: electronics, automotive, IT, pharmaceutical, chemical, metal and non-metal processing, machinery and device production.

Depending on the size of the company, the questions were answered by: the CEO, general director, financial director, development director/ manager, technical director, industrial director, head accountant.

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