

Knowledge development box



Overview

The Knowledge Development Box (KDB) is aimed at incentivising companies to undertake innovative activities in Ireland by providing an effective corporate tax rate of 6.25% for income generated from commercialising certain intellectual property (“IP”).

The KDB applies to accounting periods commencing on or after 1 January 2016 and the relief must be claimed within a two year period from the end of the accounting period to which the claim relates.

The KDB is designed to complement the other innovation tax incentives in Ireland, targeting different stages of a company’s IP development:

- the R&D tax credit supports firms at the time they are undertaking the actual R&D which generates the IP;
- the intangible assets relief reduces the after-tax cost to companies who are investing in and exploiting certain intangible assets and using them in respect of their Irish trade; and
- the KDB targets the future income that is generated from the results of the R&D activity.

Key facts about the KDB:

- The effective corporation tax rate for income qualifying for relief is 6.25%.
- The KDB applies for accounting periods commencing on/after 1 January 2016 and a claim must be made within two years from the end of the accounting period.
- Relief under the KDB is linked to the proportion of qualifying R&D expenditure being incurred by the Irish company as a percentage of overall group R&D expenditure on the same IP asset.
- The IP must be the result of R&D activities as defined by the R&D tax credit legislation.
- Smaller companies will not be required to patent their IP – “patentable” is sufficient.
- The income generated from the IP must flow into the same entity that undertakes the R&D.
- The nexus formula must be used to determine how much of the IP income qualifies for the KDB.
- Taxpayers will be obliged to ‘track and trace’ and provide documentary evidence of expenditure incurred, income generated from the IP assets, and activity undertaken to generate the IP assets.

What intellectual property qualifies for the KDB?

The IP that qualifies is restricted to:

- Certain patented inventions and copyrighted software.
- Plant breeders' rights, supplementary protection certificates for medicinal products and plant protection certificates.

Marketing-related IP such as trademarks, brands, and image rights do not qualify for the KDB.

Small companies:

Smaller and medium sized companies (defined for this purpose as companies with annual income from IP not

in excess of €7.5m, which employ less than 250 people, and which have a turnover of less than €50m or a balance sheet of less than €43m) can expand the definition of intellectual property to include inventions that are certified as being novel, non-obvious, and useful. In other words, the IP must be "patentable," but not necessarily patented.

How is the relief granted?

There is an extra tax deduction of 50% of the qualifying profit; this provides for the 6.25% effective tax rate.

How is the qualifying profit calculated (nexus formula)?

The KDB follows the "modified nexus" approach endorsed by the OECD. This approach links the KDB relief to the proportion of qualifying R&D expenditure being incurred by the company in Ireland as a percentage of overall group expenditure.



a) What is qualifying expenditure?

Qualifying expenditure means expenditure incurred by the company itself on R&D activities, where such activities lead to the development, improvement, or creation of the qualifying asset (i.e. the IP). This includes outsourcing costs to unconnected parties.

Recognising that companies may acquire IP and outsource R&D activity to a group company while still being responsible for much of the value creation that contributed to IP income, the KDB regime allows an up-lift in the amount of qualifying expenditure, to include the lower of:

- 30% of the amount of the qualifying expenditure, or
- the aggregate of acquisition costs and group outsourcing costs.

b) What is overall expenditure?

Overall expenditure includes:

1. Qualifying expenditure, as above
2. Any acquisition costs in relation to the qualifying asset
3. Expenditure incurred by group companies for the carrying on of R&D, including related-party cost-sharing arrangements.

In simple terms, the higher the proportion of R&D that takes place in the Irish entity, the greater the proportion of income that may qualify for the KDB rate.

The "qualifying profit" to which the KDB rate applies is determined by reference to the following 'nexus formula':

The KDB relief available will be reduced where the intellectual property has been acquired by the company (from a third-party or a group company) or where the company outsources R&D activities to another group company. Conversely, where an Irish company does all of the R&D work in-house, the KDB could be of significant benefit.

c) What is "profit of the specified trade relevant to the qualifying asset"?

This includes:

1. Royalties,
2. License fees, and
3. Insurance, damages, or compensation,
4. The portion of income from the sale of a product or service which relates to the IP (embedded IP).

A company must also deduct appropriate expenses incurred in earning the income.

Transfer pricing

Unlike large companies, SMEs will not be required to apply arm's length transfer pricing practices when it comes to determining the market value of the intellectual property, apportioning income to the qualifying asset, apportioning R&D activities and expenditure, and so on. Instead, SMEs will be required to apportion income on a "just and reasonable" basis, which should reduce the administration cost of claiming the KDB for SMEs.

KDB and the R&D tax credit

The KDB will be granted only where the qualifying assets are the result of qualifying R&D activities that have been carried out by the entity claiming the tax benefit. The definition of "R&D" mirrors the definition for the purposes of the R&D tax credit. Likewise, the definition of qualifying expenditure is similar for the KDB and the R&D tax credit.

Claiming the KDB should therefore be a natural extension for those companies already availing of the R&D tax credit on an annual basis.

Documentary evidence

Taxpayers will be obliged to 'track and trace' and provide documentary evidence of expenditure incurred, income generated from the IP assets, and activity undertaken to generate the IP assets. Companies claiming the R&D tax credit may be able to leverage the information already maintained for the purposes of claiming the credit when claiming the KDB.

Revenue audits

Similar to the R&D tax credit, Revenue will be able to consult with technical experts in relation to many aspects of the KDB regime. Given the similarities, we would expect that Revenue will conduct R&D tax credit and KDB audits simultaneously.

Example 1:

- Company A, an Irish Indigenous SME.
- Incurred €500k on its own R&D activity relating to the development of a qualifying asset.
- No outsourced R&D.
- Net profits of €1m relating to the qualifying asset.
- The amount of qualifying profit available for the KDB tax rate would be:

$$\frac{\text{€500k}}{\text{€500k}} \times \text{€1m} = \text{€1m}$$

- An extra tax deduction of €500k is therefore available (50% of the qualifying profit).
- Without the KDB, the corporation tax payable would be €125,000 (€1m of net profit x 12.5%).
- With the extra tax deduction, the corporation tax payable is **€62,500** (€1m net profit, less €500k additional tax deduction = €500k of taxable income x 12.5%).
- Effective tax rate on qualifying income is 6.25%.

Example 2:

- Company B, a multinational company based in Dublin.
- Incurred €500k on its own local R&D activity relating to the development of a qualifying asset.
- Sub-contracted €500k to a group company based in the USA for R&D work on the same qualifying asset.
- Net profits of €1m relating to the qualifying asset.
- The 30% uplift is the lower of 30% of the qualifying expenditure (i.e. €500k x 30% = €150k), or the aggregate of acquisition costs and group outsourcing costs (i.e. 500k).

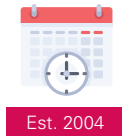
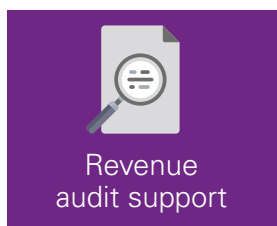
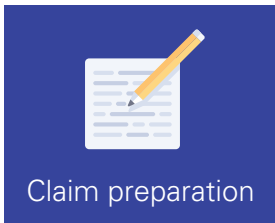
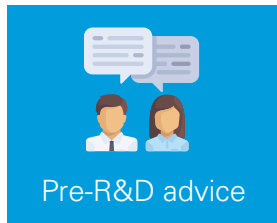
The amount of qualifying profit available for the KDB tax rate would be:

$$\frac{\text{€500k (+ €150k uplift)}}{\text{€500k + €500k}} \times \text{€1m} = \text{€650k}$$

- An extra tax deduction of €325k is therefore available (50% of the qualifying profit).
- Without the KDB, the corporation tax payable would be €125,000 (€1m of net profit x 12.5%).
- With the extra tax deduction, the corporation tax payable is **€84,375** (€1m net profit, less €325k additional tax deduction = €675k of taxable income x 12.5%).
- Effective tax rate on qualifying income is 8.44%.

KPMG's R&D Incentives Practice

We prepare claims for the R&D tax credit and KDB regimes. We are highly experienced in helping our clients identify qualifying R&D activities and related expenditure, and can work with companies to identify the assets and income that would come within the KDB.



Ireland's largest, longest established, and most experienced R&D incentives practice.



20+ multidisciplinary professionals: tax, finance, science and engineering.



We have worked with companies of every size and scale from every sector.



Revenue audit experience in all sectors.

Contact us

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