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## Chapter 1: Introduction

### 1.1 Background

The Netherlands is known for its competitive business climate. Nevertheless, the Netherlands has dropped two places on the overall IMD World Competitiveness Ranking in 2022.<sup>1</sup> The Dutch business climate especially underperformed on fiscal policy. Research done by Dialogic also states that the competitiveness of the Dutch investment climate scores under average on macro-economics and taxation.<sup>2</sup> Dutch politicians have acknowledged the importance of implementing policies to strengthen the competitive position of the Netherlands, and innovation plays an important role.<sup>3</sup> Innovation leads to economic growth and contributes to prosperity. Moreover, companies currently operate in a world where technology is evolving like never before and where climate change asks for sustainable developments. Innovation is necessary for companies to face these societal challenges and to remain competitive.

In order to enhance the innovative competitive strength of the Netherlands, the Dutch government has introduced the innovation box. The tax benefit is elaborated in article 12b of the Dutch Corporate Income Tax Act 1969 (hereinafter: CITA),<sup>4</sup> which states that profits generated by a self-produced intangible asset are not fully included in the tax base. Only immaterial assets for which the taxpayer has been issued a Research and Development certificate (R&D certificate) are qualified.<sup>5</sup> Consequently, the effective tax rate on profits from these intangible assets is 9%, while regular profits are taxed at a rate between 19 and 25,8 percent. The tax benefit is applicable to both Dutch and foreign companies and encourages them to engage in more research and development.<sup>6</sup>

The innovation box exists since 2007, although it was initially introduced as the patent box. Due to limited use of the tax benefit by companies, the box was expanded in 2008 and renamed as the innovation box in 2010. In response to an OECD action plan to combat base erosion and profit shifting, the conditions to be applicable for the tax benefit were tightened in 2017. These requirements are still intact.

Despite the beneficial effects on prosperity, multiple political parties urge for abolition of the innovation box. According to politicians Maatoug and Nijbour the tax benefit is an ineffective measure that primarily benefits a small group of large corporations.<sup>7</sup> This is also evident from

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<sup>1</sup> International Institute for Management Development, 2022.

<sup>2</sup> Dialogic, *Het Nederlandse investeringsklimaat*, Utrecht: 2021, p. 4.

<sup>3</sup> Brief van Minister van Economische Zaken van 11 november 2022, nr. DGBI-I&K/22545365.

<sup>4</sup> In Dutch: Wet op de vennootschapsbelasting 1969.

<sup>5</sup> In Dutch: S&O-verklaring. The S&O-verklaring is included in Wet vermindering afdracht loonbelasting en premie voor de volksverzekeringen.

<sup>6</sup> Belastingdienst/Directie Vaktechniek Belastingen, besluit van 1 september 2014, nr. BLKB2014/1054M.

<sup>7</sup> Amendement van de leden Maatoug en Nijboer van 8 november 2022, 36 202, nr. 53, p. 2.

figures provided by the Dutch Ministry of Finance. In 2018, 80 percent of the costs associated with the innovation box were incurred by 19 large companies. ASML, for example, took advantage with an effective tax rate of 15%, while being the third largest multinational in the Netherlands.<sup>8</sup> Although the facility is also targeted for small and medium sized enterprises (hereinafter: SMEs), they hardly profit. Practice shows that SMEs struggle with accurately calculating the profits that qualify for the innovation box. Even though the tax facility has already been simplified by introducing the optionality to apply a flat-rate scheme.

The complex application of the innovation box cannot be seen as an exemption. The Dutch House of Representatives opts for a simpler tax system with fiscal schemes that meet social interest. In response, Secretary of State Van Rij has informed the House of Representatives about his intention to assess Dutch tax arrangements, including the innovation box. Evaluation will take place based on four criteria: (1) Relevance and justification for government intervention, (2) effectiveness and efficiency, (3) complexity in terms of implementation and enforcement by the Tax Authority and (4) application in practice by taxpayers.<sup>9</sup> The assessment must show whether the innovation box still complies with the objective set by the government to stimulate innovation, and therefore contribute to the international competitive position of the Netherlands, while it simultaneously fits in with a simplified tax system.

## 1.2 Research question

This thesis examines the effectiveness of the innovation box, as well as the target group that the legislator aims to reach. My main research question is:

*Does the innovation box in the articles 12b-12bg Dutch Corporate Income Tax Act 1969, as of 2021, still meet the target group and effectiveness goals as stated when the tax benefit was introduced in 2007?<sup>10</sup>*

In order to answer my main research question, I will address the following sub-questions:

1. What legislative amendments have already been made to the innovation box since introduction and what goal did the adjustments serve?
2. What does the current innovation box, described in articles 12b-12bg Dutch CITA, entail?
3. What objectives does the tax arrangement serve and who is the facility targeted for?
4. What effect did the tax benefit have on innovation and what kind of companies make use of the innovation box?

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<sup>8</sup> Forbes Global 2000, 2022

<sup>9</sup> Brief van Staatssecretaris van Financiën van 31 oktober 2022, nr. 2022-0000257727, p. 3.

<sup>10</sup> Artikel 12b-12bg Wet op de Vennootschapsbelasting 1969; The innovation box was known as 'octrooi box' in 2007, after an amendment in 2010 it was named the innovation box.

### 1.3 Outline

To answer the main research question, each sub-question will be addressed within separate chapters. First, chapter two will elaborate on the evolution of the innovation box since its introduction as a patent box in 2007. The purpose of the legislative amendments stated in chapter two is described based on parliamentary documents. The articles of law currently devoted to the innovation box will be discussed in chapter three. Thereafter chapter four will focus on the objectives and target group that the government aims to reach with the tax benefit, again by using parliamentary documents. In chapter five, qualitative data will be used to test the effectiveness and target group reach. Any potential pain points of the tax facility will therefore be exposed in this chapter. The sixth chapter will proceed on the analysis in chapter five by appointing adjustments that could contribute to the effectiveness of the innovation box. Recommendations for improvement will be presented based on the study of relevant literature. Each chapter will contain a conclusion to the relevant sub-question. Finally, the thesis will be concluded by answering the main research question.

### 1.4 Scope

The main research question focusses on the effectiveness and target group reach of the innovation box. Effectiveness can be described as the extent to which the stated objectives are actually achieved. Target group is defined as the specific group that the government aims to reach with the tax arrangement. The efficiency of the innovation box will not be taken into account. Efficiency refers to achieving the desired results in the most cost-effective manner. The analysis in this thesis will solely focus on the innovation box as described in the Dutch Corporate Income Tax Act 1969. International legislation will not be addressed, and no comparisons will be made with similar tax regimes in other (European) countries. However, if the basis for legislative amendments lies in international legislation, references will of course be made. The analysis will be conducted through literature review, quantitative data will not be used.

## Chapter 2: Evolution of the innovation box

### 2.1 Introduction

Innovation is of great importance with regard to economic growth and employment. In 2000, the European Union has acknowledged this by agreeing upon a strategic goal to become the most competitive knowledge-based economy in the world.<sup>11</sup> The European Council asked the member states to implement tax policies that stimulate private companies to invest in research and development, which contributes to the Dutch and European investing climate.<sup>12</sup> Following France's and Hungary's example, the Netherlands has introduced a patent box that provides a tax credit in case of successful innovations.<sup>13</sup> This chapter will elaborate on the establishment of the patent box and any changes made since implementation. The objectives set by the government regarding the tax benefit are discussed as well. The partial conclusion at the end will answer the following sub-question: *What legislative amendments have already been made to the innovation box since introduction and what goal did the adjustments serve?*

### 2.2 Establishment of the patent box

Early 2005, the then Secretary of State De Wijn presented a memorandum called *Werken aan winst* to the Dutch House of Representatives, which introduced a patent box facility. The purpose of such a tax arrangement is to improve the Dutch business climate and attract new companies.<sup>14</sup> A reduced tax rate should particularly interest large multinational corporations to locate their Research and Development (hereinafter: R&D) activities in the Netherlands.<sup>15</sup> The necessity of a patent box plays a lesser role for SMEs, as they often lack the resources to relocate activities to another country solely for tax benefits. SMEs are companies with up to 250 full-time employees and a turnover of less than 50 million. The proposed bill does, however, emphasize the importance of a patent box for SMEs. The relocation of businesses to the Netherlands indirectly strengthens the knowledge-based economy, which subsequently contributes to the competitive position of Dutch SMEs.<sup>16</sup> Therefore, SMEs are certainly taken into account by the legislator when considering the implementation of a patent box.

Initially, the government was skeptical about introducing a patent box, but the Second Chamber strongly supported it.<sup>17</sup> The employer's federation VNO-NCW was also in favor, although they preferred broader access to the box and a lower effective rate of 5%.<sup>18</sup> The

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<sup>11</sup> Presidency Conclusions, Lisbon European Council 23 and 24 March 2000, nr. 5.

<sup>12</sup> Presidency Conclusions, Lisbon European Council 23 and 24 March 2000, nr. 13.

<sup>13</sup> Kamerstukken II 2005/06, 30 572, nr. 8, p. 23.

<sup>14</sup> Kamerstukken II 2005/06, 30 107, nr. 2, p. 2.

<sup>15</sup> Kamerstukken II 2005/06, 30 107, nr. 2, p. 23.

<sup>16</sup> Kamerstukken II 2005/06, 30 107, nr. 3, p. 6.

<sup>17</sup> Kamerstukken II 2005/06, 30 107, nr. 9, p. 27.

<sup>18</sup> Kamerstukken II 2005/06, 30 107, nr. 4, p. 9.

positive attitude of the House of Representatives and society ultimately led to a draft legislation. The bill regarding the patent box must meet three conditions: (1) it must be attractive for businesses; (2) it must stimulate innovation; and (3) it must be practicable and budgetary manageable.<sup>19</sup>

In its response to the legislative draft, the Council of State advised to also make the patent box accessible to entrepreneurs subject to the Dutch Personal Income Tax Act 2001 (hereinafter: IB-entrepreneur). As previously mentioned, the government did acknowledge the importance of the tax benefit for SMEs, to which the IB-entrepreneur belongs. However, De Wijn deems application by IB-entrepreneurs unnecessary, stating that they have the option to incorporate their business into a corporation by the use of article 3.65 of the Dutch Personal Income Tax Act 2001.<sup>20</sup> The State Secretary's stance is quite remarkable, given that an entrepreneur's choice of legal form depends not solely on the fiscal climate. The business structure and liability regime are also strongly taken into consideration. In addition, the legislator has expressed the desire for fiscal neutrality between IB-entrepreneurs and those subject to the corporate income tax. Opening up the patent box to IB-entrepreneurs is not inconsistent with the set conditions and, in fact, enhances the effectiveness. A domestic competitive market between IB-entrepreneurs, SMEs, and large corporations positively impacts the international competitive position of the Netherlands. Nevertheless, the patent box, which came into effect on the first of January 2007, applies exclusively to entrepreneurs subject to the corporate income tax.<sup>21</sup>

### 2.3 The patent box as of 2007

The patent box is included in article 12b of the Dutch CITA. The article in 2007 states that profits related to an intangible asset produced by the taxpayer himself, are taxed at an effective tax rate of 10%.<sup>22</sup> Although the taxpayer can only opt for the tax benefit if a patent is granted for the self-produced immaterial asset. Plant variety rights are regarded as patents, while assets similar to brands and logos are excluded. Before the reduced tax rate can be applied, the qualified profits must pass a threshold which is equal to the total amount of production costs related to the intangible asset. If all these conditions are met, companies can attribute profits to the patent box up to four times the amount of the production costs.<sup>23</sup> In case of two qualified intangible assets by the same taxpayer, the production costs of both assets are added together before the thresholds are determined.<sup>24</sup> This could be beneficial if one asset is more profitable.

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<sup>19</sup> Kamerstukken II 2005/06, 30 572, nr. 3, p. 10.

<sup>20</sup> Kamerstukken II 2005/06, 30 572, nr. 4, p. 22.

<sup>21</sup> Kamerstukken II 2006/07, 30 572, nr. 25, p. 1.

<sup>22</sup> The effective tax rate is based on a tax rate of 25,5%. The effective tax rate with respect to the first two tax brackets is not taken into account.

<sup>23</sup> Kamerstukken II 2006/07, 30 572, nr. 12, p. 1.

<sup>24</sup> Kamerstukken II 2005/06, 30 572, nr. 8, p. 23.

One of the conditions set for the patent box referred to the fact that it has to be practicable. It is questionable whether the patent box, as described in 2007, meets this requirement. The legislation or parliamentary documents do not clearly define intangible asset, nor do they provide a method on how to determine the profit arising from the asset, causing great difficulties for companies to derive their taxable amount.<sup>25</sup> Critics also arose concerning the need to apply for a patent. Obtaining a patent comes along with high administrative costs and can be sensitive to competition, as the innovation will become public. This is especially disadvantageous to SMEs, as larger corporations have more resources available to exploit the innovation in a quicker timespan.<sup>26</sup> In addition, not all novelties are patentable. Software is an important example of this.<sup>27</sup> Members of the Dutch parliament indicate that the initial patent box fails to attract large foreign corporations, who frequently apply for patents, to the Netherlands, which makes it questionable whether the set requirements contribute to the objective of improving the Dutch business climate.<sup>28</sup>

#### 2.4 Access with R&D certificate

In response to the criticism, politicians Kortenhorst and Tang plead for softer entry requirements. According to them, intangible assets for which an R&D certificate is granted, should also be applicable for the patent box.<sup>29</sup> As a result, the box is linked to an already existing tax advantage within the Dutch wage tax that stimulates innovation, called the *Wet Bevordering Speur- en Ontwikkelingswerk* (hereinafter: WBSO). The WBSO reduces costs for companies and self-employed entrepreneurs engaged in research and development activities. When companies are granted an R&D certificate, they are required to remit less wage tax as withholding entities. Self-employed entrepreneurs can apply a fixed deduction to their income tax. An R&D certificate is issued for the development of innovative physical products and product processes, software, and technical scientific research.<sup>30</sup> The WBSO is mainly used by SMEs, therefore the expansion of the patent box is also intended to encourage more SMEs to apply for the tax advantage.<sup>31</sup>

To meet the budget requirement, the total amount of production costs related to an R&D-asset that can be attributed to the innovation box is limited at €100.000 a year. Consequently, the reduced effective tax rate only applies to profits up to €400.000. The application process for an R&D certificate is significantly shorter, thus companies are able to commence innovative developments earlier. The limitation no longer applies if a patent is granted at a later stage, although the patent does not have retroactive effect.<sup>32</sup>

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<sup>25</sup> Van der Lande, *WFR* 2007/527, p. 2.

<sup>26</sup> Redactie Vakstudie Nieuws, *V-N* 2006/43.2, p. 34.

<sup>27</sup> Daniels & Oosterhoff, *WFR* 2006/767, p. 2.

<sup>28</sup> Kamerstukken II 2006/07, 30 572, nr. 13, p. 18.

<sup>29</sup> Amendement van de leden Kortenhorst en Tang van 8 november 2007, 31 206, nr. 9, p. 2.

<sup>30</sup> Rijkdienst voor Ondernemend Nederland, RVO-192-2021/HL-INNO, p. 4.

<sup>31</sup> Brief van Minister van Economische Zaken en Klimaat van 20 september 2022, nr. DGBI-I&K/22410257, p. 2.

<sup>32</sup> De Nies, *TFO* 2008/108, p. 10.



## 2.5 Expansion to innovation box

From practical experience, it is evident that the patent box still has not achieved its intended effect. As a result, the government decides to significantly revise the patent box in 2010. In this way, the Cabinet aims to maintain the attractiveness of the Netherlands for innovative enterprises.<sup>33</sup> The effective tax rate is lowered to 5%, and the profit cap for both the R&D and patent asset is removed. Hence, the benefits gained from both types of assets are treated equally starting from 2010. This also reduces the administrative burden for companies and the tax authority.<sup>34</sup> The requirement stating that the production costs must be recouped before benefits can be attributed to the box remains intact. This threshold is increased if companies charge operating losses resulting from a qualified assets against the full tax rate, which is permitted by a resolution since 2009.<sup>35</sup> After the expansion measures, the tax advantage will no longer be known as the patent box but rather as the innovation box.

In 2011 and 2013, amendments are made to further accommodate innovative companies. The application process for a patent can take several years over which entrepreneurs have no control. Benefits achieved during the period between application for the patent and its granting are initially not eligible for the innovation box.<sup>36</sup> Starting from 2011, the legislator has decided that the threshold before being applicable for the box, is reduced by the amount of these fully taxed benefits.

Although multiple methods can be used to determine the qualified benefits, it has proven to be a challenging task for many companies. Especially for SMEs, the administrative costs can outweigh the tax advantage.<sup>37</sup> Since 2013, it is possible to determine the profits that qualify for the innovation box on a flat-rate basis.<sup>38</sup> The working of this regulation is further explained in section 3.6.

## 2.6 Implementation of BEPS action plan

The latest major changes to the innovation box are made in 2017, following a report by the Organisation for Economic Co-operation and Development (OECD). Globally integrated corporations increasingly use tax planners to exploit opportunities to minimize their tax burden.<sup>39</sup> The OECD has introduced an action plan to counter the development of base erosion and profit shifting (BEPS) issues in a co-ordinated and comprehensive manner.<sup>40</sup>

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<sup>33</sup> Kamerstukken II 2008/09, 32 128, nr. 3, p. 12.

<sup>34</sup> Kamerstukken II 2008/09, 32 128, nr. 3, p. 13.

<sup>35</sup> Besluit Staatssecretaris van Financiën van 11 augustus 2009, nr. DGB2009/4084M (Stcrt. 2009, 12556).

<sup>36</sup> Kamerstukken II 2010/11, 32 505, nr. 3, p. 7.

<sup>37</sup> Nota van toelichting van het Besluit Staatssecretaris van Financiën van 20 december 2012, BLKB2012/417M (Stb. 2012, 694), p. 23.

<sup>38</sup> Besluit Staatssecretaris van Financiën van 20 december 2012, BLKB2012/417M (Stb. 2012, 694), p. 5.

<sup>39</sup> OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, p. 8.

<sup>40</sup> OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, p. 11.

BEPS Action 5 addresses harmful opportunities for multinationals to avoid taxes through intellectual property (IP) regimes.<sup>41</sup> It allows countries to implement a preferential regime, provided that it only generates a benefit in the case of substantial activity. The presence of economic activity by the taxpayer himself is determined using the nexus approach. This approach requires companies to determine the benefits that qualify for the innovation box based on the proportion of expenditures directly related to R&D activities undertaken in the Netherlands.<sup>42</sup>

Only expenditures made by the taxpayer himself on (1) IP assets for which a patent is granted or (2) copyrighted software, qualify for the nexus ratio. Smaller enterprises with an average turnover below €50 million also qualify with IP assets that share features of patents.<sup>43</sup> Therefore, most SMEs are still applicable for the innovation box if solely an R&D certificate is granted. Meaning that profits obtained by investments in the production process are treated differently for large and small taxpayers.<sup>44</sup> Since 2017, the Dutch innovation box complies with the BEPS action plan, whereafter amendments only affected the effective tax rate.

## 2.7 Partial conclusion

This chapter covered the establishment and subsequent changes of the Dutch innovation box. In order to analyze its effectiveness and target audience reach, it is crucial to understand the purpose behind these changes.

The Dutch government introduced a patent box in 2007, which was later renamed to innovation box in 2010, with the goal of improving the business environment and attracting innovative companies. The Secretary of State did require the tax advantage to be budgetary manageable and practically executable. To meet these criteria, the box had stringent access requirements and limited applicability. In addition, the tax benefit was, and still is, not applicable to IB-entrepreneurs.

The fact that the innovation box was not used frequently, caused the Dutch Cabinet to implement several changes. The amendment to open up the box to R&D assets and the option to apply a flat-rate scheme were primarily aimed at SMEs. Furthermore, changes were made to comply with a plan of the OECD to combat tax avoidance. The following chapter will discuss

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<sup>41</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

<sup>42</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 24-25.

<sup>43</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 26.

<sup>44</sup> Vleggeert, *WFR* 2016/49, p. 4.

the law articles and working of the current innovation box. This will also show how the Dutch government has implemented point 5 of the BEPS Action Plan.

## Chapter 3: The current Dutch innovation box

### 3.1 Introduction

The previous chapter discussed the evolution of the innovation box since its introduction in 2007. The basis of the current innovation box thus lies in the OECD Action Plan, which was introduced to counter tax evasion.<sup>45</sup> Point 5 of the BEPS Action Plan allows taxpayers to profit from an IP regime only in the presence of substantial activity. As a result, companies must apply the nexus approach to determine the benefits that are applicable to be taxed at a reduced rate.<sup>46</sup> The Netherlands has implemented this approach in 2017. This chapter will elaborate on the law articles within the Dutch corporate tax act currently devoted to the innovation box. An example to explain the working of the tax benefit is given as well. The conclusion that ends this chapter will answer the following sub-question: *What does the current innovation box, described in articles 12b-12bg Dutch CITA, entail?*

### 3.2 Design of the tax credit

The innovation box is designed to encourage entrepreneurs to engage in innovative activities in the Netherlands. Earlier, another R&D tax credit called the WBSO was discussed, which benefits companies regardless the success of the innovative asset. The innovation box provides a benefit only when actual profits are generated from the development of an R&D asset.<sup>47</sup> The criteria to which the taxpayer and the asset must comply will be further explained in the following sections. In short, article 12b of the Dutch CITA indicates that a taxpayer has the option to apply a tax credit on revenues gained from a qualified, self-produced immaterial asset.<sup>48</sup>

The legislator has chosen to partially exempt profits that qualify for the innovation box from taxation. Since 2021, a share of 65.2 percent (1- (9/25,8)) is exempted, resulting in an effective tax rate of 9% if the marginal rate is 25.8% and 6.6% for a marginal rate of 19%. The first tax bracket is only applicable to profits up to €200.000.<sup>49</sup> Regardless the number of qualifying assets that a taxpayer has produced, these are all added to solely one innovation box.<sup>50</sup>

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<sup>45</sup> OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing.

<sup>46</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 26.

<sup>47</sup> Kamerstukken II 2005/06, 30 107, nr. 2, p. 24.

<sup>48</sup> Artikel 12b Wet op de Vennootschapsbelasting 1969..

<sup>49</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.B.e*, p. 1.

<sup>50</sup> Kamerstukken II 2005/06, 30 572, nr. 8, p. 23.

### 3.3 Criteria of the innovation box

The previous section mentioned several terms that impose requirements on the taxpayer to be eligible for the innovation box. A distinction is made between large and small taxpayers, with more lenient access requirements for smaller companies. The Dutch government has adopted the criteria from the BEPS Action Plan to define a small taxpayer.<sup>51</sup> Article 12ba paragraph 2 Dutch CITA states that companies with gross profits from R&D assets up to €37.5 million over 5 years, and a maximum group-wide turnover of €250 million over the same 5 years, are seen as small.<sup>52</sup> Gross profits are net revenues generated by the intangible asset plus any costs incurred after the intangible asset is finished.<sup>53</sup>

#### 3.3.1 Immaterial asset

Whether a taxpayer is eligible for the innovation box depends, among other factors, on the produced immaterial asset. However, the definition of immaterial assets is missing in the articles dedicated to the innovation box (Articles 12b-12bg Dutch CITA). The law only states that trademarks, logos, and assets similar to those do not qualify. From parliamentary documents, it can be inferred that the following elements should apply to the term immaterial asset: separability, identifiability, transferability, and repeatability.<sup>54</sup> Identifiability refers to the requirement that the intangible asset and goodwill must be distinguishable. Separability means that the economic benefits generated by the asset can be traded independently from benefits related to other assets.<sup>55</sup> Moreover, the immaterial asset must be likely to generate benefits over multiple years.

As mentioned earlier, the innovation box was thoroughly revised in 2017 to comply with the OECD's requirements aimed at preventing tax avoidance. The OECD defines intangible asset as follows: *'Something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances'*.<sup>56</sup> It is noteworthy that the Secretary of State does not make a reference to this definition, even though, in my opinion, the meaning aligns with the elements he has mentioned. Both the definition of the Secretary of State and that of the OECD state that benefits must arise in the case of (fictional) trade. In addition, the requirement that it should be non-material and/or non-financial aligns between both definitions.

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<sup>51</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 28.

<sup>52</sup> Artikel 12ba lid 2 wet op de vennootschapsbelasting 1969.

<sup>53</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.C.a*, p. 2.

<sup>54</sup> Kamerstukken II 2016/17, 34 552, nr. 14, p. 39; In Dutch: separeerbaarheid, identificeerbaarheid, overdraagbaarheid en herhaalbaarheid.

<sup>55</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.B.b*, p. 3.

<sup>56</sup> OECD (2022), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, OECD Publishing, Paris, p. 247.

### 3.3.2 Self-produced

A second requirement stipulates that the taxpayer who is willing to apply the innovation box must have produced the intangible asset themselves. According to the Secretary of State, this means that the immaterial asset must be developed for the account and risk of the taxpayer. This requirement is met when an entity has decision-making authority and is functionally capable of directing the research and development activities.<sup>57</sup> The aim of this criterion is to grant benefits only to taxpayers engaged in substantial economic activities in the Netherlands. The substance-criterion from the BEPS Action Plan stands separate from this.<sup>58</sup>

Outsourcing of R&D activities is also possible as long as the for-account-and-risk-criterion is met. It is important, however, that the taxpayer is able to prove that this requirement is met. Therefore, in the case of contract-R&D, it is possible for the contracting party to qualify for the innovation box, even though the contracted party is mainly responsible for generating the asset.<sup>59</sup> Even purchasing an intangible asset can eventually qualify as a self-produced asset. This is the case if the taxpayer develops the purchased asset into a new intangible asset for which a separate R&D certificate and/or patent is granted.<sup>60</sup> According to article 12ba paragraph 5 of the Dutch CITA, the innovation box is only applicable to the developed portion of the immaterial asset.<sup>61</sup>

Whether the taxpayer complies with the above-mentioned criteria needs to be determined based on the facts and circumstances of each separate case. Not clearly explaining the criteria can result in additional work for companies and the tax authorities, which could be a threat to the effectiveness of the innovation box in my opinion.

### 3.3.3 Entry ticket innovation box

The distinction between small and large taxpayers is relevant in determining the entry tickets to the innovation box. For smaller taxpayers, an intangible asset is deemed as qualifying if an R&D certificate has been issued for the asset.<sup>62</sup> For other taxpayers, an additional legal ticket is required as well. By requiring two entry tickets for the larger entities, the Netherlands goes beyond the requirements set out in the OECD report<sup>63</sup>, aiming to ensure that research and developments activities take place in the Netherlands.<sup>64</sup>

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<sup>57</sup> Belastingdienst/Directie Vaktechniek Belastingen, besluit van 1 september 2014, nr. BLKB2014/1054M, p. 3.

<sup>58</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.B.c*, p. 1.

<sup>59</sup> Belastingdienst/Directie Vaktechniek Belastingen, besluit van 1 september 2014, nr. BLKB2014/1054M, p. 3.

<sup>60</sup> Belastingdienst/Directie Vaktechniek Belastingen, besluit van 1 september 2014, nr. BLKB2014/1054M, p. 4.

<sup>61</sup> Artikel 12ba lid 5 Wet op de Venootschapsbelasting 1969.

<sup>62</sup> Artikel 22 Wet vermindering afdracht lb en pvv.

<sup>63</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

<sup>64</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.C.a*, p. 2.

To be able to use the innovation box, it is essential that there is a direct causal relationship between the self-produced intangible asset and the business activities for which the *Rijksdienst voor Ondernemend Nederland* (RVO) has issued an R&D certificate.<sup>65</sup> The RVO is part of the Dutch Ministry of Economic Affairs and Climate Policy, and issues an R&D certificate for activities aimed at developing products, product processes, or software that are technically new for the company.<sup>66</sup> The fact that an R&D certificate is also issued for technical-scientific research is not relevant, as a direct causal relationship with an intangible asset is often lacking in such cases. Routine development activities and the development of a prototype with user value are not eligible for an R&D certificate. A prototype has user value if it can be used as a business asset or has commercial significance.<sup>67</sup> In addition, no certificate is issued for the application, assembly, or implementation of software, or for projects that use already available software.<sup>68</sup>

For larger taxpayers, in addition to an R&D certificate, a legal ticket related to the intangible asset is required, which can take different forms: (1) a granted, or pending, patent or plant breeder's right; (2) software that also qualifies for the R&D certificate; (3) non-chemical plant protection products and biocides; (4) a permit to trade a pharmaceutical; (5) a supplementary protection certificate granted by *Octrooiencentrum Nederland*; (6) an utility model; (7) and an R&D asset that is related to an asset for which both an R&D certificate and a legal ticket are granted.<sup>69</sup> The second requirement is also met if a taxpayer holds an exclusive license to use one of the aforementioned legal tickets. This is particularly beneficial for group companies that centrally manage patents.<sup>70</sup>

The Netherlands complies with the OECD report by requiring a patent or something similar for larger taxpayers, but this does put them at a disadvantage compared to smaller taxpayers. As mentioned earlier, applying for a patent is time-consuming and expensive due to the need of extensive examination. In my opinion, it's remarkable that an R&D certificate is required for any type of taxpayer. This means that the Netherlands might impose stricter requirements than surrounding countries, which doesn't align with the objectives set by the government.

### 3.4 Benefits through nexus approach

To determine the extent to which the benefits are eligible for the innovation box, three steps must be followed. Firstly, the benefits arising from the qualifying intangible asset must be calculated. This can be done by using the fiscal arm's length pricing methodologies, on which is elaborated in the following sub-section. Subsequently, the calculated benefits are reduced by the remainder of the threshold amount. This threshold amount is further explained in

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<sup>65</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.C.b*, p. 1.

<sup>66</sup> *Rijksdienst voor Ondernemend Nederland*, RVO-192-2021/HL-INNO, p. 9.

<sup>67</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.C.b*, p. 2.

<sup>68</sup> *Rijksdienst voor Ondernemend Nederland*, RVO-192-2021/HL-INNO, p. 11.

<sup>69</sup> Artikel 12ba lid 1 onderdeel b *Wet op de Vennootschapsbelasting 1969*.

<sup>70</sup> *Kamerstukken II 2016/17*, 34 552, nr. 13, p. 18.

section 3.5. Lastly, the amount from step 2 is multiplied by the nexus ratio, which stems from the BEPS action plan.<sup>71</sup>

#### 3.4.1 Fiscal arm's length pricing methodologies

The benefits arising from a qualifying asset can be determined through (1) the per-asset method, (2) the stripping method, and (3) the cost-related method. The method chosen should align best with the nature of the business and the type of R&D activities that led to the qualifying intangible asset.<sup>72</sup>

##### *The per-asset method*

Under this method, the production costs and benefits eligible for the innovation box are determined separately for each individual qualifying intangible asset. It must be possible to calculate the benefits for each individual asset, which means that an innovation should not be intertwined within the entire business process.<sup>73</sup>

##### *The stripping method*

To apply this method, a company must segregate its core functions from its support functions. It is important, however, that research and development is one of the core functions of the business. After allocating a portion of the profit to the support functions, the remaining profit is divided among the core functions based on the extent to which they contributed to the profit. Only benefits resulting from research and development activities that have led to qualifying intangible assets are eligible for the innovation box.

##### *The cost-related method*

In businesses where the R&D function is considered supportive, benefits are determined based on the integral costs of the qualifying assets. Often, a markup of 8 to 15 percent of the costs is considered as a benefit for the innovation box.<sup>74</sup> The percentage is based on the market value of the benefit.

#### 3.4.2 The nexus approach

To ensure that companies can only benefit from a tax advantage if they engage in substantial economic R&D activities in the country that corresponds with that tax advantage, the OECD introduced the nexus approach. The so-called nexus formula is designed to establish a clear

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<sup>71</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

<sup>72</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.D.a*, p. 2.

<sup>73</sup> Besluit Staatssecretaris van Financiën van 13 december 2021, nr. 2021-22459 (Stcrt. 2021, 48152), p. 2.

<sup>74</sup> Besluit Staatssecretaris van Financiën van 13 december 2021, nr. 2021-22459 (Stcrt. 2021, 48152), p. 3.

link between the benefits eligible for the innovation box and the R&D activities carried out in the Netherlands, and looks as follows:<sup>75</sup>

$$\text{Qualifying benefits} = \frac{\text{Qualifying expenses} \times 1,3}{\text{Total expenses}} \times \text{benefits}$$

The qualifying expenses are expenses incurred by the taxpayer for the purpose of conducting research and development work on the qualifying asset themselves and expenses related to outsourcing R&D activities to a non-affiliated entity. An entity in which the taxpayer holds at least one-third of the interest is considered an affiliated entity according to Article 10a section 4 of the Dutch CITA.<sup>76</sup> The total expenses include not only the above-mentioned expenses but also the costs of outsourcing R&D activities within a group.<sup>77</sup> To avoid that taxpayers are entirely discouraged to outsource activities within the group, the qualifying expenses are multiplied by 1.3. The effective tax rate of 9%, or 6.6% if the lower tax bracket is applicable, is eventually applied to the amount of qualifying benefits, although these are first reduced by the threshold amount. The determination of the threshold amount is explained in the following sub-section.

### 3.5 Threshold before being eligible

Profits arising from innovations are only eligible for the innovation box if they exceed the threshold amount determined under Article 12bc section 1 of the Dutch CITA.<sup>78</sup> This requirement is also known as the "ingrowth rule" and essentially states that the production costs of the qualifying assets must be recouped before the innovation box can be applied. This includes all costs necessary to make the asset ready for operation.<sup>79</sup> Furthermore, the threshold is also increased if losses have been deducted at the regular rate or if a qualifying asset is transferred from abroad to a Dutch corporation. The latter only applies if the fair market value is higher than the production costs.

### 3.6 Flat-rate scheme

Since 2013, it has been possible to calculate the benefits that qualify for the innovation box by using a flat-rate scheme. Both large and small taxpayers can apply this method if they have produced a qualifying intangible asset, and it does not matter whether the profits actually derive from this asset.<sup>80</sup> Taxpayers are allowed to attribute 25% of their annual profit to the

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<sup>75</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, 25.

<sup>76</sup> Artikel 10a lid 4 Wet op de Vennootschapsbelasting 1969.

<sup>77</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.D.b*, p. 2.

<sup>78</sup> Artikel 12bc lid 1 Wet op de Vennootschapsbelasting 1969.

<sup>79</sup> Van de Streek, in: *Cursus Belastingrecht Vpb.2.2.13.E.b*, p. 1.

<sup>80</sup> Besluit Staatssecretaris van Financiën van 13 december 2021, nr. 2021-22459 (Stcrt. 2021, 48152), §6.1.



innovation box with a maximum amount of €25.000. Per asset, the flat-rate scheme can only be applied for three consecutive years.<sup>81</sup>

About one-third of all taxpayers who use the innovation box determine their qualifying benefits using the flat-rate scheme.<sup>82</sup> From my point of view, this scheme is very important to keep the innovation box applicable to SMEs. However, I wonder whether the innovation box, in its current form, is not too complex to use and leads to excessively high administrative costs. In my opinion, It should not be the case that companies opt for the simpler flat-rate scheme when they could obtain a greater advantage through regular use of the innovation box.

### 3.7 Example

Company X is considered a small taxpayer and has produced an intangible asset for which an R&D certificate has been issued. The company has outsourced less than 50% of its R&D activities, meeting the requirement that the asset is developed by the company itself. The total development costs are €200,000. In year 1, the company incurred a loss of €50.000, which was deducted that year. In year 2 and year 3, the company made a profit of €175.000 each year.

Company X can only apply the innovation box when the qualifying benefits exceed the threshold of €250,000. This is the case in year 3, so in that year, €100.000 will be taxed at an effective rate of 9%.

### 3.8 Partial conclusion

In this chapter, the working of the innovation box has been discussed. The innovation box encourages entrepreneurs to innovate, and when this is done successfully, it results in a tax advantage. To be eligible to use the innovation box, a taxpayer must produce an intangible asset at their own risk and expense for which an R&D certificate has been issued. For larger taxpayers, a second access ticket is also required. The definition of an immaterial asset cannot be derived from the law articles devoted to the innovation box, and I find it remarkable that the legislator does not align with the OECD's definition. In addition, the methods that can be used to calculate the qualifying benefits have been discussed. The first step is to calculate the benefits arising from the intangible asset using the transfer pricing methodology. Subsequently, only the benefits that exceed the threshold are eligible. To grant a benefit only in the case of substantial economic activities, the nexus approach must be applied as the final step. Determining the qualifying benefits often results in high administrative costs, which could explain why approximately 30% of the companies that opt for the innovation box make use of the flat-rate scheme. This method is primarily aimed at SMEs, as their profits that are

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<sup>81</sup> Artikel 12bd Wet op de Vennootschapsbelasting 1969.

<sup>82</sup> Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, p. 11.

attributable to the innovation box often do not balance out these high administrative costs. The next chapter will delve further into the target group and effectiveness of the innovation box.

## Chapter 4: The objectives of the innovation box

### 4.1 Introduction

In the previous chapter, the working of the innovation box is discussed. It is equally important to understand why the government has chosen to provide a tax advantage to innovative companies. While preferential regimes like the innovation box can be costly measures, a significant number of European countries have opted to stimulate innovation through such schemes. In this chapter, I will elaborate on the importance of innovation and why it is essential for the government to encourage it. As the benefits of innovation extend beyond the innovating company itself.

Furthermore, sections 4.2 and 4.3 will discuss the purpose and target audience for which the innovation box was introduced. Since much of this was already covered in Chapter 2, these aspects will be elaborated on in a brief manner.

The innovation box is of course part of the Dutch tax system and is one of the fiscal schemes through which the government seeks to influence the behavior of citizens and businesses. In 2022, the State Secretary decided to evaluate almost all of these fiscal schemes, including the innovation box. This chapter will state the criteria against which the Dutch fiscal schemes will be assessed. Ultimately, this chapter will provide an answer to the third sub-question: What objectives does the innovation box in article 12b Dutch CITA serve and who is the facility targeted for?<sup>83</sup>

### 4.2 Importance of innovation

Innovation is a broad concept that can take on various forms. Knowledge, entrepreneurship, and the availability of financial resources are widely regarded as important ingredients for innovation.<sup>84</sup> When specifically considering innovation in the context of fiscal arrangements, it can be described as innovations in the way entrepreneurs design, produce, and deliver their products to customers.<sup>85</sup>

One might wonder why the government should encourage businesses to invest in research and development activities. After all, the future of a company may seem uncertain if the company's management does not invest in R&D in the absence of fiscal facilities.<sup>86</sup> Nevertheless, it is crucial for the government to stimulate businesses to innovate, as innovation has a positive impact on society that extends beyond the benefits to an individual company. Innovation contributes to economic growth, improves employment opportunities, and is vital for prosperity. Since these external effects do not directly benefit an individual

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<sup>83</sup> Artikel 12b Wet op de Vennootschapsbelasting 1969.

<sup>84</sup> Dialogic, *Het Nederlandse investeringsklimaat*, Utrecht: 2021, p. 20.

<sup>85</sup> Vording, *TFO* 2016/143.3, p. 1.

<sup>86</sup> Kemmeren, *WFR* 2009/433, p. 4.

company, while they bear the costs of innovation, companies tend to invest less than is socially desirable.<sup>87</sup>

Furthermore, investments in R&D activities are associated with significant uncertainties. These often costly investments in innovation are risky, as it is not guaranteed that the incurred costs will result in a usable outcome. In addition, there is the risk that the benefits of an innovation may flow to others than the company itself.<sup>88</sup>

However, it is worth questioning whether the innovation box can positively influence the uncertain outcome of an innovation, as the box only provides a tax advantage when positive profits have been realized. In my opinion, a reduced tax rate is justified because society also benefits from investments made by an individual company, but large investments remain a significant risk due to the threshold provision in Article 12bc of the Dutch CITA.<sup>89</sup> In my view, the impact of the innovation box would be even greater without the so-called "ingrowth" rule, provided that companies still have the option to fully deduct the incurred costs.<sup>90</sup>

In addition, I think it is important to mention that companies engaged in innovative activities benefit from a stable fiscal policy from the government. An investment in the development of a new product or production process is often a long-term project, making it crucial for a company to have certainty about tax advantages that can be applied in the future. Continuously changing regulations regarding the innovation box introduce additional uncertainties for companies, potentially hindering innovation.<sup>91</sup> This should be taken into account when pleading for adjustments to or even the abolition of the innovation box.

#### 4.3 Objectives of the innovation box

From the parliamentary documents concerning the innovation box, it is evident that the government introduced the innovation box with two primary objectives. Firstly, the legislator aims to encourage companies to invest more in research and development.<sup>92</sup> Secondly, the innovation box was introduced in 2007 with the intention to attract more business activity to the Netherlands, and eventually with the goal to strengthen its competitive position.<sup>93</sup>

Granting a tax advantage for successful innovation also aligns with the goals set during the European Council meeting in Lisbon in 2000, where it was agreed that EU countries should allocate 3% of their national income to research and development.<sup>94</sup> It seems to me that due

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<sup>87</sup> Brief van Minister van Economische Zaken van 11 november 2022, nr. DGBI-I&K/22545365, p. 6.

<sup>88</sup> Vording, *TFO* 2016/143.3, p. 2.

<sup>89</sup> Artikel 12bc Wet op de Venootschapsbelasting 1969.

<sup>90</sup> 'Ingrowth' rule refers to the threshold provision in article 12bc of the Dutch CITA.

<sup>91</sup> Vording, *TFO* 2016/143.3, p. 3.

<sup>92</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 21.

<sup>93</sup> Kamerstukken II 2005/06, 30 107, nr. 2, p. 2.

<sup>94</sup> Kamerstukken II 2005/06, 30 572, nr. 8, p. 24.

to the Lisbon objectives, it was necessary for the Netherlands to introduce a facility to retain innovative companies. After all, neighboring countries were also encouraged to provide incentives for innovation activities.

#### 4.4 Target group goals

The innovation box is a tax facility that has been part of the Dutch corporate income tax system since 2007.<sup>95</sup> Both domestic and foreign companies are subject to corporate income tax in the Netherlands and can, if they meet the requirements as stated in chapter 3, opt for the innovation box. As previously explained, entrepreneurs subject to the Dutch personal income tax cannot apply for this facility, while the legislator has decided to treat IB-entrepreneurs and corporate income taxpayers equally under the WBSO scheme, which also aims to encourage innovation.

In Chapter 2, the evolution of the innovation box is discussed. It is evident from accepting an R&D certificate as entry ticket since 2008 and from allowing to use a flat-rate calculation method from 2013 that the government's objective has been to make this facility applicable to small and medium-sized enterprises (SMEs) as well.<sup>96</sup> A company is considered an SME if, on the one hand, it employs fewer than 250 full-time equivalents (FTEs) and, on the other hand, has an annual turnover of less than €50 million and/or an annual balance sheet total of less than or equal to €43 million.<sup>97</sup> Investments directed towards innovation can require a significant amount of capital, which poses substantial risks for SMEs. Therefore, fiscal incentives related to innovation are particularly crucial for smaller businesses, as they may face more difficulty in attracting investors and capital.<sup>98</sup>

#### 4.5 A simpler tax system

The Netherlands has numerous tax schemes through which the government seeks to either encourage or discourage certain behaviors among its citizens. The large amount of tax schemes has made the tax system complex, although clear evidence that each of these schemes achieves their intended goals does not exist. In response to the desire of the Dutch Parliament, State Secretary Van Rij has committed to working towards a simpler tax system, with solely tax schemes that contribute to the public interest.<sup>99</sup>

To achieve this, Van Rij announced in 2022 that most of the tax schemes in the Netherlands would be evaluated based on four criteria:<sup>100</sup>

1. Whether the objective of a tax scheme is still relevant and necessary;

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<sup>95</sup> Wet op de Venootschapsbelasting 1969.

<sup>96</sup> Kamerstukken II 2007/08, 31 206, nr. 15, p. 8.

<sup>97</sup> Aanbeveling (EU) 2003/361/EG van de Commissie van 6 mei 2003 betreffende de definitie van kleine, middelgrote en micro-ondernemingen (PbEU 2003, L 124), p. 39.

<sup>98</sup> Vording, *TFO* 2016/143.3, p. 2.

<sup>99</sup> Brief van Staatssecretaris van Financiën van 31 oktober 2022, nr. 2022-0000257727, p. 1.

<sup>100</sup> Brief van Staatssecretaris van Financiën van 31 oktober 2022, nr. 2022-0000257727, p. 3.

2. Whether prior evaluations indicate that a scheme is ineffective and/or inefficient;
3. Whether the tax authorities face difficulties in administering and enforcing the scheme due to its complexity;
4. Whether taxpayers frequently misapply the scheme in practice.

The innovation box is one of the tax schemes that will be evaluated based on these criteria. While innovation is of great importance to Dutch society and the economy, fiscal benefits provided by the government do result in a loss of government revenue. The costs associated with the innovation box have significantly increased in recent years, making it relevant to assess whether the innovation box is achieving its objectives and whether it fits within a simplified tax system.<sup>101</sup>

In my opinion, simplifying the tax system does come with a potential risk with regard to maintaining the attractiveness of the Dutch business climate. Abolishing tax benefits can particularly discourage large multinationals from keeping their headquarter in the Netherlands. In recent years, major companies like Shell and Unilever have already relocated their headquarters abroad, and more companies may follow their example if the tax environment in surrounding countries proves to be more favorable. Although the public opinion is increasingly turning against favorable tax facilities for multinationals, it is crucial for the Dutch economy and prosperity that these companies choose to establish themselves here. In my view, the attractiveness of the Dutch business climate should not come at the expense of the desire to simplify the tax system.

#### 4.6 Partial conclusion

This chapter elaborated on the importance of innovation and the objectives of the innovation box. In this context we speak about innovations in the way that entrepreneurs design, produce and deliver their products to customers. It is important to invest in innovation, as both the company and society will benefit from these investments. The external effect and the uncertainties concerning large investments explain the urge for fiscal benefits.

From section 4.3 we can conclude that the innovation box is introduced with the objective to encourage investments in research and development and to attract business activity to the Netherlands. Because of the Lisbon objectives, the tax benefit is also necessary to retain innovative companies. The target group consists of domestic and foreign companies with innovative activities in the Netherlands.

The innovation box is recently evaluated on four criteria concerning its relevance and working in practice, as Secretary of State Van Rij has the desire to simplify the tax system. In my

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<sup>101</sup> Brief van Staatssecretaris van Financiën van 31 oktober 2022, nr. 2022-0000257727, p. 2.

opinion, simplifying the tax system might be a risk regarding the attractiveness of the Dutch business climate.

## Chapter 5: Effectiveness and Target Group Reach

### 5.1 Introduction

In the previous chapter I discussed the objectives that the Dutch government has set when it introduced the innovation box in 2007. This chapter will analyse if these objectives are actually achieved by the innovation box in its current form. After all, several amendments have been made over the years which should contribute to achieving those objectives but it could well be that these changes did not contribute to or even deteriorate from the effectiveness of the innovation box. Section 5.2 will delve further into the target group reach and section 5.3 will elaborate on the effectiveness of the tax facility which was introduced to stimulate innovation. In section 5.4 I will discuss the results of the evaluation on numerous Dutch fiscal schemes, mainly focusing on the outcomes that relate to the effectiveness and target group reach of the innovation box. Finally, the partial conclusion will provide an answer to the fourth sub-question: What effect did the innovation box have on innovation and the business climate, and what kind of companies make use of the tax benefit?

### 5.2 Target group reach

To assess the impact of the innovation box on R&D, innovation and the business climate, it is also important to outline the type of enterprises that benefit from the tax advantage. This section will primarily focus on the number and size of the companies that have opted for the innovation box and the extent to which various legislative changes have influenced this.

#### 5.2.1 Type of companies that use innovation box

In Chapter 4 I already mentioned that both SMEs and large corporations are part of the target audience for the innovation box. For the purposes of this thesis, companies with more than 250 full-time employees are considered large corporations. The government has made the tax benefit more accessible for SMEs, for example, by introducing the flat-rate calculation method, although using this method limits the qualifying benefits to an amount of €25.000.<sup>102</sup> On the other hand, the administrative costs are significantly reduced when using this simpler method since there is no need to calculate to what extent the profits actually derive from the qualifying asset.<sup>103</sup> Section 5.2.3 will delve deeper into the significance of the flat-rate scheme.

In 2019, a total of 3,320 companies opted for the innovation box, of which nearly three-quarters (73.3%) are categorized as SME.<sup>104</sup> As mentioned in section 2.2, only companies established as legal entities are eligible for the innovation box, natural persons are excluded. The fact that, compared to the large enterprises, more SMEs make use of the tax benefit

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<sup>102</sup> Artikel 12bd Wet op de Vennootschapsbelasting 1969.

<sup>103</sup> Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, *Continuïteit en Complexiteit*, p. 11.

<sup>104</sup> Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, *Continuïteit en Complexiteit*, p. 12.



makes sense, given that the vast majority (99.3%) of companies in the Netherlands fall within the SME sector.<sup>105</sup>

While the Dutch government has clearly stated that large multinational enterprises are part of the target audience for the innovation box, it is noteworthy to mention that in 2019, over 90% of the budgetary impact of the innovation box is caused by large enterprises.<sup>106</sup> This can be partly explained by the fact that the innovation box only provides a benefit in the case of successful innovation, and the absolute profits of large enterprises are significantly higher than those of SMEs. It remains a question of whether it is socially justifiable that mainly a small group of multinationals seems to benefit from a tax measure that costs approximately 1.5 billion euros annually.<sup>107</sup> As mentioned in section 4.2, a fiscal incentive regarding innovation is justified as the benefits of successful innovations extend beyond the company itself, while businesses do fully bear the costs of a failed investment. The innovation box, however, does not impact the profitability of a qualifying asset and is, therefore, not a solution for the uncertainties associated with investments. From my point of view, whether the innovation box is socially desirable depends on whether the benefits that these large companies enjoy are in proportion to their contribution to employment and the society as a whole. If this is the case will be further discussed in section 5.3.

#### 5.2.2 Before and after legislative amendments in 2017

In order to answer the main research question of this thesis, it is important to clarify whether the group of companies currently using the innovation box aligns with the target audience that the Dutch government had in mind when introducing this tax incentive in 2007.

In 2015, an evaluation of the innovation box was conducted, which analyzed the effectiveness and target audience reach from 2007 to 2013.<sup>108</sup> This evaluation revealed that, due to the allowance of an R&D certificate as an entry requirement since 2008 and the introduction of the flat-rate calculation method in 2013, the number of users of the innovation box significantly increased.<sup>109</sup> The substantial impact of the softer entry requirements since 2008 is also evident from the fact that 82% of companies indicated that they make use of the innovation box through an R&D certificate.<sup>110</sup> Furthermore, 80% of the respondents stated that the benefits obtained from the innovation box would be less sufficient if solely having an R&D certificate as entry ticket is no longer sufficient.<sup>111</sup>

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<sup>105</sup> CBS (2019) *Bedrijven; bedrijfstak*. CBS StatLine. Retrieved on 26 October 2023.

<sup>106</sup> Kamerstukken II 2005/06, 30 107, nr. 2, p. 23; Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, *Continuïteit en Complexiteit*, p. 12.

<sup>107</sup> Van Hoorn, Kranendonk & de Mol van Otterloo, ESB 2021/4802, p. 495.

<sup>108</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015.

<sup>109</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 7.

<sup>110</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 46.

<sup>111</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 46.

The responses from the survey are, in my opinion, noteworthy in light of the legislative changes related to the innovation box that occurred in 2017. Since that time, only smaller taxpayers are allowed to use the tax benefit if they have been issued an R&D statement.<sup>112</sup> Larger companies now require a second entry ticket, which can take various forms but is likely to be similar to a patent. This change might explain why in 2012, 88% of companies opting for the innovation box belonged to the SME category, whereas in 2019, only 73% of businesses fall into this group. In addition, the financial impact caused by the large companies using the innovation box increased by more than 13% compared to 2013.<sup>113</sup> Although it is important to mention that the profits in the years 2010-2012 of the larger companies could have been lower due to a financial crisis in 2008, from which the market was still recovering in those years.

All in all, it is difficult to determine whether the legislative changes in 2017 have had an impact on the number of companies opting for the innovation box. Due to the distinction between smaller and larger taxpayers, I believe the changes have little impact on smaller businesses, as they do not require a second access ticket. On the other hand, larger enterprises often have the resources to apply for a patent, so the legal changes also have little influence on whether they opt for the innovation box or not.

### 5.2.3 Importance of flat-rate scheme

The importance of the flat-rate calculation method is in my opinion highlighted by the fact that approximately one-third (32.7%) of the businesses opting for the innovation box uses this straightforward calculation method.<sup>114</sup> The majority (87.9%) of companies that use this method belong to the SME sector, which is logical given the fact that the profits that they can attribute to the innovation box are often not significantly high and therefore fall below the annual limit of €25.000.<sup>115</sup>

The fact that calculating the portion of profits that are related to the qualifying asset is considered as one of the most challenging elements of the innovation box contributes, in my opinion, to the popularity of the simplified method.<sup>116</sup> I would, therefore, be in favor of changing the maximum period of three years during which the simplified calculation method can be used, which applies per asset, to an indefinite period. From my point of view, the financial impact of this change is very low, while it aligns with the goals of making the innovation box more accessible for SMEs.

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<sup>112</sup> The definition of a smaller taxpayer is elaborated on in section 3.3.

<sup>113</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 7; Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, *Continuïteit en Complexiteit*, p. 12.

<sup>114</sup> Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, *Continuïteit en Complexiteit*, p. 12.

<sup>115</sup> Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, *Continuïteit en Complexiteit*, p. 12; Limit as described in article 12bd Dutch CITA.

<sup>116</sup> Jaarverslag Coördinatiegroep taxhavens en concernfinanciering 2021, *Continuïteit en Complexiteit*, p. 11.

### 5.3 Effectiveness of innovation box

As stated in section 4.3, the innovation box is introduced with the objective to encourage investments in research and development and to attract business activity to the Netherlands. This sections will further discuss if these objectives are achieved by the innovation box in its current form.

#### 5.3.1 Effect on innovation

The evaluation conducted in 2015 states that for the period ranging from 2008 until 2012, econometric research shows that, on average, users of the innovation box reinvest 54 eurocents in R&D and innovation for every one euro of tax reduction caused by the use of the tax credit.<sup>117</sup> It might seem that this effect is quite low, especially compared to the ‘Bang-for-the-Buck’ rate of the WBSO, which is approximately 1.<sup>118</sup> However, the report emphasizes that a rate of 0,54 aligns with findings in other literature and more significance should be given to the ‘spillover’ effect of the innovation box.<sup>119</sup> The ‘spillover’ effect refers to the extent to which investment in R&D activities come along with positive externalities. The innovation box does contribute to the business climate in the Netherlands by creating strong networks between innovative companies.<sup>120</sup> On the contrary, the CPB argues that because of the fact that innovations are protected by Intellectual Property Rights, companies are able to capture a large part of the societal benefits which decreases the positive spillover effect.<sup>121</sup>

It is noteworthy to me that the report emphasizes that the innovation box might not be the most suitable way to stimulate investments in R&D, as the government has no influence on how companies spend the benefits that are obtained because of the fact that their profits are taxed at a reduced rate.<sup>122</sup> Velzing agrees with the evaluation report on the fact that the innovation box does not successfully stimulate companies to participate in new innovative investments. He mentions the possibility for the government to oblige companies to reinvest the benefits obtained by use of the innovation box in new R&D activities.<sup>123</sup> From my point of view, this idea does contribute to the effectiveness of the tax facility, although I do understand that this increases the administrative costs of the innovation box even more.

#### 5.3.2 Attractive business climate

The evaluation also states that the innovation box does have a positive impact on the business climate, although companies emphasize that the place of business is not solely chosen based on fiscal arrangements.<sup>124</sup> Hemels mentions that in 2017 already 21 countries that are

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<sup>117</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 8.

<sup>118</sup> Dialogic, *Evaluatie WBSO 2011-2017*, Utrecht: 2019, p. 11.

<sup>119</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 8.

<sup>120</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 9.

<sup>121</sup> CPB Netherlands Bureau for Economic Policy Analysis et. Al, *A Study on R&D Tax Incentives*, The Hague: 2014, p. 45.

<sup>122</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 8.

<sup>123</sup> Velzing, *ESB 2022/4806*, p. 84.

<sup>124</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015, p. 8.

member of the European Union have implemented a patent box and argues that all countries would be better off if they jointly agree to abolish the patent box facilities.<sup>125</sup> I do think that because of the fact that neighboring countries have also introduced a patent box facility, the innovation box does not contribute significantly in attracting new companies to the Netherlands, but mainly prevents large corporations to move their R&D activities to other countries.

#### 5.4 Outcome of evaluation Dutch fiscal schemes

In mid-2023, Secretary of State Van Rij presented the report that evaluates the Dutch fiscal arrangements to the Dutch House of Representatives.<sup>126</sup> For the purposes of this thesis, it is particularly relevant to discuss the assessments of the innovation box regarding the effectiveness and the justification for government intervention. For each fiscal arrangement, all criteria have received a positive, negative, or uncertain score.

The report indicates that none of the previously mentioned criteria has been assessed negatively regarding the innovation box.<sup>127</sup> The fact that the effectiveness of the innovation box received a positive score can be explained by the assessment being based on conclusions from previous evaluations.<sup>128</sup> The grounds on which the positive analysis is based, therefore, align with the results from the evaluation report from 2015 discussed in Section 5.3.1.<sup>129</sup>

According to the report, the goals of the innovation box are still up-to-date which justifies government intervention. The positive assessment is partly because the tax advantage encourages investment in activities that generate positive externalities.<sup>130</sup> However, the CPB has a different perspective, arguing that government intervention is only warranted in cases of market failure, which they argue does not apply to patent boxes. They believe that patents protect companies against imitation and actually encourage other companies to invest in innovation.<sup>131</sup> From my point of view, the CPB's argument may hold for large corporations, but it overlooks small and medium-sized businesses that can use the innovation box through an R&D statement. Thus, I do agree with the findings from the report published in 2023. In my opinion, the innovation box is aligned with current social and political themes, such as those related to the environment and energy transition. Tax expert Christians also points out that the innovation box can specifically stimulate MKB businesses to contribute to current environmental and energy goals through innovative investments.<sup>132</sup>

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<sup>125</sup> S. Hemels, 'The Dutch R&D Incentives: A Triumph for innovation or a Lobby Success?', 2019, p. 10.

<sup>126</sup> Brief van Staatssecretaris van Financiën van 7 juli 2023, nr. 2023-0000162264.

<sup>127</sup> Ministerie van Financiën, Ambtelijk rapport Aanpak fiscale regelingen, juni 2023, p. 40.

<sup>128</sup> Ministerie van Financiën, Ambtelijk rapport Aanpak fiscale regelingen, juni 2023, p. 19.

<sup>129</sup> Dialogic, *Evaluatie innovatiebox 2010-2012*, Utrecht: 2015.

<sup>130</sup> Ministerie van Financiën, Ambtelijk rapport Aanpak fiscale regelingen, juni 2023, p. 25.

<sup>131</sup> CPB Netherlands Bureau for Economic Policy Analysis et. Al, *A Study on R&D Tax Incentives*, The Hague: 2014, p. 45.

<sup>132</sup> S. Christians, 'Innovatiebox voor het MKB verdient positieve evaluatie', accountancy van morgen.nl 17 november 2022.

## Chapter 6: Conclusion

The previous four chapters all contained a partial conclusion in which an answer was provided on one of the four sub-questions. Based on these answers, this chapter will provide an answer to the main research question of this thesis:

*Does the innovation box in the articles 12b-12bg Dutch Corporate Income Tax Act 1969, as of 2021, still meet the target group and effectiveness goals as stated when the tax benefit was introduced in 2007?*

The Dutch government introduced the innovation box in 2007, although it was known as the patent box until 2010. Since introduction, the innovation box has two primary objectives: Firstly, the legislator aims to encourage companies to invest more in research and development. Secondly, the innovation box is intended to attract more business activity to the Netherlands, with the goal to strengthen its competitive position. The target group that the government aims to reach with the innovation box consists of both SMEs as large corporations. In addition, the innovation box is solely targeted for enterprises that are established as legal entity and are subject to the Dutch corporate income tax.

The innovation box is designed to encourage companies to engage in innovative activities by providing a tax credit on revenues gained from a self-produced innovative immaterial asset. Currently profits that are attributable to the innovation box are taxed at an effective rate of 9%.

The fact that the innovation box was not used frequently, caused the Dutch Cabinet to implement several changes. The amendment to open up the box to R&D assets and the option to apply a flat-rate scheme were primarily aimed at SMEs. Furthermore, in 2017 changes were made to comply with a plan of the OECD to combat tax avoidance. To be eligible to use the innovation box, a taxpayer must produce an intangible asset at their own risk and expense for which an R&D certificate has been issued. For larger taxpayers, since 2017 a second access ticket is also required.

All in all, it is difficult to determine whether the legislative changes in 2017 have had an impact on the number of companies opting for the innovation box. Due to the distinction between smaller and larger taxpayers, I believe the changes have little impact on smaller businesses, as they do not require a second access ticket. On the other hand, larger enterprises often have the resources to apply for a patent, so the legal changes also have little influence on whether they opt for the innovation box or not. It can be concluded that the innovation box in its current form still reaches the desired target group.

It can also be concluded that the current innovation box achieves the objectives that are set in 2007. The innovation box has a positive impact on innovative investments. However, the

tax facility is less successful in attracting companies, but cannot be abolished as it is important in preventing enterprises to move to other countries.

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