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REPORT

From:	General Secretariat of the Council
To:	Delegations
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council

Greece's Patent Tax Incentive (IP regime) (EL015 REV)

EL015 REV – PATENT TAX INCENTIVE (IP REGIME)

	1a	1b	2a	2b	3	4	5	OA
EL015 rev – Patent tax Incentive – deferred taxation	X	?	X	?	X	X	X	X

In accordance with the 24 November 2016 report of the Code of Conduct Group to the Council, the following assessment has been prepared with regard to paragraphs 1 to 5 of the Code, based on the OECD description (hereafter referred to as "agreed description"[1]) provided by the Greek authorities in July 2022 and approved by the Group in its meeting of 20 September 2022. The measure was assessed against all Code criteria and the modified nexus approach.

[1] For this particular exercise, the Member State's reply to the OECD questionnaire for FHTP.

Explanation

Significantly lower level of taxation:

"Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"

Greece informed the Group that it has amended the provisions of article 71 A of Law 4172/2013 (ITC)[2]. According to the new rules in force as of 1.1.2022, "the profits that a company derives from the exploitation of an internationally recognised patent in its name, developed by it, are exempt from income tax for up to three consecutive years, starting from the year in which these profits were first derived. The exemption is granted under the condition that there is a connection with the R&D expenditures incurred by the company for the development of the patent." The exempted amount appears in a special reserve account and is subject to taxation in accordance with the general provisions of the Income Tax Code, for the part that is distributed or capitalized each time.

Thus, such deferred taxation (0% tax rate for up to 3 years) applies to relevant profits (royalties, embedded royalties and proceeds from the alienation of IP assets) compared to the current Greek company tax rate of **22**%.

This deferred taxation results in a cash-flow advantage leading – temporarily - to a significantly lower level of taxation than the rate generally applying. **It is therefore potentially harmful within the meaning of paragraph A of the Code.**

Criterion 1:

"whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a concerns the *de jure* application of the measure.

The regime is available to all taxpayers (enterprises) that develop qualifying IP assets and profit from them. Thus, both Greek resident companies and Greek permanent establishments (PEs) of non-resident companies subject to Greek corporate income tax which carry out R&D activities and derive IP income from such activities can benefit

[2] The new provisions were adopted by way of article 89 of Law 4864/21; published in the Governmental Gazette n. A' 237 / 02.12.2021. and the relevant Ministerial decision: Joint Ministerial Decision (KYA) No 79628/2022 "Determining the terms, conditions and procedures for the application of art. 71 A "Patent Incentives" of Law 4172/2013 (A΄ 167), as amended by art. 89 of Law 4864/2021 (A΄ 237)".

from the Patent tax incentive. There seem to be no provisions restricting the benefits to transactions with non-residents.

We have therefore proposed a cross ("X") for this criterion.

1b) Criterion 1b is used to complement the assessment under criterion 1a which only looks at the literal interpretation of the measure. It takes account of the *de facto* effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b.

In light of the recent introduction of the Patent tax incentive, it is unlikely that statistical or impact data is either available at this stage, or representative enough to reflect the comprehensive effects of the newly introduced regime. Moreover, the agreed description in the format used lacks such data.

This is a horizontal issue for almost all assessments. To the extent that our assessment is based on currently available information on [or lack of] statistics, we suggest that the group reserves the possibility of a potentially different outcome of a future assessment based on more complete information.

We have therefore proposed a question mark ("?") for this criterion.

Criterion 2:

"whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. *de jure* interpretation and *de facto* analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a) What has been written under criterion 1a applies analogously to criterion 2a.

There are no rules preventing domestic taxpayers from benefiting from the IP regime or to exclude domestic transactions.

We have therefore proposed a cross ("X") for this criterion.

2b) On the basis of the explanations provided above and the marking under criterion 1b, the evaluation of criterion 2b follows the same reasoning.

In light of the recent introduction of the Patent tax incentive regime, it is unlikely that statistical or impact data is either available at this stage, or representative enough to reflect the comprehensive effects of the newly introduced regime. Moreover, the agreed description in the format used lacks such data.

This is a horizontal issue for almost all assessments. To the extent that our assessment is based on currently available information on [or lack of] statistics, we suggest that the group reserves the possibility of a potentially different outcome of a future assessment based on more complete information.

We have therefore proposed a question mark ("?") for this criterion.

Criterion 3:

“whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages”

In November 2014 the Group agreed, in co-ordination with developments at the OECD, on the modified nexus approach as the appropriate method to ensure that patent boxes require sufficient substance. Therefore, criterion 3 of the Code is to be interpreted in line with the modified nexus approach. The key elements of the modified nexus approach are: Scope (qualifying IP assets), Nexus ratio, Tracking and tracing, Rebuttable presumption and Treatment of losses.

1. Scope:

Qualifying IP assets: Income benefiting from an IP regime has to come from a qualifying asset, comprised in one of the three categories 1) patents and functionally equivalent assets including utility models, protection granted to plants and genetic material, orphan drug designations and extensions of patent protection; 2) copyrighted software, and 3) assets that share the features of patents and are substantially similar to the two previous categories and are certified as such by a competent government agency in the State[3].

Qualifying assets: the Greek Patent Tax Incentive regime benefits only: “Internationally recognised patents”. *Internationally recognized patents* are patents for which a Patent Diploma has been granted that falls within at least in one of the following cases:

aa) “European Patent Diploma”, issued by the European Patent Office and patented in Greece.

ab) ‘’Patent Diploma’’, patented by the Industrial Property Organization, excluding the Utility Model Certificates, that has also been registered in one more country, which:

i) has joined in the European Patent Convention or cooperates under the framework of this Convention, or

ii) is an OECD member or is a candidate for accession or is under an enhanced engagement regime.

The income tax exemption is provided under the condition that Patent Diplomas are valid at

[3] Category limited to companies which are not part of a group with more than €50m turnover and gross revenues of €7.5m from all IP assets.

least until the last day of the year for which the exemption is requested.

The EL IP regime does not cover the third category of IP assets for small and medium size enterprises[4]. Thus, no annual reporting obligation to the FHTP, nor a spontaneous exchange of information is necessary.

Qualifying income: the agreed description indicates that royalties from licensing an IP right (Income acquired in return for the use or the right of use of patents) and income from the sale of patents (capital gains) can benefit. Embedded royalties are also included in the qualifying income[5].

2. Nexus ratio:

The tax advantage granted under the Greek IP regime is a deferred taxation. Such tax exemption applies on the relevant qualifying net[6] IP income. The exempted amount, calculated as below, appears in a special reserve account and is subject to taxation in accordance with the general provisions of the Income Tax Code (ITC), for the part that is distributed or capitalized each time.

The portion of income qualified for the deferred taxation is calculated under the modified nexus formula: [QE (+30% uplift) / OE x OI]:

- QE being qualifying expenditure, excluding explicitly costs for outsourcing to related parties and acquisition costs;

- OE being overall expenditure, including costs with outsourcing to related parties and acquisition costs;

- OI being overall income calculated as a net income and including (embedded) royalties and net capital gains (with a transfer pricing method).

Embedded royalties: to calculate the embedded IP income, the enterprise shall apply the general principles and guidelines of the OECD on intra-group transactions (i.e. OECD transfer pricing Guidelines).

3. Tracking and tracing:

MS must require companies to track expenditure, IP assets and income. When such tracking would be unrealistic and require arbitrary judgements, MS may allow the application of the nexus approach so that the nexus may be between expenditure, products arising from IP assets and income (product-based approach). It requires tracking of all QE and OE at the level of the product.

[4] Given that such inventions are substantially similar to the IP assets in the first two categories, they should be certified in a transparent certification process by a competent government agency that is independent from the tax administration.

[5] regardless of whether such products sold were produced in the premises of the company or in third parties' premises , for which the patent was used.

[6]The profits which qualify for the benefits are calculated as the overall income from the qualifying IP asset produced in R&D activities less all expenses incurred in earning that income.

The Greek law sets specific provisions regarding the tracking and tracing requirements under the IP regime. Eligible and non-eligible R&D costs, profits from the operation, as well as any losses from the same cause are recorded separately in the enterprise's accounting books for each patent.

4. Rebuttable presumption[7]:

Under the Greek IP regime, the nexus ratio is not treated as a rebuttable presumption.

5. Treatment of losses[8]:

The treatment of losses associated with the IP income corresponds to the separate loss method which prevents IP losses to be set off against the general tax rate. IP losses cannot be used against ordinary income, but they may be carried forward to be used only against future IP income. More specifically, losses associated with the IP income are not recognized and losses arising from the same cause in any of the two years following the fiscal year in which the enterprise first received this benefit for the particular patent will not be deducted when determining the profit from the business activity.

Therefore, we would propose a cross ("X") for this criterion.

Criterion 4:

"whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"

- General transfer pricing rules:

Greece applies the arm's length principle and its regulations make reference to the OECD Transfer Pricing Guidelines.

The arm's length principle is relevant to the following features of a patent box: the reduction of the tax base by a fixed percentage, if any; the calculation of royalty profits; the application of safe harbour rules; the asymmetrical treatment of losses (if any).

[7] Jurisdictions could treat the nexus ratio as a rebuttable presumption but would need to limit to exceptional situations where the ratio could be rebutted to those that meet at minimum the following requirements: the taxpayer should first use the nexus ratio to establish the presumed amount of income that could qualify for benefits; the nexus ratio (excluding the up-lift) should equal or exceed 25%; the taxpayer should demonstrate that because of exceptional circumstances, the application of the nexus ratio would result in an outcome inconsistent with the nexus approach (burden of proof on the taxpayer).

[8] Note 14 to Action 5 Report: Jurisdictions should also use any tax losses associated with the IP income in a manner that is consistent with domestic legislation and that does not allow the diversion of those losses against income that is taxed at the ordinary rate.

- Reduction of the tax base by a fixed percentage: *in principle, reducing a company's arm's length profits by a fixed amount means that the final result does not reflect the arm's length principle. This is a question about the circumstances in which fixed reductions of the tax are acceptable and is therefore part of the overall assessment that the Group needs to make.*

The tax benefit under the Greek IP regime is granted through a tax exemption and not a reduction of the tax base. Therefore, the amount of the basis of income is not modified in the IP regime in a way that would not reflect the arm's length principle.

- Calculation of royalty profit (embedded royalties): *where transfer pricing rules exist, the profits that go into a patent box will reflect the arm's length principle because they are just a part of the company's total profit. In principle this applies both to royalties and embedded royalties. If the IP regime covers also the latter category, its identification within the sale price of a product should rely on transfer pricing principles.*

What has been written under criterion 3 above on the same topic applies analogously to criterion 4.

- Safe harbour rules: *adoption of safe harbours is not in accordance with internationally agreed principles; safe harbours are not recommended in the Transfer Pricing Guidelines.*[9]

The Greek IP Regime does not seem to provide for such safe harbour rules.

- Asymmetrical treatment of losses: *where the profits from particular IP assets are taxed at a lower rate in a patent box then the losses should be treated in the same way and not deducted outside the box at a higher rate.*

What has been written under criterion 3 above on losses applies analogously to criterion 4.

We would therefore propose a cross ("X") for criterion 4.

Criterion 5:

"whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations *etc*. before a measure can be considered transparent.

The nexus approach contains commitments to additional transparency in three areas. These concern the third category of qualifying assets, new entrants to existing IP regimes after 6 February 2015 and the rebuttable presumption rule. Commitments regarding new entrants to pre-existing regimes are not subject to the present assessment and are part of a separate monitoring process. The commitments in the 2015 Report cover both the report of certain information to the Forum on Harmful Tax Practices and the spontaneous exchange of

[9] *Transfer Pricing Guidelines*, p167.

information between competent authorities.

Third category of qualifying assets

Not applicable, as the third category of IP assets is not covered by the Greek IP regime.

New entrants

Not applicable, as the regime came into force in 2022.

Rebuttable presumption rule

Not applicable, as the nexus ratio is not treated as a rebuttable presumption.

We would therefore propose a cross ("X") for criterion 5.

Overall assessment:

In light of the assessment made under all Code criteria, the Greek IP regime should be considered **not harmful** from a CoC point of view.

Overall the Greek IP regime is in line with the modified nexus approach. Similar to other recently introduced or amended measures, question marks remain in the grids in relation to criteria 1b and 2b.

In summary, our overall assessment is that this measure is **not harmful**.