Food for thought

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R&D tax credits for agri-food manufacturers

When it comes to innovation that qualifies for the R&D tax credit, many companies assume that their projects are not eligible. Despite regular broadcasting, companies across Ireland believe that qualifying R&D projects are generally aimed at pharmaceutical and technology companies. In reality, there are organisations in a wide range of sectors that can benefit.

For example, R&D tax credits in the agri-food industry are available for companies looking to provide products that are healthier, free from allergens or looking to increase the shelf life of their products. At Grant Thornton, we have looked at what drives development and what R&D looks like for agri-food manufacturers.

What triggers change in the agri-food industry?

Several factors contribute to the need for R&D in the agri-food industry. These include commercial factors such as the need to improve the shelf-life of a product, legal changes such as the recent sugar tax and consumer demands such as a need for gluten or lactose-free products.

There are also issues surrounding ethics as consumers become more aware of animal welfare and, particularly in recent months, single-use plastics in packaging. All of these factors initiate the need for development, if agri-food companies are to keep up with the demands of the consumer.

Agri-food R&D tax relief

R&D of agri-food has been around for generations but this does not mean that new advances are not being made every year.

As new diets are explored in greater detail along with the evolving commercial nature of 'on the go' food and gut friendly alternatives, companies are undertaking greater amounts of R&D now than in times gone by.

These development projects are not just everyday routine activities; they are activities, which could potentially be deemed 'qualifying activities' for R&D tax credits therefore reducing the cost of financing the projects by up to 37.5%. The following are trends that may lead to qualifying R&D for the R&D tax credit:

- Practitioners are continuously researching **allergies** and the impact they can have on people's day-to-day health. With a rise in diagnosed dairy and gluten intolerances, many companies are seeking to provide a commercially competitive product eliminating such ingredients, whilst not compromising on taste and usability.
- **Ready meals** are generally known to be unhealthy. Many companies are conducting R&D projects in order to turn such meals into healthier and more nutritious options. Examples of this include less preservatives, lower salt content or gluten free ingredients. Provided there is a scientific/technological uncertainty and the company seeks to discover a scientific/ technological advancement, which is unknown in the agri-food industry at present, then there is a strong possibility that such projects will be qualifying for the R&D tax credit
- **Scaling up of kitchen tests/process improvements** - many foods are capable of being made on a small scale. The scaling up of the process where tonnes, as opposed to kilos of ingredients are being processed is often a development programme in itself. Scaling up and process improvements are often deemed qualifying activities for the R&D tax credit.
- **Shelf life** - food waste is a concern and the rate at which foods deteriorate can be due to numerous variables. Some of these variables may include the following:
  - processing techniques;
  - storage temperature; and
  - packaging solutions.

  Development of increased shelf life solutions through R&D will often qualify for the R&D tax credit relief.

Does your company qualify for R&D tax credits?

Although R&D in the agri-food industry has been around for generations, new technologies and scientific advancements result in the agri-food industry ever evolving to take advantage of the latest research and understanding of what the consumer wants.

At Grant Thornton we have a specialist R&D team with significant experience in all aspects of making R&D tax credit claims for high profile and large value projects both in Ireland and the UK. Many of our experienced tax specialists have scientific and engineering backgrounds.

Preparing for Brexit from an indirect tax perspective

Has your agri-food business a strategy in place?

Preparing for Brexit from an indirect tax perspective is challenging, particularly given the complexities these taxes present in their own right. It is vital for businesses to prepare for the outcomes from an indirect tax perspective without delay.

Potential implications of Brexit on indirect taxes:

- import VAT may become payable at the point of importation into Ireland from the UK;
- introduction of customs and excise duties which currently do not apply on intra-EU trade;
- increased administration and compliance costs; and
- revision of invoicing and reporting protocols.

Value Added Tax (VAT)

Post-Brexit, the UK will be in a position to set its own VAT rates and add or remove particular supplies of goods or services to the zero rating, reduced rate or exemption schedule. The UK may also introduce their own version of the 'place of supply' rules.

The UK can also ignore the VAT judgements made by the Court of Justice of the European Union (CJEU) which could provide the UK with a competitive advantage over EU member states.

Once Brexit is in place, intra community supply of goods and services will be treated as imports and exports between the UK and other EU member states including Ireland. The current process of Irish businesses zero rating supply of goods and services to VAT registered customers in the UK (provided certain criteria are met) may no longer be an option.

Instead, **import VAT may become payable** at the point of importation of supplies from the UK. This should not result in a change to the ultimate cost of imported goods, this would result in a cash flow cost and a greater administrative burden on businesses. It would be prudent for Revenue in Ireland to introduce procedures to alleviate the potential VAT cash flow cost.

Customs

Post Brexit, it is possible that the UK will be outside the customs union of the EU. In that event, it is possible that there could be a reintroduction of more significant customs controls which will have both a time and cost implication for Irish businesses who are trading with the UK.

Tariffs are not the only barrier to international trade. In fact, non-tariff barriers are often more problematic. At present UK and EU standards are aligned, meaning that it is not possible for the countries within the EU to raise non-tariff barriers between one another. Whilst the standard that the UK products adhere to are unlikely to change overnight, the UK may choose to introduce different standards which could cause greater complexities for Irish businesses who trade with the UK.

Impact assessment

Preparing for and dealing with an Brexit starts now. No one knows the true impact of Brexit. This does not mean that businesses should not begin the planning process.

Affected businesses should understand what the likely impact of any VAT and customs changes will be on their respective business models, supply chains and profitability.
Each business will be affected in different ways depending on the nature, volume and complexity of their supply chains.

If your business is involved in cross-border trade with suppliers or customers in the UK, we strongly recommend that an impact assessment is undertaken as soon as possible.

An impact assessment should include a strategy as to how Brexit might affect your business development and plans for growing the business:

- examination of existing supply chains to consider the impact of any VAT and customs changes;
- review of financial and reporting systems; and
- review of existing customs procedures (imports and exports as well as other customs facilitation measures).

Conclusion

Of course there is no 'one size fits all' answer as to what Brexit will hold for the Irish agri-food market. A good starting point is to initiate an impact assessment without delay. If you would like to discuss an impact assessment or if you would like further information, please contact a member of our tax team.

InFocus with Kieran Rumley, Love Irish Food

Kieran Rumley is Executive Director of Love Irish Food. Kieran has over 30 years experience of marketing locally produced food and beverage brands in Ireland with companies such as Showerings Irl, C&C, Dairygold and Batchelors.

Kieran holds a Bachelor of Science (BSc) in Management from the University of Dublin, an MSc in Management from the University of Bath and is a Fellow of the Marketing Institute of Ireland (MII). Love Irish Food, as an organisation, works with the food and beverages industry to safeguard the future of the branded food and drink manufacturing sectors in Ireland. Its members employ more than 15,000 people in food and allied businesses across the Irish economy.

Q To start off can you tell us a little about how Love Irish Food came into being?

A Love Irish Food was established in 2009 in response to a significant switch in grocery food trading in the Republic of Ireland to Northern Ireland. Up to 20% of household shopping at any one time was trading across the border with the loss of over €1 billion in retail value in 2009. The Love Irish Food initiative was created by locally produced food brands to actively remind shoppers that short term savings could result in a loss of brand choice and the permanent loss of Irish brands in the local economy. The association started with 28 brands and now represents almost 100 brands distributed throughout the Irish grocery market. The Love Irish Food mark which has an 80%+ recognition, developed to become a clear mark of provenance for Irish produced food and drink brands. Its unique focus is solely on food and drink brands.

Q How have market conditions changed since the establishment of Love Irish Food?

A In 2009 the economy was gripped in a mindset of fear. The focus was on protecting family and local community. We faced ghost estates, a 15% unemployment rate and up to 1,500 people emigrating weekly and with it, key skills. Ajai Chopra became a household name. 'Staycations' and home entertainment were buzz words. We learned new, more economic cooking skills. There was a conscious awareness of the effect of buying locally produced foods in supporting the local and national economy. Fast forward to 2018, unemployment is now heading to 5%, key employment skills are in short supply, we have a housing stock shortage and eating out and holidays aboard are booming.

In a relatively short period of time the national economic mindset and focus has flipped. Yet as a nation we now carry a sovereign debt of €200 billion, with gross debt projections continuing to grow and a current annual debt repayment level of €6 billion and of course Brexit. Having come through a maelstrom we should not forget our legacy of debt and we need to be very mindful of threats to our economy that are outside of our control. Continuing to support local food brand production must remain central to shopper mindset and this is the challenge that Love Irish Food addresses through its activities.

Typically, these activities would encompass the national media advertising of the brand message across the year. Focused profiles of its member brands and activities and activation at events such as Bloom where consumer interest in Love Irish Food and member brands has over 30,000 visitors attending and meeting with its producer members.

Q What are some of the barriers to growth that your members face?

A Love Irish Food brand companies represent a large swathe of the Irish food industry, representing SME and multinational food and drink producers. Domestically, access to finance, good quality staff skills, retention of staff and modest market growth make up some of the local challenges. This combined with Brexit, volatile international trading relationships and currency volatility make for big hurdles to growth. Some of these challenges will be well flagged and prepared for whereas others may well reflect changes to environmental issue, such as the recent changing attitudes to the use of plastics in the industry. These hurdles will vary depending on the member company. SME's will face very different challenges to those of our multinational member brands. The limitation of resources and manpower that they face means that the onus of administrative requirements, for example, the recent GDPR legislation all pose serious calls on their time. This for companies, where oversight of the entire business by the owner manager, means that the burden of administrative regulation increasingly takes its toll on the available time for production and sales development, the basis on which the company was created.

Q How big of an impact has Brexit already had on your members?

A Love Irish Food has undertaken and released data from a number of its members surveys. A hard Brexit would have a severely negative impact in Ireland and the UK on the availability of fresh food produce, finished goods and ingredients. However, to date Brexit has not significantly impacted on the level of trading, it has directed companies future planning. Re-evaluation of existing trading, investment in new markets and up-skilling to confront these opportunities has and is being undertaken as a key operational focus of member companies. With Brexit different scenarios have to be planned for, skills and new languages must be learned, such as that involving customs and tariffs and time set aside for the development of plans that may never come to fruition but are necessary where one of those plans may result in the post-Brexit development of the company. All of this takes an enormous investment in manpower time.

Q What do you think are the key success factors in building and scaling a brand?

A Having a consumer ready advantage is a prerequisite. On top of this the company needs a scalable market whether domestic or export. It needs confidence, belief, knowledge, human skills and finally it needs the financial resources to allow it achieve its ambition. Scaling a brand is one of the big challenges facing a SME investment in its brand development process. It may emerge from a forced situation of production constraints where the brand may have outgrown its production capability. If the decision is to invest in a new production facility then the overhead attributing to this investment may well force a quantum growth of the brand. The fundamental question of course is: Can the brand sustain this challenge? Where the answer is questionable, outsourcing allowing for a more phased growth may be a better option. There is always an attraction of having shiny new kit especially for emerging brands. Brand owners need to be aware that invariably there is an excess of production capability available in most food sectors than is required. Tapping into this may well allow the short developmental time needed to grow a brand to its next level on a planned for and more profitable basis prior to bringing an excess production capability in house.

Q How have consumers reacted to the Love Irish Food logo?

A The challenge of building a national brand is not to be underestimated. There are a great many brand marks in the market referencing jobs, quality and provenance from food to fintech. Love Irish Food has focused its total effort on the food industry and in a matter of years the Love Irish Food brand has become the pre-eminent consumer provenance mark for the branded food and beverage industry market. Consumer are aware of and understand the meaning of the mark and what it stands for. Consumer brands want to share in this by becoming members of Love Irish Food and to highlight their local production credentials and contribution to local communities as a competitive point of difference, especially to those imported brands that may have historically been produced locally. It also helps these locally produced brand members to set themselves apart from brands with Irish sounding names that are produced outside of the state.

Q Do you feel that retailers do enough to support emerging and growing Irish food brands?

A The Irish grocery sector is a highly competitive market. There are some good nurturing opportunities for brands among retailers. However, national distribution within the chains for emerging brands is enormously difficult. Some sectors are massively driven by imported brands, for example, biscuits and yoghurts. National shelf space for locally produced brands is exceptionally difficult to achieve as the category planning/leadership is driven by brands produced outside of the state. Irish retailers could do considerably more to highlight on shelf, genuinely produced Irish food brands, where the brand is actually produced locally and where local ingredients are used.

Q The Love Irish Food story has been a massive success over the last nine years. How do you envisage growth over the next decade?

A Love Irish Food as an association will always be driven by opportunity to promote locally produced food and drink brands. Local production is key. There is a high bar to membership of the association where over 80% of the value of a brand must be achieved through local production in Ireland, where other marks may well have much lower constraints. In addition, the brand that qualifies for membership must use local ingredients in its production, where those local ingredients are available to standard. Over 15,000 jobs are dependent on Love Irish Food member companies. There remains an enormous dependency on jobs that support Irish produced food brands. Growth will come through harnessing more companies to become members and support Irish production of quality food products that are produced for Irish tastes and with Irish food ingredients and this will be the direction of Love Irish Food growth over the coming years.

Bord Iascaigh Mhara (BIM) and Grant Thornton forge strategic partnership

BIM, Ireland's seafood development agency, in partnership with Grant Thornton, announced the launch of its new management development programme, Propel.

The ambitious programme is specifically aimed at CEOs and senior teams working within fishing, aquaculture and seafood processing sectors in Ireland and has been designed to equip them with skills to develop stable, sustainable and profitable businesses within this important sector. The programme will offer a comprehensive approach to the development of individuals and companies through a range of supports, education programmes and advice.

Speaking at the launch of the new management programme, Jim O'Toole, BIM CEO said: "*This new programme has been developed in direct response to industry trends and demands. This sector recorded growth of over 6% last year and contributes some €1.15 billion to the Irish economy. To drive growth and prepare for the challenges facing us, BIM is working with the men and women at managerial level within the sector to enable them to adapt quickly to change and build their businesses in fishing, aquaculture and processing.*"

Supports and services will be offered by members of BIM's Skills Development team and Grant Thornton's Business Consulting team. The programme will cover key disciplines including finance transformation, operational excellence, strategic support, innovation, sustainable development and skills development.

Each participant on the management programme will undergo a business diagnostic session with BIM and Grant Thornton to determine the specific challenges unique to their business model.

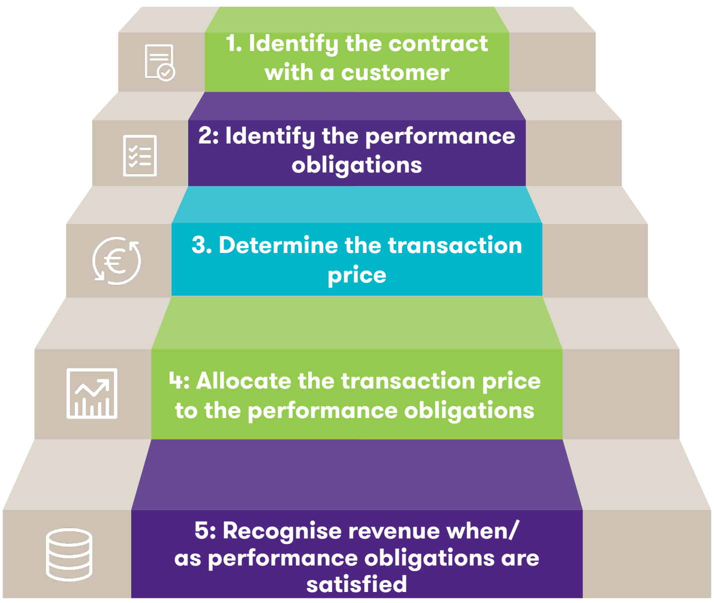
A report will be drawn up following each session detailing areas where they can enhance the performance of their business. Brendan Foster, Business Consulting Partner at Grant Thornton said: "*At Grant Thornton we recognise the value of the Irish seafood sector to the economy and the role that the sector plays in sustaining rural communities throughout Ireland. That's why Grant Thornton is delighted to partner with BIM and to help to unlock the potential for growth in Ireland's seafood sector.*"

Spaces on the programme are limited to 12 companies in 2018. The programme is being financed by BIM through the European Maritime and Fisheries Fund (EMFF).

IFRS 15 at a glance – a new global standard for revenue recognition

Although in many cases agri-food businesses may ultimately conclude that the majority of their current accounting policies and practices will not change under IFRS 15, this can only be established after carefully assessing current practice against the new revenue model and application guidance.

An evaluation of the new control-based model and new criteria (centered around a five step process) will be necessary as some agri-food businesses may find the timing of revenue recognition differs under IFRS 15.



1. Identify the contract with a customer
Contract must have commercial substance, be approved by both parties, have clear payment terms and collection of consideration should be 'probable'.

Step 2: Identify the performance obligations
A cornerstone of the IFRS 15 model is the fact that revenue is recognised based on satisfaction of 'distinct' performance obligations of multiple elements of the contract, rather than the contract as a whole.

Step 3: Determine the transaction price
Watch out for variable pricing arrangements (awards or incentive payments) and right-of-return obligations.

Step 4: Allocate the transaction price to the performance obligations
Where there is more than one performance obligation, the transaction price must be allocated to each performance obligation based on relative stand-alone selling prices.

Step 5: Recognise revenue when/as performance obligations are satisfied
Determine when 'control' transfers – over time or at a specific point in time? Consider customer acceptance.

IFRS 15 changes the criteria for determining whether revenue is recognised at a point in time or over time. IFRS 15 also has more guidance in many areas where current IFRS's are lacking such as:

- multiple-element arrangements;
- non-cash and variable consideration;
- rights of return and other customer options;
- seller repurchase options and agreements;
- warranties;
- principal versus agent (gross versus net);
- licensing intellectual property;
- breakage;
- non-refundable upfront fees; and
- consignment and bill and hold arrangements.

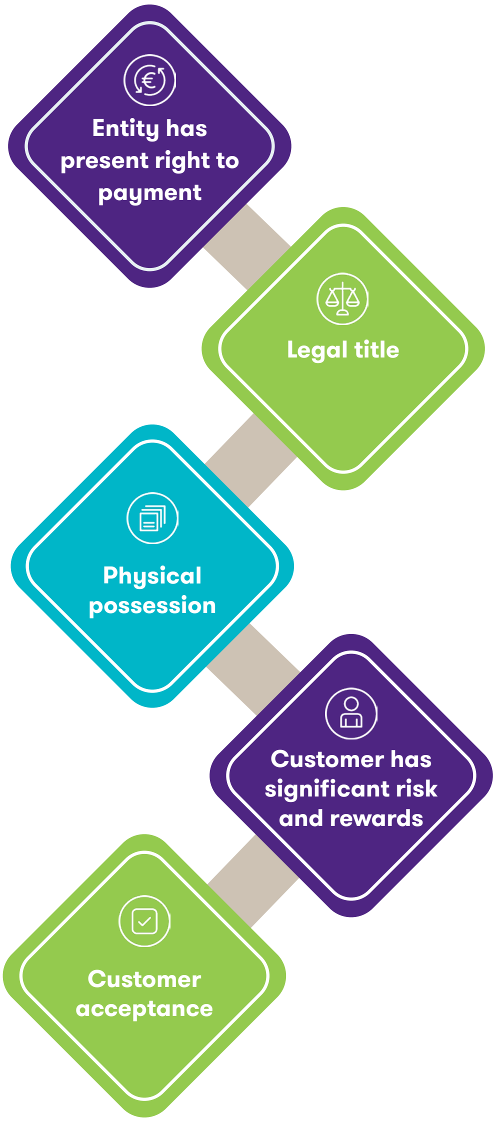
IFRS 15 will require considerably more disclosure about revenue including information about contract balances, remaining performance obligations (backlog) and key judgements made.

Impact for the agri-food sector

Businesses in the agri-food sector deal with a broad range of accounting issues including, treatment of contract acquisition costs and other consideration payable to retailers, the impact of complex shipping terms, assessing whether revenue should be recognised over time or at a point in time, evaluating the impact of complex distributor agreements and questions of customer acceptance. IFRS 15 provides additional guidance in many of these areas and as a result, companies will need to carefully assess their current practices for possible changes to the timing of revenue recognition.

With the issuance of IFRS 15, the focus shifts to the question of 'control' and this will require a change in the way businesses have traditionally approached their revenue recognition practices.

Indicators of control transfer



Transition and effective date

IFRS 15 is effective for annual periods beginning on or after **1 January 2018**. Transition is retrospective, subject to some simplifications, including an option to not restate comparative periods. Early application is permitted.

EXAMPLE

Consideration payable to a retail customer

An agri-food producer enters into a contract to sell goods to large supermarket group for a period of one year. The supermarket chain is required to purchase at least €400,000 of goods during the year.

The contract requires the supermarket chain to make changes to the shelving and display cabinets at the stores from which the goods will be sold. On the date on which the contract is entered into, the vendor makes a non-refundable payment of €40,000 to the supermarket chain to compensate for the related costs.

The payment to the supermarket customer does not result in it obtaining any distinct good or service. This is because, although the shelving and display cabinets will be used by the supermarket to sell the goods, the vendor does not obtain control of any rights to those shelves or display cabinets.

Consequently, the €40,000 payment is accounted under the new standard for as a 10% reduction in the transaction price when the vendor recognises revenue for the transfer of goods. To achieve this, the €40,000 payment is initially recorded as an asset and is amortised as the related sales of goods are recorded.

We are Grant Thornton

At Grant Thornton we work with over 200 Irish agri-food businesses across the entire value chain. Our dedicated agri-food team has a wealth of national and international experience in the agri-food sector providing bespoke professional services to companies of all sizes. If you require further information on any topics or would like to discuss other professional services matters, contact our agri-food team or visit our website **here**.

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