



## **FRENCH RESEARCH AND DEVELOPMENT TAX CREDIT**

*(Article 244, quater B, 49 Septies N, 199ter B, 220B)*

*Disclaimer:*

*This memorandum is aimed introduce entrepreneurs to the main principles of the French Research and Development Tax Credit; it should not be considered as a tax advice.*

*Specificities existing in the “textile-clothing-leather” field as well as particularities involving tax consolidated groups are not discussed in this memorandum. Therefore, impacts of personnel and fixed assets transfers, or the case for partnerships, are not discussed either.*

*The information discussed in this document is not intended to be complete. In order for your specific situation and needs to comply with French tax rules, you should refer to your tax advisor. In Singapore, you can contact Mr. Florian Quinquis who will refer you to the knowledgeable specialist*

### **1. SCOPE**

#### **1.1 Introduction to the French Research and Development Tax Credit (“Crédit d’impôt recherche”)**

This French research and development tax credit is optional. Option is performed when filing Form 2069A to attach to Form IS 2572 (a corporate tax form).

Companies with research spending over 100 Million have to attach to their filing a detailed description of ongoing work with a list of assigned staff and tangible means. Tell when the project was started. The administration has 3 months to answer to credit a research claim.

Specificity: French tax research and development tax credit filing related to corporations S. Corp. and their partners / shareholders as well as tax consolidated groups should file the claim with dedicated forms.

This research and development tax credit represents 30 % of the costs incurred for research up to a limit of 100 Million Euros; and 5 % above that limit.

The tax credit is deducted from the income tax owed for the year in which the research and development expenses have been incurred. This tax credit will affect the tax owed, after using any other tax deduction and any credit.

Excess in tax credit not applied to tax owed represents a credit that may be used for payment over the next three years.

Any remaining unapplied fraction, after the three year period, should be reimbursed. This tax credit is a negotiable instrument through a “cession dailly”.

JEI (“Jeunes Entreprises Innovantes” – Young Innovating Companies), new Companies (the year of creation until the four following years)), small and medium

enterprises with less than 250 employees with a revenue of capped at 50 million (or a balance sheet of a maximum of 43 million). Distressed companies may claim for immediate reimbursement of their credit.

## **1.2 Interested Companies**

The research and development tax credit focuses on industrial, commercial, agro-business companies, taxable under usual principles.

The same applies to commercial companies that conduct a non-commercial activity.

This tax credit may apply to some tax-exempt companies: newly formed companies benefiting from exceptional exemptions, young innovating companies, companies created with the purpose of restructuring enterprises in difficulty, companies operating in urban development zones, in Corsica, in a research and development center, or in specific job revitalization centers.

Self-employed activities are excluded, as well as other companies already benefiting from tax exemption under exceptional tax code sections.

## **1.3 Research activities**

### **1.3.1 Conditions:**

They have to be operated within the European Economic Area (if not patent protections and intelligence)

### **1.3.2 Field of research and development**

- Fundamental and basic research activities;
- Applied research activities that aim at discerning possible applications of the results found from fundamental and basic research, of finding new solutions facilitating the achievement of predetermined objectives. The result of an applied research consists of a probationary model of products, operations, methodology, or process;
- Experimental development activities conducted through the use of prototypes or pilot installations and units, with the intent of gathering all necessary information to provide technical elements of decisions for the production of new materials, systems, products, processes, services or their improvement (modification that does not result from the simple usage of present and existing techniques, but that include novelty);
- Experimental development activities should be the following:
  - The devising of a preexisting process elaborated by another company, of which the company in question has had no access;
  - The acquisition of a patent with the intent of adapting it to a specific application or to achieve a product that is substantially new;
  - Product development with the intent of upgrading it in compliance with norms.

### 1.3.3 Research and development activities for SME companies

Design and manufacturing / production operations are included in the scope.

The following is considered as eligible research and development operations:

- At the completion of the experimental process, the functioning of a prototype or a pilot installation as a normal unit,
- Validation of concept prototypes, trial productions, aiming at launching and improving the production processes as well as the cost of products which sole purpose is intended for testing or “experimental production”,
- Costs incurred for organizational adjustments of materials and equipment necessary for mass production,
- Study costs to adapt products to changes in style or fashion, market surveys as well as costs surveys,
- Study for the conception of a system, a mechanism, a machine, that would lead to the elaboration of technical product diagrams (on the other hand, costs of industrial designs needed for the design of a prototype should be taken into account as research and development operations).
- Mining or petroleum research activities actually related to natural resources prospection,
- In-house education and training activities,
- Scientific and technical documentation centers and activities (gathering, classification, diffusion of information), scientific monitoring.
- Collection of general data,
- Engineering projects studied according to existing techniques with the intent of furnishing complementary information before implementation.  
On the other hand, feasibility analysis of a research and development project is included in the research and development operations,
- Work done by companies to adapt its products to existing norms, unless the undertaken work complies with the requirements of the research and development operations,
- The setup of a teleprocessing system that permits the automatic transmission of data in the absence of an operator, because of its non-innovative character,
- Costs incurred for the development of new line of products,
- Costs incurred for the purpose of testing patented processes, whereas experimental work has not generated any substantial improvements of processes,
- Projects consisting in the setup of a payment terminal unit, in consequence of its non-innovative character, even though it improves significantly the reliability of existing techniques.

### **1.3.4 Software design exclusion or limitation**

#### **a) The principle**

The activity of software designing cannot be understood as a research and development activity unless it includes tasks related to a conceptual phase of preliminary study, functional analysis and structural analysis.

The designed software should be new or should represent a substantial improvement.

Activities pertaining to existing software, that do not provide substantial improvement, as well as the design costs of a software that is not primarily made of innovative components, are excluded from the research and development tax credit.

#### **b) The design process**

Since the designing phase of the creation of software can be understood as a research and development activity, the expenses corresponding to the programming phase as well as tests performed and trial versions of this software can be taken into consideration for the computation of the related research and development tax credit.

#### **c) Release and upgrade**

In no case, expenses incurred for market and upgrade process should be considered as research and development expenses.

Following operations do not generate tax credits:

- Upgrade design or adaptation of an existing software,
- Improvement of an existing software by adding supplementary interfaces,
- Adaptation or rewriting of an existing software,
- Development of mailing software on a telematics server,
- Development of a diagram and technical drawing programs for personal computers,
- Development of a social and professional networking database software

#### **d) Ruling**

Prior to starting any research and development operations, companies may request from the administration an approval of eligibility. This provides further insurance that research and development tax credit can be benefited.

The response time from the administration is about three months.

A failure from the authorities to provide an answer would automatically imply acceptance of the benefit of the tax credit from administration.

The ruling may be claimed directly to the Ministry in charge of research and development, to the BPI (former OSEO – French organization for the support of innovation and development of small and medium enterprises), or to the National Agency for research and development (ARN).



Any request received after the project launch is not eligible to this specific ruling. Solely the claim should be received prior to the beginning of works. The company may begin with the project before the administration's position is received.

## **2. EXPENSES ELIGIBLE TO TAX CREDIT**

The research and development tax credit is computed on the calendar year basis, regardless the company's fiscal year.

### **2.1 Expenses with no cap or extra basis**

#### **2.1.1 Depreciation of fixed assets**

This applies to fixed asset depreciation expense that is tax deductible related to fixed assets which are directly and exclusively dedicated to the realization of research and development activities.

In case of a mixed usage, only the portion allocated to the research and development activities is eligible.

If case of financial lease, leaser should purchase and provide new equipment. Eligible depreciation expenses are the one beard by the leaser who should provide the company with a certificate including the fixed asset, its purchase price and the amount of depreciation applied.

Tax principle requires this certificate to be attached to the form 2069A.

#### **2.1.2 Researchers and research technicians payroll expenses**

This applies to payroll expenses related to researchers and research technicians that are directly and exclusively dedicated to research activities. Support personnel are excluded (secretary, equipment maintenance, salespeople...)

Researchers and research technicians payroll expenses related to part-time or partial year dedication to research activities should only be taken into consideration according to a pro rata of the time effectively devoted to the research activities.

All salaries, fringe benefits, bonuses and obligatory national insurance contributions (social security, unemployment insurance, and supplementary pension fund) are eligible.

Fiscal taxes based on salaries as well as profit-sharing which already benefiting from welfare benefits and tax incentives are excluded.

Expenses related to outsourced researchers and research technicians are also included, if all the following conditions are met;

- Those people should be directly and exclusively affected to research and development activities,
- Related eligible expenses should represent the cost beard by the primary employer.

#### **2.1.3 Novice Ph. D. ("Jeunes Docteurs") expenses**

When expenses are related to anybody holding a Ph. D. or an equivalent diploma, the eligible amount of these expenses can be doubled during the 24 first months

following his recruitment. Eligible expense may be doubled when the Ph. D. employee is not employed for determined period of time (only employed through a “contrat à durée indéterminée”) and if the company staff is not inferior to prior years.

Only those with a Ph. D. or its international equivalent are eligible, excluding national diplomas of medicine doctorate, pharmacy, veterinary...

#### **2.1.4 Executives compensation**

Compensation of executives effectively and personally involved in the research and development activities is eligible to the tax credit and thus can be taken into its calculation under the condition that it constitutes a deductible expense from the company's net taxable income.

##### **a) C Corp income tax (Sociétés soumises à l'IS)**

Payroll expenses in relation to « gérant » CEO category can be included in the research and development tax credit. However, it should be tax deductible and only the portion that is related to the research and development activities is taken into consideration, therefore excluding managing portion.

##### **b) S Corp. Income tax (Sociétés soumises à l'IR)**

S Corp partner compensations are not tax deductible.

It is therefore eligible for the research and development tax credit.

However, in order to enable the company to benefit from the fixed rate set up for operating expenses related to the manager's compensation (quoted 75 % of payroll expenses), it is also allowed to use a basic compensation equal to the average compensation of an executive as established by the French Institute for Statistics and Economic Studies (INSEE) and limited to the fraction related to the research and development activities.

The average salary of an executive given by the INSDEE should be increased by a coefficient representing social taxes of 1,35 which is equivalent to a maximum compensation of 62,370 Euros for 2009.

#### **2.1.5 General and Administrative Expenses**

Operating expenses are valued on an inclusive basis at 75 % of payroll expense (including executive compensation), regardless of the place of residence of the researchers and technicians, and at 200 % of payroll expenses (not doubled as discussed § 2.1.3) that are related to person holding a PhD or equivalent diploma during the first 24 months following their first recruitment, under the double condition that the Ph. D. employee is not employed for determined period of time (only employed though a “contrat à durée indéterminée ») and if the company staff is not inferior to prior year's.

#### **2.1.6 Issuance and maintenance of patents and certificate of vegetable obtaining**

**a) Issuance.** Expenses eligible to the research and development tax credit have been extended to the expenses incurred in the issuance and maintenance of these certificates, to which can be added the amortization of the certificates capitalized. The following expenses can be taken into consideration:

- Consultant and patent lawyer fees

- Fees for agents that registered the patent abroad if the patent is registered in France as well (translation fees)
- Taxes incurred in the registration of patents in foreign countries or international organizations that insure the protection of the invention

b) **Maintenance.** Expenses for maintenance are mainly limited to the annual tax incurred for the maintaining of the patents.

### **2.1.7 Amortization of acquired patents**

Only patents acquired to be used within the company for research purposes can be amortized. This is valid for those that are intended to be industrialized, even if they are not amortizable.

### **2.1.8 Protection expenses for patents and certificate of vegetable obtaining**

Patent protection expenses may or may not follow research and development operations; they may even be the only research expenses recognized by the entity. Expenses incurred in actions for counterfeiting led by the companies, such as legal fees and including lawyers and experts fees, are eligible.

Payroll expenses incurred by the company for the protection of the patents are also eligible. Expenses incurred in foreign countries are eligible as long as they are taken into consideration for the determination of the net taxable income in France. Expenses related to design; models and trademarks are not eligible for the research and development tax credit.

### **2.1.9 Expenses in relation to the normalization**

#### **a) Compensation costs pertaining to the official meetings for normalization**

For the tax credit computation, the company should take into consideration 50 % of the compensation costs pertaining to the periods during which employees participate in the official meetings for the normalization.

All salaries, fringe benefits, bonuses and obligatory national insurance contributions (social security, unemployment insurance, and supplementary pension fund) should be included in the computation.

#### **b) Other expenses related to the normalization**

Other expenses are valued at a flat rate of 30 % of the payroll expenses. This flat rate is a right to the company and no election for actual expenses incurred can be made, under any circumstances. These other expenses are included in the computation for 50 % of their value.

These other expenses include all expenses other than salaries, fringe benefits, reunion organization time, administrative expenses, translation fees, transportation fees, lodging...

## **2.2 Limited expenses**

### **2.2.1 Monitoring of technological development expenses**

Expenses for the monitoring of technological development are eligible for 20 % of the incurred expenses when they are related to research and development activities and incurred in France or in a foreign country, with a 400.000 Euros limit per year and per company.

The technological development monitoring is a process of permanent update which objective is the systematic organization of information collected on scientific advances, techniques related to products, processes, information methods and systems in order to detect development opportunities.

Subscriptions to scientific magazine, to databases and the participation to scientific symposiums are eligible expenses. Payroll expenses resulting from the participation to symposiums (bonus, indemnity, etc.) are not eligible if these expenses are already eligible for the research and development tax credit.

Expenses for the monitoring of technological development are only eligible as long as they are related to actual research activities. Therefore, a company cannot benefit from the tax the tax credit for monitoring technological development only, or for monitoring expenses that are not related to research activities.

Expenses for the monitoring of technological development incurred in a foreign country are eligible under the above mentioned conditions as long as they are included in the taxable income computation in France.

### **2.2.2 Subcontracting expenses**

#### **a) Out of France expenses**

Companies can outsource their research and development operations to public organizations, universities, or authorized private entities (or scientific / technical experts) established in another country of the European Union or a country that has signed a tax treaty to prevent fraud and tax avoidance.

This disposition related to abroad outsourcing does not modify the obligation, or absence of obligation, for these foreign organizations, to obtain an approval from the Ministry of Research, so that their expenses are eligible to the tax credit.

#### **b) Subcontracting operations between dependent entities:**

(limited to 2 million Euros)

Dependency is said to exist between two companies when one owns directly or through a third party the majority of the capital of the other or has the power of decision or when a third company owns directly or through a third party the majority of the capital of both or has the power of decision.

#### **c) Subcontracting operations between independent entities:**

(limited to 10 million euros and an additional 2 million euros for expenses that are included for twice their amount)

Twice the amount of the following expenses is taken into consideration for the calculation of the research and development tax credit:

- Public research organizations
- Higher education institutions for private law that deliver Master degrees
- Non-for-profit and authorized privately owned foundations for scientific cooperation
- Authorized foundations working in the research sector

The following are deductive private enterprises

- authorized private enterprises
- authorized associations under the 1901 law

- authorized individual experts

Global limitation: outsourced research and development expenses may be included in the tax credit computation of a company for a maximum amount of 12 million euros.

### **2.2.3 Bonus and contribution in relation to insurance contracts for the legal protection of patents and certificate of vegetable obtaining**

They are eligible up to a 60.000 euros limit. The amount is different in IFRS and in French GAP. IN French GAAP it is a reduction of the tax, in IFRS it is accounted as a reduction of costs.

## **3. CALCULATION**

### **3.1 Calculation**

#### **3.1.1 Rate to apply**

The research and development tax credit represents 30 % of the costs incurred for research up to a limit of 100 million euros; and 5 % of the costs above that limit.

#### **3.1.2 Treatment of grants and reimbursable advances**

Public grants attributed by the European Union, the government or any territorial collectivities related to operations giving rights to the research and development tax credit should be deducted from the computation of the tax credit in the year of collection and to the pro rata of the base subject to the research and development tax credit.

The same is applicable for reimbursement advances. If need be, they are added to the base of the calculation of the research and development tax credit of the year of the reimbursement.

### **3.2 Tax Return and tax status**

The research and development tax credit is an option. It implies to file form 2069A as an attachment to form IS 2572.

**Pay attention to the fiscal year: the research and development tax credit is computed on the calendar year, regardless of the company's fiscal year. The option should be taken when the corporate tax return is submitted.**

### **3.3 Deduction and reimbursement of the research and development tax credit**

The tax credit is deducted from the income tax owed during the year in which the research and development expenses have been incurred. For companies with a fiscal year that does not coincide with the calendar year, the recording impacts taxes owed on the fiscal year following the one where research and development expenses included in the computation of the tax credit have been incurred. The recording is performed when taxes due are paid. If the research tax credit exceeds the tax due or if the company shows a taxable deficit, the credit excess may be used for 3 years or reimbursed if not applied by the end of this period.

Tax exempt companies, JEI (Jeunes Entreprises Innovantes)



### **3.4 Accounting of the research and development tax credit as per French Gaap**

#### **3.4.1 Related income recognition**

The income resulting from the research and development tax credit is gradually acquired, as research expenses are incurred.

Indeed, the amount of the tax credit is exclusively dependent the research expenses incurred during the year.

As a consequence, when the research expenses are incurred, the tax credit is generated and can be reliably estimated as a result from a ratio provided by the tax administration to be applied on actual expenses incurred.

If the company's fiscal year does not match the calendar year, the portion of the tax credit corresponding to the research expenses incurred at the closing should be recorded as accrued income tax receivable.

#### **3.4.2 Related income disclosure**

The resulting income is to be recorded as follows:

- Debit against the income taxable expense if it is immediately applied
- Segregated in account #699 if it is not or partially applied by crediting account #444.

The generated income is not a taxable item.

### **4. Accounting**

The treatment is different for IFRS and for French Groups. For French groups, it is a reduction of the tax liability while for IFRS groups it is accounted as reduction of costs.