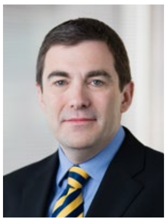
R&D Tax Credit and KDB - Public Consultation



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30 May 2022

Dear Sir/Madam,

Research & Development Tax Credit Review 2022 – Public Consultation

KPMG is pleased to respond to the public consultation on Research & Development (R&D) Tax Credits and the Knowledge Development Box (KDB).

KPMG is Ireland's largest tax practice. Our clients include businesses engaged in R&D activities operating in a wide range of industry sectors and with differing degrees of R&D intensity.

Our feedback to the consultation questions draws on insights from detailed soundings taken from businesses conducting R&D activities, which included a survey of 78 of our clients, all of whom have claimed the R&D tax credit. They have shared with us the impact that R&D tax credit claims have on their ability to win and sustain R&D projects in Ireland as well as the impact of those R&D capabilities on their wider Irish business operations.

KPMG has reviewed the data from our survey to inform our responses to the questions raised by the Department of Finance in its consultation document along with some additional questions which we believe provide valuable insights to the importance of R&D incentives to Irish businesses, both SMEs and MNCs.

In framing our responses to the consultation, we have drawn on these insights as well as our experience in advising our clients on R&D tax credit claims since 2004 when the R&D tax credit was introduced. In this submission, we have set out recommendations for improvements which we believe would further enhance the impact of the R&D tax credit in supporting and sustaining business investment in R&D activity.

The contact points for this submission are Ken Hardy and Damien Flanagan (contact details are set out above). Should you wish to discuss any aspect of the attached submission please do not hesitate to contact us.

Kenneth Hardy　　Damien Flanagan

Ken Hardy
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Contents

01 Executive Summary

In this report we set out responses to the questions raised in the Department of Finance consultation into the Research and Development ("R&D") tax credit and Knowledge Development Box ("KDB") regimes. Our responses are based on (i) our extensive experience in assisting companies with the preparation of their R&D tax credit ("RDTC") claims and managing Revenue enquiries/audits, and KDB claims since the inception of the RDTC in 2004 and the KDB regime in 2016 and (ii) Responses to a detailed survey KPMG conducted with R&D performing companies in May of this year.

Our Survey – Key Observations

Our survey of 78 Irish and foreign owned businesses who engage in R&D activities in Ireland reaffirmed what has been widely accepted since the RDTC was first introduced in 2004 - the RDTC plays an important role in attracting investment in R&D activity as well as sustaining the R&D activity already here.

In 2020, the cost of the RDTC to the Exchequer was €658m.This means that claimant companies invested over €2.6 billion on qualifying (for RDTC purposes) R&D expenditure – a large proportion of which is made up of salary costs. This Figure disregards the non-qualifying expenditure including support staff, activity outsourced to third parties which may not be claimable, and ancillary supporting activities in the local community (facilities, maintenance, canteen etc). Therefore, in reality, the claimant companies invest significantly more than €2.6 billion in both the actual 'doing' of the R&D activity but also to facilitate/enable the R&D to take place. This is a crucial contribution to our economy.

The key takeaway points from our survey can be summarised as follows:

- 63% of survey respondents increased overall R&D expenditure over the last 3 years in Ireland with the same percentage planning on increasing R&D expenditure over the next 3 years
- 74% of MNCs responded that if the RDTC was not available there would be a marked decrease (at least one third) on the current level of R&D activity that takes place in Ireland.
- 50% of MNCs said that without the R&D tax credit more than two thirds of R&D activity would likely move abroad.
- 83% of survey respondents believe that an increased R&D tax credit rate of 35% would see more R&D undertaken by their company in Ireland.
- 92% of survey respondents believed that an enhanced R&D tax credit rate of 50% would incentivise R&D of green technologies (e.g. solar, wind, hydro or biomass energy etc.).
- 85% of MNC respondents believe that the RDTC at least compares equally well to other regimes, with only 15% believing that Ireland's R&D tax credit regime is less favourable to other schemes.
- The 25% rate and the availability of the RDTC as 'cash back' were the two most attractive features of the regime across all companies surveyed. However, for SMEs the availability of 'cash back' was No.1.

In our view, the survey responses very clearly demonstrate that the R&D tax credit is a vital incentive for companies who undertake R&D activity in Ireland and is integral for attracting additional R&D investment (i.e. jobs and capital expenditure) while also sustaining existing levels of R&D activity.

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The ever-changing international tax landscape requires that the RDTC must continue to evolve and be improved

Business Expenditure on R&D (“BERD”) in Ireland has increased every year since 2011 and in 2019 it amounted to €3.3bn with estimates for 2020 at €3.4bn. In 2019, the business sector accounted for 74.5% of total Gross Expenditure on R&D (“GERD”) (which includes R&D expenditure incurred by business, academic and government sectors), well above the EU average of 66.5% and second only to Hungary. What this demonstrates is that Ireland disproportionately relies on its business sector to fund R&D. The RDTC, and to a significantly lesser extent the KDB, are the principal tax incentives available to support the companies who engage in R&D activities.

Suggested Enhancements to R&D Tax Credit

The responses from our survey confirm that the R&D tax credit is a very valuable incentive to companies conducting R&D activity in Ireland and compares favourably internationally. However, the ever-changing international tax landscape requires that the RDTC must continue to evolve and be improved. We believe that the following enhancements to the RDTC would ensure that it remains fit for purpose, and amongst the ‘best in class’. All of these enhancements should be available to all taxpayers, but would be particularly impactful for SMEs:

i. Ensure Ireland’s R&D tax credit scheme meets the criteria to be a “Qualified Refundable Tax Credit” under GloBE rules and also complies with the new 2021 US Regulations.

ii. The rate of the relief should be increased to at least 35% for the first €1M of qualifying R&D expenditure.

iii. Increase the RDTC rate to 50% with respect to R&D carried out on green technologies.

iv. Allow for automatic cash refunds in one instalment in Year 1 where the RDTC amount is below €300k. The only cost to the State is cash flow.

v. Expand the costs which may be included as qualifying R&D expenditure to include specific indirect supporting and ancillary activities.

vi. Increase the limits on the amount of allowable expenditure on outsourced activities to third parties to the greater of 25% of a company’s non-outsourced R&D expenditure or €250,000.

In addition, we believe the following enhancements should be made to the KDB regime to increase its relevance and uptake amongst Irish companies:

- Extension of qualifying IP to include ‘know-how’ and trade secrets.
- Extend the provisions of S769R (i.e. the section that applies to companies with income arising from IP of less than €7.5m) to bring larger companies within scope.
- Clarification and extension of ‘transitional measures’ to R&D activity carried out pre 1 January 2016.
- Consideration of whether the scheme could be made fully refundable (similar to the RDTC) in light of the OECD BEPS Pillar 2 rules.

Throughout this document we expand on each of the above points.

02 Our Survey Objectives & Methodology:

KPMG sought relevant feedback on attitudes towards the R&D tax credit from companies operating across Ireland. In May 2022 we surveyed a sample of companies including large companies (60% of respondents) and SMEs. The survey included both foreign owned multinational companies operating in Ireland (73% of respondents) and Irish-owned businesses (27% of respondents) from across a multitude of industry sectors. Please see Figures 1 and 2 for a full breakdown of business sizes and industry types.

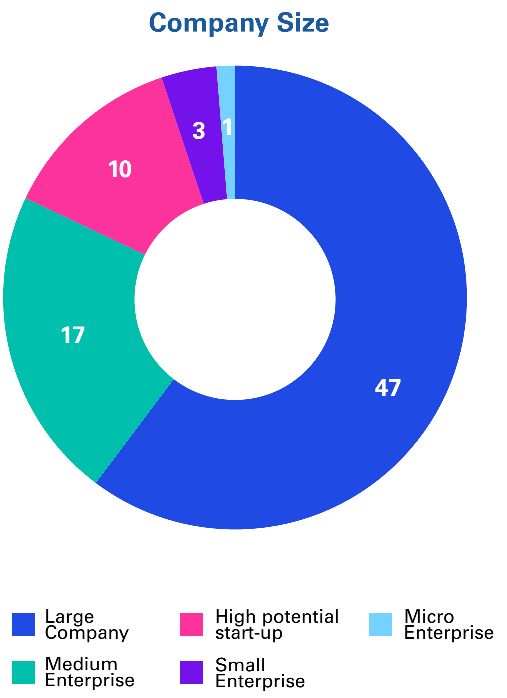


Figure 1 - breakdown of company size for all respondents[1]

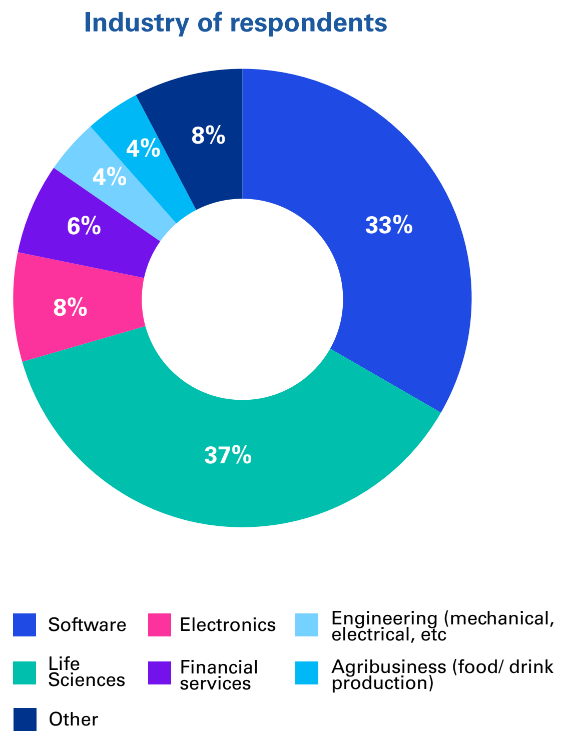


Figure 2- breakdown of industry sectors for all respondents

[1] Company sizes (micro, small, medium and large) are based on the EU definition for each - https://ec.europa.eu/growth/smes/sme-definition_en

03 Responses to Consultation Questions

(i) Research and Development Tax Credit and Knowledge Development Box

Q1. What are the key considerations to be taken into account when deciding whether to base your R&D activity in Ireland?

Response;

From a general tax perspective, factors that will influence businesses' decisions to set-up operations and remain in Ireland will be the certainty and stability of the tax regime, as well as the ease and related cost of compliance. The cost and ease of tax administration will become an even more important differentiator between jurisdictions.

Specifically, in relation to deciding where to locate R&D activity, the cost of conducting that R&D activity remains one of the primary factors in the decision matrix. This assumes that factors such as geographic location are relatively neutral and that competitor locations have equivalent access to necessary R&D capabilities.

The RDTC is a key lever to help reduce the cost of R&D activity. The consistency of the rate of Ireland's RDTC together with the various legislative enhancements to the credit since its introduction in 2004 have helped companies plan its R&D investment in this respect. We frequently hear that the availability of the RDTC, when combined with IDA R&D related grants, is often the tipping point in investment decisions when Ireland is compared with other jurisdictions. But it is only one of a number of factors that combine to make Ireland an attractive destination for R&D activity.

Other factors such as access to a skilled labour pool, the ability to leverage off deep capabilities, clusters and adjacencies in the R&D sector are important. These factors are only developed over time and are dependent on the R&D project team having sustained experience of conducting similar work on projects.

Co-location opportunities with suitable test environments are also important considerations for R&D which is closely linked to the commercialisation of the product / service. This involves access to a production test environment at scale for manufactured product or delivery platforms for software applications.

The wider business and research environment in Ireland is another key consideration. It offers an opportunity to conduct R&D on a collaborative basis as well as for an Irish project team to draw upon a proven network of providers of outsourced R&D services.

Q2. What do you value about the design of the R&D tax credit?

Response;

Responses to our survey indicate that the most important aspects of the design of the RDTC are (i) the 25% rate (38% of respondents) (ii) the cash back mechanism (23%), (iii) the broad range of eligible expenditure (including capital expenditure) activities which are covered by the RDTC (c. 22%) and (iv) the ability to recognise the RDTC above the line (c. 9%). Please see Figure 3 below.

What do you value about the R&D Tax Credit (RDTC)?

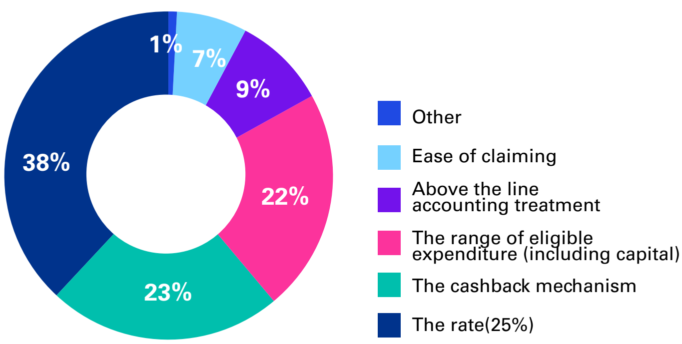


Figure 3- what do you value about the RDTC

Interestingly, among SME's only, the availability of the RDTC as a cash refund was what was most valued – 30% identified the cashback mechanism as the most important aspect of the R&D tax credit. We consider further in Question 10 below with respect to how the RDTC can be improved for SMEs.

Q3. How do you think the Irish R&D tax credit can remain competitive in the evolving international tax landscape? In answering this question, please have regard to EU State aid considerations and to both multi-lateral and jurisdictional changes in the international tax landscape.

Response;

(i) How is Ireland doing comparatively?

We asked MNC's that conduct R&D in other international jurisdictions how they felt Ireland's RDTC regime fared in comparison to those other jurisdictions. While this was a broad question, and did not ask about specific elements of Ireland's RDTC, the majority of respondents (85%) felt that Ireland compares well or equally, with just 15% stating that they believed Ireland compared less well than other locations (see Figure 4 below). This is a very positive result and highlights that the improvements to the RDTC in terms of rate, 'cash back' and accounting treatment have been well received and allows the RDTC compete favourably internationally.

How do you think Ireland's RDTC regime compares to other international jurisdictions?

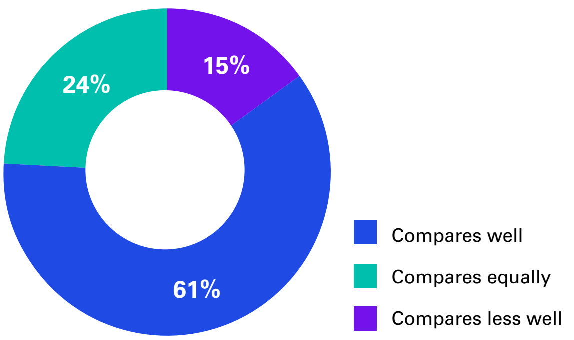


Figure 4- How does Ireland compare to other locations

(ii) Remaining competitive internationally.

While the Pillar Two rules released in December 2021 will constrain countries' ability to compete based on the corporation tax rate alone, they also create new potential areas of competition and opportunities for those countries who have signed up to the agreement. Specifically, the rules treat certain refundable tax credits, grants and subsidies as income (rather than reductions in tax) for the purposes of calculating a company's effective tax rate, ensuring that such incentives will become increasingly important areas of competition for countries seeking to attract investment from the world's largest companies in the future. In this regard, it is notable that other countries have already publicly stated that they may expand their offerings in these areas to attract foreign investment.[2]

Acknowledging that EU State Aid considerations may inhibit EU countries from responding quickly to such developments outside the EU, it is crucial that Ireland optimises the elements under its own control to remain an attractive location for investment. In this regard, we must ensure that our RDTC regime continues to offer a strong incentive to businesses to establish substantial operations here involving a highly skilled workforce. Indeed, the need for a best-in-class RDTC regime is more pronounced in Ireland in comparison with larger economies. Larger economies have many more resources available to them, as well as larger universities and deeper talent pools, all of which position them well for R&D activities. Ireland's RDTC must therefore be noticeably better to address the inherent disadvantage it faces as a smaller economy.

Where successful, we believe Ireland could distinguish and enhance its reputation as a global centre of excellence for research and innovation, which would in turn create a positive feedback loop when seeking to attract further such operations here, hence increasing corporate, income and consumption taxes for the Exchequer.

(iii) Changes necessary for the R&D tax credit regime in light of recent international tax developments

(a) OECD BEPS Pillar Two

Ireland must ensure the RDTC meets the criteria of a 'qualified refundable tax credit'

To ensure the Irish RDTC regime remains competitive at attracting and retaining investment into Ireland, it is vital that the RDTC meets the criteria of a 'qualified refundable tax credit' under BEPS Pillar Two. A qualified refundable tax credit is treated as income for GloBE purposes. Failing to meet the criteria of a qualified refundable tax credit,

[2] Including Switzerland.

the RDTC is instead treated as reducing covered taxes. A non-qualifying refundable tax credit will therefore result in a lower effective tax rate (as covered taxes are reduced) for the company in comparison to a credit that meets the definition of a qualifying refundable tax credit, resulting in potentially higher top up tax payable under the Pillar Two rules. As a result, jurisdictions which offer qualified refundable tax credits will naturally be more attractive to groups within the scope of Pillar Two than those with non-qualified refundable tax credits.

The definition of a 'qualified refundable tax credit' requires the credit to be designed in such a way that it must be paid as cash or available as a cash equivalent within four years of satisfying the condition to receive the relief. 'Available in cash' includes the ability to offset the refundable amount against other tax liabilities owing to the tax authority. The current Irish RDTC regime provides in most instances that the tax credit will be refundable within four years. For certain companies that are loss making with insufficient payroll liabilities (rarely seen in practice), in accordance with the application of section 766B Taxes Consolidation Act 1997, they will not be eligible to obtain the refund within four years.

The OECD commentary on Pillar Two, released in March 2022, provided further detail on the criteria necessary to be a 'qualifying refundable tax credit'. This included the requirement that the refund amount is not limited to any 'tax liability'. The term 'tax liability' is not defined in the commentary. A broad interpretation of the term tax liability could include payroll taxes (although should not include a limit based on payroll costs). The refund amount eligible under section 766(4B) Taxes Consolidation Act 1997 is limited by the amount of corporation tax or payroll liabilities in accordance with section 766B. Clarity should be sought as to whether the definition of tax liability is limited to taxes on profits or whether the definition could also include payroll taxes. At present, there is a risk that the current RDTC will not be considered a 'qualified refundable tax credit' under Pillar Two.

To address both concerns, we recommend that both restrictions (i.e. payroll and corporation tax) contained in section 766B be removed. Given the restrictions are, in our experience, rarely reached there should be little additional cost to the Exchequer by removing these caps. However, the importance of making these changes is significant.

Value of the current R&D tax credit regime

As currently provided for under Irish domestic tax legislation, any amount payable under the RDTC regime is not considered income for any tax purposes. Under the Pillar Two rules, a 'qualified refundable tax credit' will be considered income under the GloBE rules and would therefore potentially be subject to a top-up tax. For taxpayers in scope of GloBE, this could result in the RDTC being taxed at 15%, substantially eroding the economic benefit arising from the RDTC regime and reducing the incentive to invest in research and development activities (e.g. €25 of tax credits results could result in a net benefit of €21.25, with €3.75 returned to the Exchequer via a top-up tax).

For Ireland to remain competitive and an attractive location to carry out research it's necessary to increase the value of the R&D credit from 25% to at least 30% to ensure the value of the RDTC remains the same post adoption of the Pillar Two rules. As other countries may also seek to adjust the value of the RDTC post adoption of the Pillar Two rules, in order for Ireland to remain internationally competitive, we recommend the RDTC is increased to 35%.

(b) US changes to foreign tax credit eligibility

Under new US Regulations released in 2021, the tax consequences of the Irish RDTC regime for companies seeking to claim a foreign tax credit in the United States has changed. These changes disincentivise US parented groups from carrying out research and development activities in Ireland. For accounting periods commencing on or after 28 December 2021 (i.e. these new regulations are currently effective for most companies), where an RDTC regime does not meet the 'exclusion' criteria contained in the regulation, any reduction in Irish corporation tax due to relief under the RDTC regime will not be available as a foreign tax credit in the United States. Prior to this change, the amount of Irish corporation tax creditable in the US was the liability payable before RDTC relief. In order to ensure that the RDTC is treated as not reducing corporation tax for the purposes of US foreign tax credit rules, the RDTC regime must provide the taxpayer the option to claim the RDTC relief as a cash refund in the year of claim. We outline below possible amendments to the RDTC regime that will ensure it complies with the new US regulations;

- **Option 1:** The RDTC regime is updated to include a taxpayer option to have the amount of the credit fully refundable in cash in the year of claim. The amount of the refund would not be limited by reference to the corporation tax or payroll tax liabilities of the claimant company/group. An acceptable variation of this would be to allow the refund in the year of claim, but make the refund payment in instalments over three years. These options would align with the changes necessary to ensure the RDTC is a 'qualified refundable tax credit' under BEPS Pillar Two rules.
- **Option 2:** The RDTC would be directly offset against a claimant company's payroll tax liability in the year of claim or at the option of

the taxpayer is refundable against a claimant company's total payroll liabilities (including salaries, bonuses etc). The credit would not be available for offset against corporation tax payable by the claimant and would not be calculable by reference to the claimant's corporation tax liability. This would effectively sever the link between the credit and Irish corporation tax, with the result that it should not result in it having an impact on the foreign tax creditable in the US. It would also incentivise employment in the area of research and development. However, as discussed above, the RDTC should not be limited to the amount of payroll tax liabilities, as is currently provided for in section 766B Taxes Consolidation Act 1997, to ensure it is also a 'qualified refundable tax credit' under the Pillar Two rules.

Given that the US Regulations as they stand are not compatible with the RDTC, it is critical that the above amendments are telegraphed as soon as possible. While any amendment will not be effective until the Finance Act 2022 is signed, investment decisions are being made now and the uncertainty is unhelpful.

Q4. In the absence of the R&D tax credit, can you say what proportion of your R&D would take place in Ireland?

Response;

Investment in R&D

We asked our clients about changes in the level of investment in R&D activities over the previous three years. 63% stated that their R&D investment had increased. Just 20% indicated that their R&D investment had decreased, and the balance (17%) noted that their R&D investment had remained unchanged (see Figure 5).

Over the last 3 financial years, has your overall R&D spend...

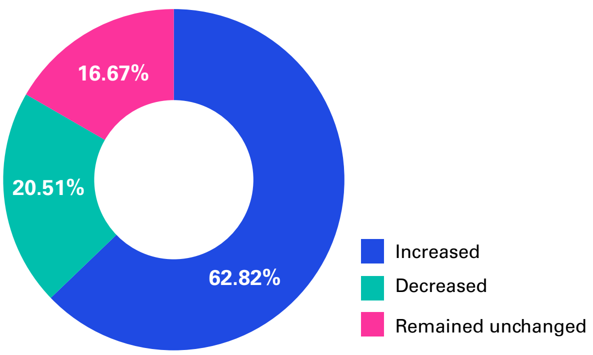


Figure 5 - R&D investment in previous 3 years

A similar proportion of clients (63%) indicated that their company planned to increase R&D activity over the next three years, with only 6% noting that their R&D activity was expected to fall (see Figure 6 below). It would be safe to assume that the financial support available under the RDTC is baked into these projections.

Whilst an increase in R&D activity is, for good reason, one of the key focus areas when it comes to R&D incentives, the sustaining of R&D activities at a particular level is often overlooked or taken for granted. In a competitive international environment, the ability to retain a certain level of R&D activity at an Irish site of an MNC can be a challenging endeavour and retaining existing levels of R&D is as important as attracting new jobs and investment. The retention of employment in high value R&D jobs can often have an impact on the ability of a company to also retain less skilled manufacturing type roles, where R&D is co-located with the manufacturing of the output of the R&D.

How would you describe planned levels of R&D activity in your company for the next 3 years?

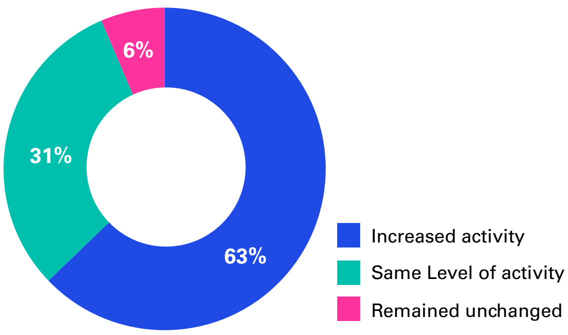


Figure 6 - R&D investment in next 3 years

Importance of the RDTC for investment in R&D activity

As part of our survey, we asked MNC respondents what portion of their R&D activity would take place in Ireland in the absence of the R&D tax credit. The responses received demonstrates the importance of the R&D tax credit with respect to R&D investment decisions for groups with multiple jurisdictional locations.

50% of MNCs said that only a maximum of 1/3 of the R&D currently undertaken here would remain in Ireland without the R&D tax credit i.e. more than 2/3 of R&D activity would likely move abroad. In addition, the majority of MNC respondents to our survey (i.e. 74%,) indicated that if the RDTC was not available there would be a marked decrease on the current level of R&D activity that takes place in Ireland i.e. between 33% - 100% of the R&D would move abroad. See Figure 7 below.

Business Expenditure on R&D ("BERD") in Ireland has increased every year since 2011 and in 2019 it amounted to €3.3bn with estimates for 2020 at €3.4bn[3]. Based on 2019 actual data, we understand that 70.4% of BERD is incurred by MNCs[4].

Factoring in a reduction of even 33% of R&D activity carried out by MNCs (i.e. the minimum amount which 74% of respondents indicated would no longer take place in Ireland), this could equate to over €750M of BERD and a reduction of almost 20% of Gross Expenditure on R&D (which includes R&D expenditure across all sectors including the business, government and education sectors). Ireland relies heavily on R&D activity carried out by the business sector 74.5% of total Gross Expenditure on R&D ("GERD") (which includes R&D expenditure incurred by business, academic and government sectors) carried out by the business sector in 2019, the second highest in the EU, not to mention the additionality that results from this level of business investment.

If you are an MNC, in the absence of the RDTC can you say what proportion of your R&D would take place in Ireland?

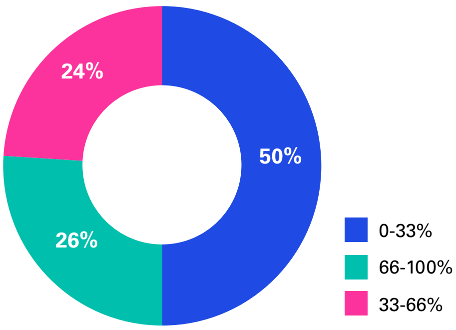


Figure 7 – Without the credit, what % of R&D would take place in Ireland (MNC)?

Interestingly, of the 50% of respondents who said that more than 2/3 of their R&D activity would likely move abroad without the R&D tax credit, 75% either increased or maintained the same level of R&D activity over the last 3 years with 56% of respondents stating that R&D activity had increased in this period.

88% of respondents who said that more than 2/3 of their R&D activity would likely move abroad without the R&D tax credit, anticipate either a similar level or an increase in R&D activity over the next three years. The companies that are investing the most in R&D, are often the most mobile.

We believe that these results indicate the importance of the RDTC for both maintaining and increasing R&D activity in the State. It is quite clear that the absence of the credit would mean the loss of opportunities to compete effectively for new R&D projects. The volume of R&D activities would reduce over time. The Irish operations would likely become less central to the business with resulting loss of employment and business growth opportunities.

Increase rate to 35%

As a follow on to this question, we asked the survey participants whether an increase in the RDTC rate from 25% to 35% would see more R&D work undertaken in Ireland. As shown below in Figure 8, 83% of survey respondents believe that an increased R&D tax credit rate of 35% would see more R&D undertaken by their company in Ireland.

Do you think a 35% RDTC rate (increased from the current 25% rate) would see more R&D undertaken by your company?

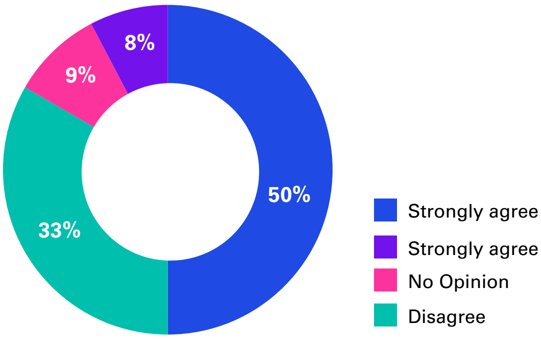


Figure 8 – Would a 35% RDTC rate (increased from the current 25% rate) see more R&D undertaken by your company?

The cost of the RDTC often grabs the headlines, €658m in 2020, but not the fact that this means the claimant companies invest €2.6 billion on qualifying (for RDTC purposes) R&D expenditure – a large proportion of which is made up of salary costs. This Figure disregards the non-qualifying expenditure including support staff, activity outsourced to third parties which may not be claimable, and ancillary supporting activities in the local community (facilities, maintenance, canteen etc). Therefore, in reality the claimant companies spend a lot more than €2.6 billion in both the actual doing of the R&D activity but also to facilitate/enable the R&D to take place.

If the RDTC rate is increased to 35%, our survey respondents (which includes many MNCs), have said they will invest further in Ireland. This has to be positive, for all.

3 The Research and Development Budget 2020-2021 - Prepared by the Department of Further and Higher Education, The Research and Development Budget 2020-2021 - Prepared by the Department of Further and Higher Education, Research, Innovation and Science

4 https://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2019-2020/ Research, Innovation and Science

Q5. One of the main policy rationales of the R&D tax credit is to promote high quality jobs and investment in the Irish economy. In your experience, has your decision to conduct R&D in Ireland resulted in you recruiting additional staff, interns or apprentices?

Response;

From our discussions with our clients, it is clear that conducting R&D activities in Ireland leads to the recruitment of additional skilled employees. In addition to creating new R&D employment opportunities, sustaining R&D activity within an organisation leads to improved competitiveness and allows for Irish companies to secure future R&D activity enabling them to develop their Irish sites as R&D hubs within the broader group.

Figure 9 below shows how many employees our survey respondents currently employ in Ireland.

How many FTEs (full time equivalents) do you currently employ in Ireland?

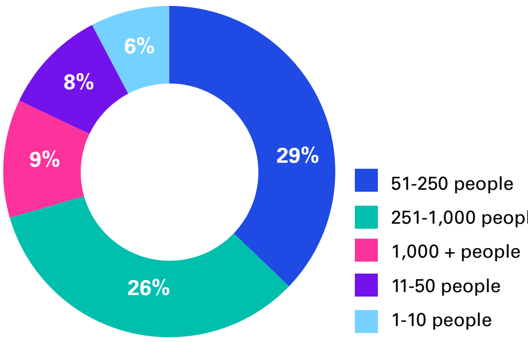


Figure 9 – How many FTEs (full time equivalents) do you currently employ in Ireland?

As shown in Figure 5 above, 63% of survey respondents have identified that R&D investment has increased in Ireland of the last three years. Increased R&D investment in nearly all cases leads to an increase in employees.

The significance of R&D projects being located in Ireland should not be understated or viewed in isolation either. In many examples, Irish subsidiaries of MNCs with knowledge, expertise and infrastructure resulting from their investment in R&D can often be seen as the logical location for high end manufacturing activity which arises post-R&D, often for the same product which was developed in Ireland. Therefore, not only are there highly skilled jobs created through the development of a product or process but there are also jobs created in all areas of the manufacturing process.

Q6. How many of your R&D staff are at PhD level or equivalent?

Response;

Our survey indicates that respondents have very highly skilled employees who are engaged in R&D projects.

We asked respondents what percentage of R&D staff worked in a highly skilled role requiring PhD and third-level science/ engineering qualifications. 86% of respondents identified that 60% or more of employees involved in an R&D project would be highly skilled individuals with PhD and third-level science/ engineering qualifications. See Figure 10 below:

Highly skilled roles requiring PhD and third - level science/engineering qualifications

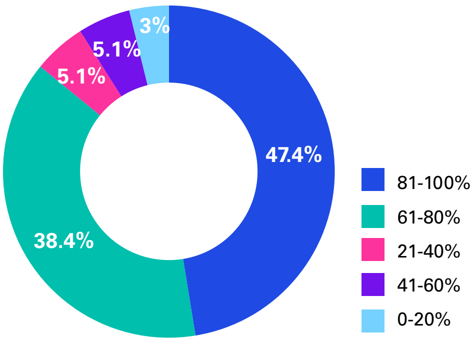


Figure 10 - Percentage of R&D project team (PhD/ third level qualifications)

Interestingly, respondents also identified that administration and support staff also are frequently involved in R&D projects.

While the majority of team members involved in an R&D project will be highly experienced and highly qualified individuals in the relevant field of science or technology, in reality administration and support staff also play a key role in R&D projects. While such individuals may not be involved 'in the carrying on' of the specific R&D activity, quite often R&D projects could not be undertaken without their involvement.

Other international R&D tax regimes allow claims on a portion of admin and support staff costs that can be appropriately apportioned to R&D activity. In the UK, for example, expenditure incurred on "Qualified Indirect Activity" can also qualify for R&D tax relief. Similarly, the New Zealand, Australian and Canadian regimes distinguish between "Core R&D activity" and "Supporting activities", both of which can qualify for R&D tax credits.

In the past, Irish Revenue's R&D Guidelines accepted that indirect supporting activities and activities ancillary to R&D could also qualify for the R&D tax credit. This was as envisaged by the Tax Strategy Group when first considering Ireland's R&D tax credit in 2003 and the RDTC was introduced on this basis. In recent years however, Revenue have adopted a narrower interpretation of "expenditure incurred in the carrying on" of R&D activity and now exclude almost all (if not all) types of indirect supporting activities/ costs.

We believe that an allowance of certain indirect supporting activities in an R&D tax credit claim to reflect the reality of the entirety of activities which make up an R&D project should be provided for. We have suggested in this submission that this could be provided via a legislative change or through changes to Revenue guidance.

Q7. Section 766B Taxes Consolidation Act 1997 places limitations on the R&D credit to be paid under section 766 and 766A TCA 1997.

- **Do you consider the limits to be appropriate? What is the impact of these limits on your R&D activities?**
- **If you claim R&D tax reliefs in other countries, are similar limitations in place? If so, how do the limitations differ and what are your views on this?**

Response;

Ignoring the impact of BEPs Pillar Two and the new US Regulations, we believe that the limitations attached the refundable R&D tax credit amount under Section 766B (TCA) 1997 are appropriate in most instances. In most cases given that the main driver of the majority of R&D tax credit claims is staffing expenditure, the R&D tax credit rarely exceeds payroll tax limits provided. There could however be situations where a company may incur a significant amount of capital expenditure either on a new R&D building/ facility or on plant and machinery, or consume expensive raw materials, which will be used for R&D activity. This could lead to a large R&D tax credit amount that exceeds the payroll tax liabilities of the company.

However, given the points above in Q3 around BEPs Pillar Two and the new US Regulations, it is critical that the payroll cap is now removed from the legislation, immediately.

In addition, we believe that a refundable tax credit paid should be available in full, in the year of the claim up to a value of (say) €300k of R&D tax credit. This would be of great benefit to SMEs, but would be available to all so should not fall foul of EU State Aid rules.

Q8. What changes might help R&D tax credit claims to be dealt with more smoothly, while ensuring better compliance?

- **How could the Department of Finance and/or Revenue improve on the quality of information and/or guidance available to companies?**
- **If you claim R&D tax reliefs in other countries, how does the claim process differ and what are your views on this?**

Response;

We have outlined below some potential areas of improvement to the RDTC which we feel could not only enhance the overall regime but would also allow claims to be processed more smoothly and allow for even better compliance:

Revenue Guidance

- Of our total survey respondents, only 24% stated that the Revenue's Guidelines were clear and allowed companies to claim the RDTC with confidence. That said, 62% of respondents noted that the Guidelines were "Somewhat clear". Therefore, while Revenue's Guidelines appear to be useful to companies who prepare and submit R&D tax credit claims, they could be improved upon.
- As experienced RDTC advisors we can offer valuable insights into companies across multiple sectors and accurately relay their experiences of claiming the RDTC. We have worked closely with Revenue in the past with respect to drafting guidelines both for the RDTC and the KDB. We are also members

of the RDTC Steering Group as established by Revenue. Therefore, we believe that any updates to Revenue's R&D Guidelines should be made following a briefing/ informal consultation with RDTC practitioners and other stakeholders who can offer valuable and practical contributions.

- In addition, the timing upon the release of RDTC Guidelines can also (depending on a company's accounting period) unfairly impact certain taxpayers and create an air of uncertainty around the credit. For example, Revenue published Guidelines on 1 July 2020 which stated 'rent' was no longer an allowable cost. As some companies had already filed their "2019 claims" by 1 July 2020 (availing of the early filing mechanism Revenue helpfully introduced as one of the Covid support measures), and some had not, there was real uncertainty and confusion among taxpayers as how to treat rent for RDTC purposes.
- We believe that limiting the release of new Revenue Guidelines to a certain period in time (e.g. at the beginning of the calendar year (i.e. in January) or with the publication of the October Budget or Finance Bill etc.) would provide companies with greater certainty as to when Revenue's Guidelines may be updated and for what periods they apply to.

Simplifying the 'science test' for SMEs

- Revenue's Guidelines (December 2021) contains a provision which aligns the R&D tax credit with Enterprise Ireland and IDA R&D grants in respect of the scientific technical aspects of R&D projects. The rationale was to simplify the practical administration of the 'science test' for the R&D tax credit regime.
- This administrative practice is limited to circumstances where the R&D tax credit claimed by the company for a 12-month accounting period is €50,000 or less. The administrative relief is also confined to companies which are small or micro enterprises. We suggest an extension and increase in the €50,000 limit below which Revenue will not conduct a 'science test' audit (once the firm was already in receipt of Enterprise Ireland RD&I, Horizon 2020, or IDA R&D grant support), by increasing the limit for application of this administrative practice to €100,000 and extending the administrative relief beyond the small companies and micro companies to which it currently applies.
- We believe that the increase in limit should assist with the overall compliance and allow for a more efficient process both for the taxpayer and for Revenue.
- Given that the R&D projects would have already been peer reviewed by State appointed scientific/ engineering expert (i.e. through the IDA or Enterprise Ireland RD&I Grant process), we believe increasing this limit is not unreasonable.

Allowance for overheads/ indirect costs

- Extending eligible expenditure to allow for certain indirect/ supporting costs which companies incur for the purpose of its R&D activity.
- Other international R&D tax regimes allow companies to allocate a portion of indirect costs or costs which are attributed to a company's R&D activity. The following list includes just some of the other international regimes that allow for a portion of indirect costs/ overheads:
  - Austrian R&D premium
  - Australian R&D tax incentive
  - Canadian Scientific Research and Experimental Development (SR&ED) credit
  - Croatian R&D tax relief
  - Danish R&D Deduction
  - New Zealand R&D tax credit
  - Romanian R&D deduction

We believe that extending the scope of eligible expenditure to include such costs and providing clear guidance on the type of overheads which qualify and those which don't, would lead to an improvement of taxpayer compliance and allow Revenue enquiries/ audits to be carried out in a more efficient manner. Further details are set out in Section 4 with respect to how this could be implemented.

Q9. Question 9. If the rules in relation to how the credit is claimed or distributed were to be altered, for example in relation to the payment or carry-forward of excess credit, what transition provisions or other considerations would be required?

In responding to this question, please have regard to multi-lateral and jurisdictional changes in the international tax landscape and their potential consequences for the Irish tax system as a whole.

Response;

We have set out below some potential updates to the RDTC scheme which we feel would enhance the attractiveness of the credit to both MNCs and SMEs.

- As outlined above in Q3, an urgent review is required of the mechanism by which the R&D tax credit is refundable, to ensure it meets the conditions to be a "qualified refundable tax credit" under the GloBE rules. As the Pillar Two rules provide that the eligibility criteria of a 'qualified refundable tax credit' is determined based on the rules in place when the claim is made, it is imperative that changes to the RDTC regime are made in 2022 to provide certainty to taxpayers.
- Furthermore, as the new US regulations take affect from for tax years beginning on or after 28 December 2021, if the RDTC is not refundable at the option of the taxpayer in year 1, the foreign tax credit relief available to US parented groups will be reduced by the amount of the RDTC that is offset against the Irish company's corporation tax liability. As such, we recommend that the rules are altered as soon as possible and any transition rules are kept to a minimum.
- We would suggest an automatic refund of cash claims for compliant taxpayers for R&D tax credit claims in one instalment in Year 1, rather than over three annual instalments as currently applies. Being mindful of the Exchequer cash-flow, we would suggest that a cash refund up to an amount of (say) €300k could be processed in full in one instalment. To the extent that a tax-payer claims an R&D tax credit in excess of €300k, the remaining balance would be refundable in the years 2 and 3, as appropriate (e.g. another €300k in Year 2 and the balance in Year 3).
- We would also recommend that R&D refunds in Year 1 (under the €300k limit) are processed automatically to ensure speedy payment to taxpayers, as opposed to the current approval process which frequently leads to significant delays in payments issuing. SMEs who rely on R&D tax credit refunds to fund its ongoing R&D can often be waiting 6 -12 months for R&D tax credit refunds to issue even where they are compliant for all other tax matters.
- This change in administrative process would not affect Revenue's right to audit and review the claims but would reduce delays within the system currently experienced by claimants. It would also be of particular support to SMEs who are more likely to have a refund claim below the limit of €300k and would benefit most from the improved liquidity arising under the administrative practice.

Q10. Do you think there are ways of improving the current R&D tax credit system to make it more attractive to SMEs, taking account of EU State aid constraints that would militate against the introduction of a targeted element to the existing tax credit?

Response;

40% of our survey respondents were SMEs and for the purpose of this Question, we have focussed on their responses to our survey questions. We have set out in Figure 11 below a further breakdown of the SMEs and the size of their organisation along with the industries each SME operate within in Figure 12.

Which of the following best describes your business / operations in Ireland?

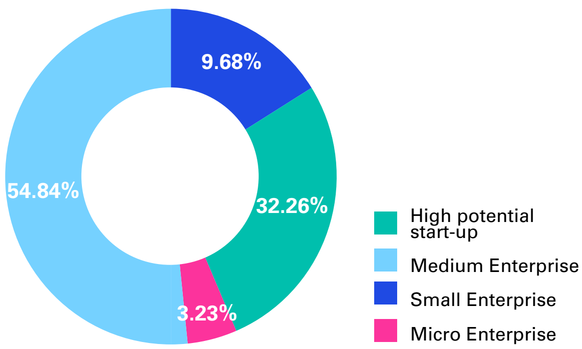


Figure 11 – Breakdown of company size for SMEs

Split of Industries for SME respondents

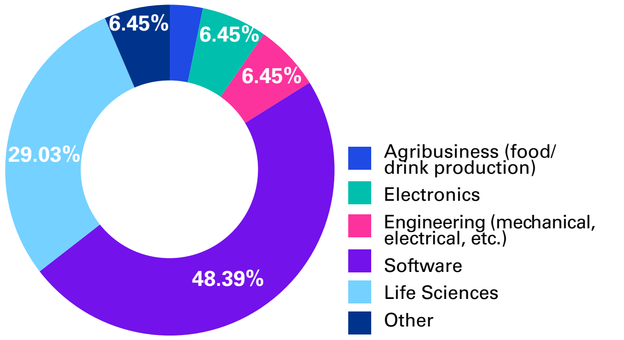


Figure 12 – Breakdown of industry sectors for SMEs

What do you value about the R&D Tax Credit RDTC?

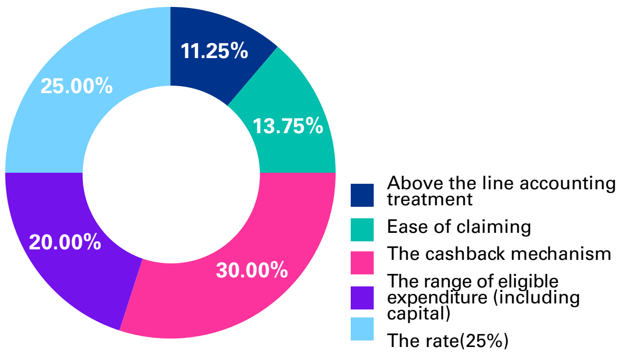


Figure 13 – What do SMEs value most in the RDTC?

As shown in Figure 13, the attribute of the RDTC regime that SMEs valued the most was the 'cash back' mechanism. This is not a surprising result given the importance of cashflow to SMEs. A number of SMEs also identified areas of improvement for the RDTC. 42% felt that payment of the RDTC refund in one instalment (as opposed to three) would improve the RDTC regime for theme. Other recommendations included increases to the limits on outsourcing, changes to the administration of the RDTC which could lead to a simpler process.

We have set out in detail in Section 4 of this submission document our suggested enhancements to Ireland's RDTC regime. The micro-SME sector were disappointed when targeted changes to the R&D tax credit in Finance Act 2019 were not brought into operation due to State Aid rules. These measures we propose would be open to all taxpayers in the context of EU State Aid rules, but would have a disproportionate benefit for SMEs:

- Credit refunded automatically in year 1 (subject to a cap of (say), €300k)
- Rate increase to 35% for first €1M of eligible R&D expenditure
- Reduced audit window
- Simplified science test for SMEs

Q11. Having regard to overall Exchequer cost, what other measures could be taken to improve supports for SMEs carrying out R&D?

Response;

In addition to the enhancements to the RDTC referred to question 10 above and in Section 4 of this report, we believe that Ireland's SARP scheme could be enhanced to better assist SMEs carrying out R&D in Ireland.

We agree with the conclusion of the SME Taskforce Report that a more level playing field should be created between indigenous businesses and large multi-national companies in terms of the measures available to assist with staff mobility and talent retention. In this regard, we strongly support that report's recommendation that the SARP regime should be opened to new hires (SME Taskforce Report Action 2.6.4).

In addition to being of immediate benefit to Irish SMEs, it would also open the regime to our universities, allowing them to compete more effectively in attracting global talent to lead research and development here. This represents an opportunity to create a powerful positive feedback loop, driving the carrying on of cutting-edge research in Irish universities while contributing to the education of highly skilled graduates from these same institutions, thereby further promoting Ireland as a global hub for Irish R&D activities with our universities at its centre

Other areas for improvement

In our survey, we asked SMEs, having regard to overall Exchequer cost, what other tax measures could be taken to improve supports for SMEs carrying out R&D? Some of the non-R&D tax credit suggestions were as follows:

- Reduced employer PRSI or reduction on employer PRSI for R&D employees,
- A graduate employment credit to compensate for the training up period (lower productivity),
- A credit for VAT on capital equipment used in a company's trade,
- Easier access for investors,
- Allowances/ assistance to SMEs for workforce expansion.

The Knowledge Development Box

Q12. Do you have any views as to how Ireland's KDB could develop in the evolving international tax environment?

In responding to this question, please have regard to the Subject To Tax Rule (STTR) element of the Pillar Two agreement and its potential consequences for KDB claimants and the Irish tax system as a whole.

As outlined in our response to question 3, the OECD Pillar Two rules released in December 2021 will constrain countries' ability to compete based on corporation tax rate alone. However, they also create new potential areas of competition and opportunities for those countries who have signed up to the agreement. Specifically, the rules treat certain refundable tax credits, grants and subsidies as income (rather than reductions in tax) for the purposes of calculating a company's effective tax rate, ensuring that such incentives will become increasingly important areas of competition for countries seeking to attract investment from the world's largest companies in the future.

Whilst the Irish Knowledge Development Box (KDB) is an OECD compliant preferential regime, the benefit of the KDB will be substantially reduced for multinational groups within the scope of the Pillar Two global minimum effective tax rate rules and for groups within the scope of the Pillar Two Subject To Tax Rules (STTR). In order to help ensure the KDB can be considered a viable investment incentive, changes to the KDB tax regime will be necessary.

OECD Pillar Two rules will impact the value of the KDB regime for in scope Multinational Companies

Under the OECD Pillar Two rules, profits taxable under the Irish KDB regime will be included as GloBE income in line with accounting principles and will be subject to the minimum effective tax rate. Despite the deemed tax deduction under Irish domestic rules resulting in the KDB profits effectively being taxable at 6.25%, these profits will be within scope of GloBE and will be subject to the minimum effective tax rate of 15%. This may give rise to additional top-up tax payable on these profits, thus almost entirely negating the benefit of the KDB regime for in scope multinational companies. We recommend that consideration is given to adjusting the KDB regime so that it falls within the definition of a 'qualified refundable tax credit' under Pillar Two rules. This would help ensure that the KDB remains viable as an incentive regime.

Subject To Tax Rules (STTR)

The STTR regime is still being developed at the OECD and a final version of these rules is not yet available. Based on the OECD Pillar Two blueprint report, released in October 2020, developing countries may apply a withholding tax on interest, royalties and defined payments where the recipient jurisdiction applies a nominal corporate tax rate of less than 9% to the payment.

Whilst the 12.5% corporate tax rate applies to eligible KDB profits in Ireland, based on the 2020 blueprint, it was envisaged that the entitlement to a deemed expenditure deduction from taxable profits, as provided for in Irish legislation, would be in scope of the STTR. Based on the statement released by the Inclusive Framework in October 2021, our understanding is that the additional withholding tax chargeable on in-scope payments taxed under the Irish KDB regime would be 2.75%, being the difference between the 9% minimum rate and 6.25% KDB rate. We recommend that further consideration and stakeholder engagement is sought on the implications of the STTR on the KDB regime when the final mechanics of the STTR are agreed by the Inclusive Framework.

Q13. What do you perceive to be the factors behind the low uptake of the KDB to date among Irish companies?

Response;

- In most scenarios, to claim KDB a company must have developed and patented a product or process or developed a computer program. However, in many cases we have found that indigenous companies do not patent their product/ process etc. but rather wish to retain as a 'trade secret' to maintain competitiveness. The KDB is not currently available on trade secrets or 'know-how' meaning a number of companies would not be in a position to claim KDB.
- The KDB can provide a significant benefit to companies who carry out all of their R&D in Ireland. Therefore, while this should in principle suit indigenous companies, many MNCs where R&D collaboration between multiple group companies would be quite common, would see any KDB benefit diluted as a result. Companies

which acquire IP and further develop said IP would also see a dilution of KDB benefit. While MNCs may look at planning ahead and seek to designate that Ireland will undertake all R&D in relation to specific products/services, long term certainty around Ireland's KDB scheme would be required, particularly with regard to OECD BEPS Pillar Two provisions and the sunset clause included for KDB.

- The income from exploiting the IP has to be earned by the same entity that undertook the R&D that created the IP. In our experience, many MNCs are structured differently and in a way which would not allow them to claim KDB.
- One important distinction between the R&D tax credit and KDB is that the KDB only provides a benefit to companies via an additional corporation tax deduction and in the absence of sufficient corporation tax liability, no tax benefit arises through KDB. Unlike the R&D tax credit, KDB is not a refundable benefit meaning that it won't be available for all tax payers involved in R&D activity.
- A considerable amount of work is required to prepare a claim which is ready to be audited Revenue. As part of filing a claim, R&D expenditure and activities need to be reviewed for previous years. For example, a company may have patent on a product/ process which it is earning income on in 2021 but the product/ process may have been developed through R&D activity that was undertaken (say) 15 years ago.

  While there are 'transitional measures' in the legislation which provides a cut-off point of 1 January 2016 for when to calculate acquisition costs, group outsourcing costs and qualifying expenditure on the qualifying asset, it's not clear in practice how a company should satisfy Revenue that the activity undertaken 15 years ago would have been qualifying R&D activity. This can be a considerable task particularly taking account of changes in company personnel, changes in ERP systems, disposal of documentation after a certain number of years etc.

Q14. Are there any particular elements of the KDB conditions that you have encountered difficulty with? Are there commercial situations which you feel should be in scope of the relief, but which fall outside the current rules?

In replying, businesses should be cognisant of the requirement for the KDB to be compliant with the OECD BEPS Action 5 agreement on the modified nexus approach for IP regimes.

Response;

- We believe that extending the KDB relief to include 'trade secrets' and 'know-how' as qualifying IP would enhance the KDB relief scheme in Ireland and allow more indigenous companies to avail of it.
- Making the KDB refundable, similar to the RDTC, would see it having an application under BEPS Pillar Two provisions.
- Clarification on the transitional measures with respect to the documentation of R&D activity which was carried out pre 1 January 2016.
- Extend the provisions of S769R (i.e. the section that applies to companies with income arising from IP of less than €7.5m) to bring larger companies within scope.
- Consideration for an Irish Group KDB election provision to allow for situations where R&D may be carried out by one Irish group entity and income attributable to the IP is received by another Irish entity in the group. An election to allow both companies be grouped for KDB purposes could help facilitate KDB claims where the groups split different operations (e.g. R&D, sales etc.).

"

In order to help ensure the KDB can be considered a viable investment incentive, changes to the KDB tax regime will be necessary

Q15. More generally, what do you think could be done to better support Ireland's indigenous innovation sector in pursuing productivity growth or the development of patentable advancements?

We have set out below some ideas which could support Irish businesses to pursue productivity growth or patentable advancements through innovation:

- Introduce innovation as a course at all levels of education from primary upwards. Developing and fostering critical thinking at all stages of education could bring about significant benefits not only with respect to Ireland's innovation but to entrepreneurs in general.
- Increased basic research funding in key underdeveloped areas for both academia and industry; e.g. carbon sequestration, novel energy generation, to attract the 'new' industries of the future.
- Support more small technology hubs run by the IDA/EI to reduce companies need for initial outlay.
- Establishing an agency with a specific focus on the generation and exploitation of IP on a national level.

04 Our recommended enhancements to Ireland's R&D tax incentives

The survey we undertook and the conversations we have had with clients has highlighted a number of areas where the current RDTC regime could be enhanced. The intention is to make Ireland a materially more attractive destination for FDI R&D than other countries and to ensure that the R&D reliefs continue to offer a strong incentive to businesses to establish substantial operations here involving a highly skilled workforce.

We recommend the following improvements, some of which are already discussed above:

Fully refundable R&D tax credit regime

As outlined above, the mechanism by which the R&D tax credit is refundable needs to be updated to ensure it meets the conditions to be a "Qualified Refundable Tax Credit" under the GloBE rules and does not negatively impact the foreign tax credit rules under the new US regulations. One way of achieving this would be to ensure that the R&D tax credit is not limited to the company's tax liability and refundable in cash at the option of the taxpayer in the year of claim. Another way would be to make it directly offsetable against Payroll tax and sever the link between the RDTC and Corporation tax.

Rate increase

The rate at which the RDTC is provided should be increased from 25% to 35% for at least the first €1M of qualifying R&D expenditure. This enhanced rate would be available for all claimants and therefore should not result in any breaches in EU State Aid rules, although it would have a disproportionate benefit for SMEs. This would strongly support Ireland's ambition to providing a best-in-class R&D tax credit regime, while sending a powerful signal to Irish and international businesses that Ireland intends to establish itself as an international R&D hub.

The threshold approach of only providing an increased rate for the first €1M of qualifying expenditure should provide a degree of certainty to the Department of Finance that the addition cost to the Exchequer would be manageable.

In our survey, 83% of respondents agreed or strongly agreed that an increase in the rate of the RDTC from 25% to 35% would increase the R&D activity carried out by their company (see Figure 14 below).

Do you think a 35% RDTC rate (increased from the current 25% rate) would see more R&D undertaken by your company?

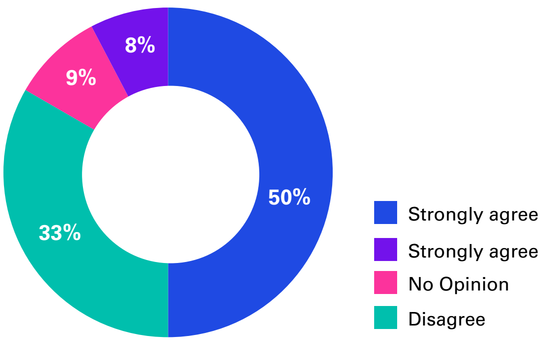


Figure 14 - Would a 35% RDTC rate (increased from the current 25% rate) see more R&D undertaken by your company?

Using recent Revenue statistics, we know that in 2020 the cost of the R&D tax credit was €658M encompassing 1,616 claimants. The value of the credit utilised is split out between different increments. Using this data for 2020 and based on a high level estimate, we believe an increase of the RDTC to 35% for the first €1M of R&D expenditure could equate to an annual cost of approximately €60m. If the RDTC rate was increased to 35% for the first €2m of expenditure, we estimate this could cost in the region of €85m annually.

Enhanced R&D tax credit rate for 'Green technologies'

Ireland should strive to establish itself as an international hub for R&D activities in the 'green technology' space. To date, Ireland has failed to attract substantial research investment in this area. To help counter this, we recommend enhancing our existing R&D tax credit regime to allow for a 50% credit on expenditure incurred on R&D activities undertaken in the 'green technology' space. This could include R&D with respect to solar, wind, hydro, or biomass energy technologies, as well as other green technologies such as soluble or compostable materials for packaging, air filtration methods, ocean cleaning technology, etc.

92% of respondents to our survey stated that they felt this enhanced rate of RDTC (i.e. 50%) would increase R&D investment in these important green technologies.

Do you feel an enhanced RDTC of 50% incentivise increased R&D of green technologies such as solar, wind, hydro, or biomass energy technology etc?

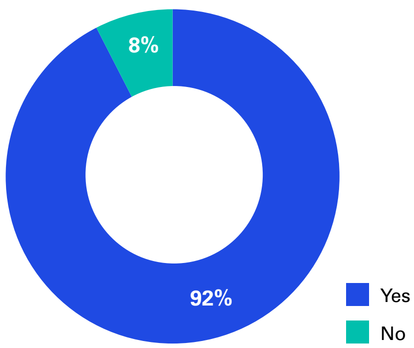


Figure 15 - Would an enhanced RDTC of 50% incentivise increased R&D of green technologies such as solar, wind, hydro, or biomass energy technology etc?

Payable credit paid to SMEs in one instalment

The current Irish repayable tax credit regime allows cash to be refunded over a three year period to companies in the absence of sufficient corporation tax for the current and preceding periods. In the same manner as UK R&D tax credit regime for SMEs, it would be more advantageous for companies if the cash refund was available in full, in the year of the claim up to a value of say €300k of R&D tax credit, and not on a phased basis over three years. The impact of receipt of funding in one year instead of over three years can be expected to be greatest for SMEs who, in practice, have less access to alternative sources of funds for R&D activity than larger firms.

This proposal would come at little cost to the Exchequer, being only the time value of money with respect to the refunds which would otherwise arise in Years 2 & 3.

Allowance for overheads/ indirect supporting costs to R&D

Revenue's current interpretation of the eligibility of expenditure on overheads restricts allowable overheads to a small number of expenditure categories including "power consumed in the R&D process". In reality, there is a much broader set of overheads incurred by a company directly in enabling and facilitating its R&D activities, but these are not funded by the tax credit.

In recent years however, Revenue have included a more narrowed interpretation of "expenditure incurred in the carrying on" of R&D activity in its Guidelines. Most recently, the Guidelines now regard an allocation of an office rent, where the office is used for R&D activity, as being non-eligible for the R&D tax credit.

For the R&D tax credit, we suggest extending allowable expenditure to include a reasonable portion of overheads/ supporting costs which are attributed to R&D activity. This could be done through a number of methods:

i. Amending the wording of section 766(1)(a) TCA 1997 to "wholly and exclusively for the purposes of R&D activities", rather than "wholly and exclusively in the carrying on by it of R&D activities", to align the definition of "expenditure on R&D" with the original policy intention. This amendment would also provide greater clarity and certainty to claimants of the relief with respect to qualifying costs.

There have been different interpretations applied to the meaning of the allowable costs that come within the definition of expenditure incurred "in the carrying on of R&D activity". This has also resulted in a number of changes to Revenue's R&D Tax Credit Guidelines. Amending the definition to "for the purpose of" which is used in other areas of the legislation therefore should provide greater clarity.

ii. A list of allowable overheads to be provided for in Revenue's R&D Guidelines (similar to the list of indirect supporting and ancillary costs provided for by Revenue in the 2011 R&D Guidelines).

iii. Aligning the treatment of overheads for R&D tax credit purposes to be similar with how R&D costs are treated for accounting purposes under International Accounting Standards.

iv. Aligning a similar approach to overheads to what is adopted by Enterprise Ireland and IDA for RD&I grant claims i.e. allow the claimant company to claim either 30% of qualifying R&D staffing expenditure to cover overheads (which is aligned with the R&D grant aid approach) or should they wish to claim a higher amount, they could do so on production of supporting evidence.

Indirect/ Supporting Activities

Our survey indicated that administration and support staff often play a key role in R&D projects. This is the reality of how R&D is carried out within industry. However, the costs of indirect or supporting activities are not provided for by the legislation or Revenue's Guidelines.

Other international R&D tax regimes allow for a portion of support staff costs to be appropriately apportioned to R&D activity. In the UK, expenditure incurred not only on R&D activity but also on "Qualified Indirect Activity" can qualify for R&D tax relief. Similarly, the New Zealand, Australian and Canadian regimes distinguish between "Core R&D activity" and "Supporting activities", both of which can qualify for R&D tax credits.

In the past, Revenue's R&D Guidelines also accepted that indirect supporting activities and activities ancillary to R&D could also qualify for the R&D tax credit. This was also envisaged by the Tax Strategy Group when first considering Ireland's R&D tax credit in 2003.

We believe that an allowance of certain indirect supporting activities/ costs in an R&D tax credit claim to reflect the reality of the costs and activities which make up an R&D project should be provided for, ideally through a change to the legislation.

Expansion of list of qualifying fields of science/ technology

Consideration should be given to expanding the list of qualifying fields beyond the existing science and technology categories to include, for example, specific reference to research into technologies such as artificial intelligence, machine learning, blockchain and other emerging technologies, many of which are currently included under "computer sciences and other allied subjects". Specific reference would bring further clarity to those undertaking research into these areas that they can qualify for the R&D tax credit.

Simplifying the 'science test' for SMEs

Revenue's Guidelines (December 2021) contains a provision which aligns the R&D tax credit with Enterprise Ireland and IDA R&D grants in respect of the scientific technical aspects of R&D projects. The rationale was to simplify the practical administration of the 'science test' for the R&D tax credit regime, by not conducting a 'science test' audit (once the firm was already in receipt of Enterprise Ireland RD&I, Horizon 2020, or IDA R&D grant support).

This administrative practice is limited to circumstances where the R&D tax credit claimed by the company for a 12 month accounting period is €50,000 or less. The administrative relief is also confined to companies which are small or micro enterprises.

We suggest an increase in the €50,000 limit below which Revenue will not conduct a 'science test' audit to €100,000 and extending the administrative relief beyond the small companies and micro companies to which it currently applies.

Reduced audit window

Currently, a Revenue audit of a company's R&D tax credit claim for a particular financial year can take place up to four years after the year in which the tax return for that period was filed.

The length of the audit window (which is up to five years after the R&D took place) can present practical difficulties in validating R&D tax credit claims given the rate at which technology moves on. Revenue appointed technical experts can be asked to give a view on technology which, by the time of the audit, is out of date and no longer 'leading edge'. This gap in timing of review has the potential to create greater uncertainty surrounding the claimant company's ability to meet the 'science test'.

We suggest a legislative change to reduce the audit window to two years from the end of the accounting period in which the claim was filed (from four years) to allow for greater certainty in relation to R&D claims and to give companies the confidence to invest the money received in further R&D activity.

Increase the current limits on outsourced R&D activities

We suggest that that the limit on outsourcing R&D activity to third parties is increased to the greater of (i) 25% of qualifying R&D expenditure or (ii) €250,000 (where it has been incurred and is matched by qualifying R&D expenditure).

We believe that the increase in the current €100,000 limit to €250,000, in part, takes into account the increased cost of doing business in Ireland since the introduction of the current €100,000 limit in Finance Act 2012. Although applicable to companies of all sizes, this increase in the limit can be expected to have the greatest impact on enterprises of a smaller scale which can rely more heavily on access to outsourced services in carrying on R&D activities.

We believe that this would act as an incentive for Irish businesses to collaborate with one another.

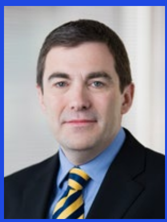
Enhancement to SARP regime

In addition to the above enhancements to Ireland's R&D tax credit regime, we believe that targeted enhancements to the SARP regime aimed at attracting valuable R&D professionals would act to further establish Ireland as a talent hub for innovation and research.

Specifically, key talent involved in R&D activities could be attracted to Ireland by applying an approach similar to that currently in place in Sweden, in which certain key foreign employees (defined by reference to where there is a skills shortage in Sweden) may qualify for an income tax reduction and their employers for a lower rate of employer social security contributions.

We propose a similar approach is applied here, in which all remuneration of employees engaged in R&D is taxed at the standard rate, irrespective of the amount of the individual's salary. This could be implemented as an enhancement to the existing SARP regime.

Contact us



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