

Taxation of Knowledge-Based Capital : Non-R&D Investments, Average Effective Tax Rates, Internal Vs. External KBC Development and Tax Limitations

This paper extends the tax analysis of knowledge-based capital (KBC) in several dimensions. The paper analyses non-R&D KBC: computer software, architectural and engineering designs, and economic competencies which account for over 70% of total KBC. The paper analyses the tax treatment of internally-developed KBC which is used in production by the developer versus KBC sold to third-party producers. The current tax rules generally favour internally-developed KBC, which disadvantages many SMEs and start-up companies specializing in innovation. The analysis reports two average effective tax rates (ETRs) depending on investors' considerations of their investment opportunities. When KBC is unique, earns excess returns due to market power, or involves financing-constraints, ETRs are high despite immediate expensing. The paper also analyses the effects of tax limitations, where many SMEs and start-up companies can't benefit from tax credits and deductions until having sufficient tax liability.

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