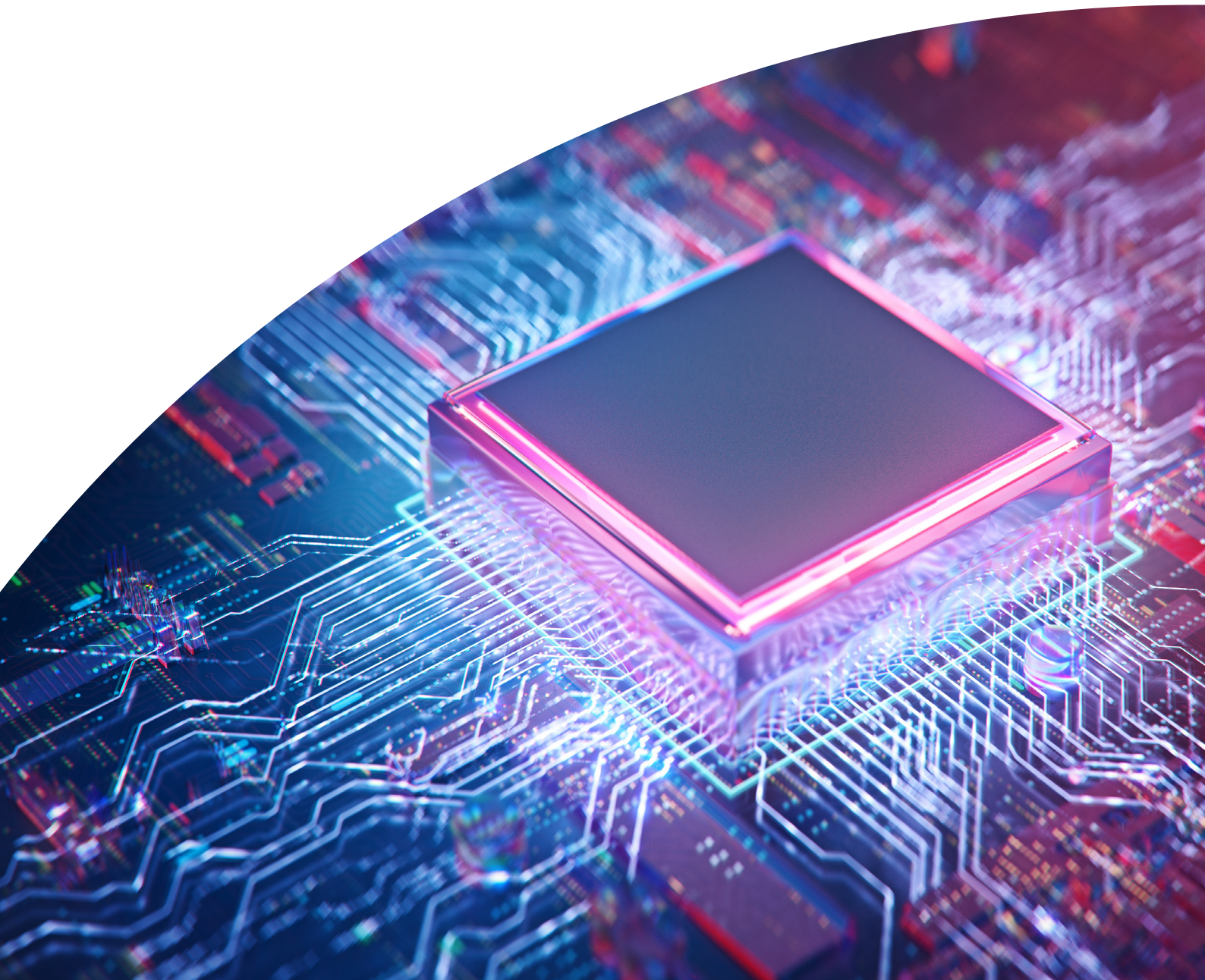


Research and Development (R&D) tax credit



What is the Research and Development (R&D) tax credit?

Ireland's R&D tax credit system is a major benefit to both multinational companies and SMEs operating in Ireland. The R&D tax credit was first introduced in Finance Act 2004 and offers a company undertaking R&D in Ireland a significant tax break, representing a potential 25% refund of costs incurred.

In essence, it means companies incurring qualifying R&D spend can potentially claim a refund of €25 for every €100 of expenditure on R&D.

Profit making companies will see a direct reduction in their tax liability, whilst loss making companies can claim the credit in three instalments. Either way, it brings a cash benefit.



The best way to demonstrate this is through the following case: Software Company Limited incurs €4 million of eligible R&D expenditure in the year ended 31 December 2015. This will result in an R&D tax credit of (€4 million x 25%) = €1 million.

The R&D tax credit can be claimed in addition to the 12.5% corporation tax deduction for any qualify expenditure. Therefore, the total tax benefit is 37.5%, ie 12.5% standard corporation tax rate plus 25% R&D tax credit.

The R&D tax credit is part of a suite of tax reliefs aimed at increasing Ireland's attractiveness as a location to house innovative activities.

How can the R&D credit be used?

Firstly used to offset the company's current year corporation tax liability. Where the credit exceeds the corporation tax liability for the year, the excess can be carried forward indefinitely to offset against future corporation tax liabilities.

Alternatively, the company can make a claim for the excess to be carried back for offset against the preceding period's corporation tax liability.

Broadly, the only restriction in obtaining a cash refund is that the R&D credit refund cannot exceed the PAYE/PRSI remitted by the company to Revenue in the last two years or the corporation tax liability for the prior ten years if higher.

It can alternatively be used as a key employee reward mechanism to remunerate R&D staff effectively tax free subject to certain conditions. The effective income tax rate for such key employees may be reduced to a minimum of 23%, provided certain conditions are met by the company and the individual. These employees have to perform 50% of their activities on specific R&D. They cannot be directors of the company nor have a material interest (being 5%) in the company. All R&D tax credit claims must be submitted no later than 12 months after the end of the accounting period in which the expenditure was incurred.



25%

potential refund of costs incurred

What is qualifying R&D activity?

In order to qualify for the R&D tax credit, the activities undertaken by the company must meet the criteria set out under Irish tax legislation.

The R&D activity must be:



Systematic, investigative or experimental activity



In a field of science or technology



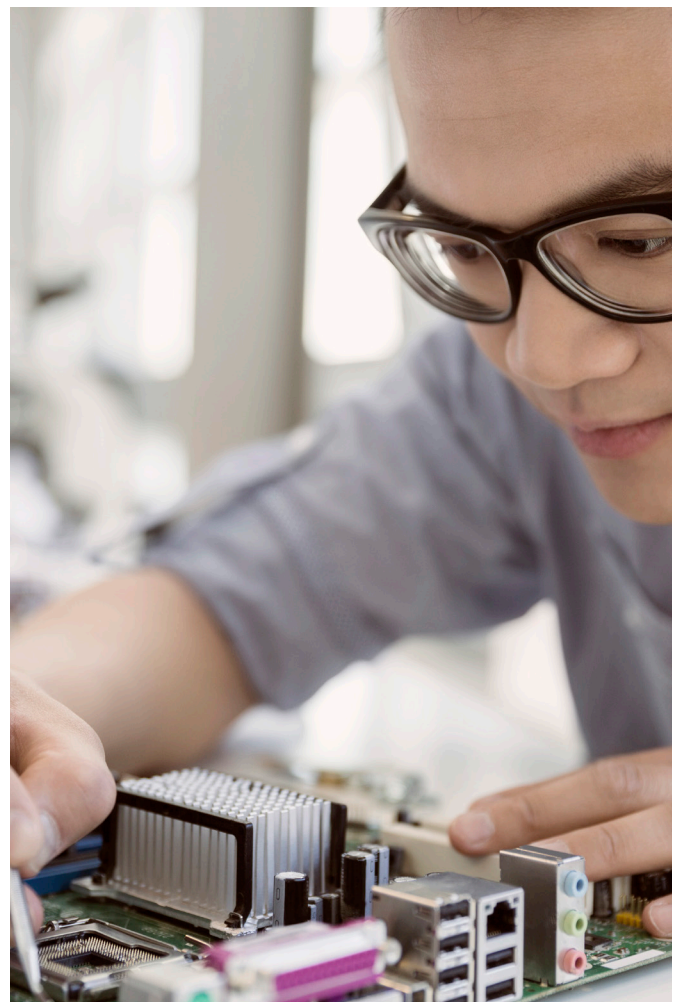
Either basic research, applied research or experimental development



Involving the resolution of a scientific or technological uncertainty and seek to achieve a scientific or technological advancement

What are examples of potential R&D activity?

- development of a new production process yield enhancement;
- development of new/substitute raw materials;
- advancements in product packaging;
- various software development;
- new pharmaceutical products; and
- medical device design.



What is qualifying R&D expenditure?

In order to utilise the R&D tax credit fully and optimally, it is important to ensure that all eligible costs are captured in the claim. Eligible R&D expenditure can come from a multitude of sources such as:

Direct costs:

- salaries and R&D employees; and
- raw materials.

Third party royalties:

- expenditure incurred on patent royalties (subject to certain conditions).

Indirect costs/ancillary activities:

- certain related indirect costs.

Plant and machinery:

- expenditure incurred on plant and machinery used for the purposes of R&D activity. These costs can be apportioned on a just and reasonable basis if required.

Qualifying buildings/structures:

- an additional R&D credit of 25% of the current year expenditure incurred on buildings in use (fully or partly for R&D purposes) is also available;
- at least 35% of the building must be used for R&D purposes over a four year period; and
- if building is sold/ceases to be used for R&D purposes in the ten years after the year in which the relief is claimed, the credit will be clawed back.

Outsourced R&D activities

Many R&D companies will have some involvement with other companies when they carry out R&D activities. A company has outsourced aspects of its R&D work where:

- amounts are paid by the company to unconnected third parties to carry out R&D activities, the expenditure which can be included in the claim is restricted to 15% of the expenditure incurred by the company itself on R&D activities or €100,000, whichever is greater;
- a company pays money to an unconnected third party in order for that third party to undertake R&D activities on its behalf, the company must notify the third party in writing that it (the company) is making a claim for the expenditure; and
- notification letters are no longer required for subcontractors who cannot claim R&D credit, which reduces administration for the claimant.

This is an area that impacts many companies and should be considered carefully.



R&D grant assistance

Where a company has received, or will receive grant assistance, then the amount received is required to be deducted from the expenditure incurred on the R&D activities.

This is because the company is not deemed to have incurred the expenditure once the grant assistance has been received.

A qualifying project in receipt of 20% grant funding:

R&D spend	€100
Non taxable grant aid	-€20
Net of grant aid	€80
CT deduction @12.5%	-€12.50
R&D credit @25%	-€20
Net cost	€47.50

R&D audits

The number of Revenue audits and self-reviews in the context of R&D tax credit claims is increasing. If a company receives notice of an impending Revenue audit, within fourteen days it should issue a notice of intention to make a voluntary disclosure if it wishes to make such a disclosure. This should mitigate against penalties and possible publication. The significance of any penalty depends on numerous factors such as the category of tax default, amount of tax involved, co-operation of the tax payer during the audit, etc. The company has the right to appeal the results of the audit within 30 days.

It is interesting that feedback from Revenue in recent months indicates that companies are falling down primarily on the accounting side of R&D tax credit claims.

This is perhaps surprising but it reflects what Revenue are experiencing in more recent audits. On the positive side, compliance with the science side of the test appears to be stronger.

Revenue has the power to appoint a technical expert to assist in the audit. However, the taxpayer has the right to object to the appointment of a particular expert. Once the expert is appointed, a disclosure agreement is signed between Revenue and the technical expert. No such agreement will be signed between the expert and the company being audited.

Common mistakes

- overstating the claim – inclusion of expenditure which is simply not eligible.
- under-claiming – eligible R&D activities have been overlooked;
- insufficient documentation to justify your claim;
- activities do not meet technical criteria: This is a complex tax technical area which interacts with other tax legislation;
- apportionment methods are not 'just and reasonable';
- capital expenditure is not 'trued-up';
- R&D reports are not prepared on a timely basis; and
- incorrectly filing the claim with Revenue.

How we can help



Prepare

scientific project reports



Conduct

R&D in-house workshops



Calculate

R&D expenditure



Free

health check



Develop

documentation methodology



Provide

full Revenue audit support



Personalised

R&D interviews



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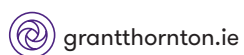
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