



R&D Tax Credit Review 2019

KPMG Response to Public Consultation
7 June 2019





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7 June 2019

Dear Sir/Madam,

Research & Development Tax Credit Review 2019 – Public Consultation

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

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. Most of these have claimed the 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 also reviewed data from a survey we commissioned to explore the circumstances in which a cohort of businesses who have been supported by government R&D grants have not claimed the R&D tax credit. This has allowed us to explore potential barriers that face businesses in taking full advantage of this important tax incentive.

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.

This consultation forms part of a number of linked consultations in which Ireland's policy makers are seeking feedback on a range of tax incentive supports for SMEs. KPMG has responded to the questions on SMEs and the R&D tax credit in this submission in addition to our separate responses to the consultations on the CGT Entrepreneur Relief and the Key Employee Engagement Programme (KEEP).

In this submission, we have set out recommendations for both tax technical and administrative changes which we believe could further enhance the impact of the R&D tax credit in supporting and sustaining business investment in R&D activity.

The contact point for this submission is Ken Hardy. Ken's contact details are set out above. Should you wish to discuss any aspect of the attached submission please do not hesitate to contact us.

Ken Hardy
Partner

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Partner

Introduction

In the chart below, we have illustrated the development life cycle of a business across four phases from ideation and incubation to full commercialisation of the product or service offering. Below each phase, we have indicated tax incentives that are designed to support the business in moving to the next phase.

In Ireland, once a business exceeds a relatively modest scale, it is common for the business to be conducted by a company owned by the entrepreneur. Additional capital to fund the business is often raised through monies subscribed for new capital in the company (whether from the founder or new investors) or from retained profits.

Outcomes from R&D activities by their very nature are uncertain. They present challenges for businesses in raising capital to fund the activities. Ireland's R&D tax credit and, in particular the ability to seek a refund where the credit exceeds the company's corporation tax liability, means that its design can accommodate and support R&D activities through the business life cycle. It can provide funding support to R&D activities conducted by early stage companies who are not profitable and do not pay corporation tax as well as supporting R&D performed by mature businesses at full commercialisation stage.

In providing our responses to the questions in this consultation, we have taken soundings from businesses at different stages of development. We have identified a common theme in the feedback they have provided.

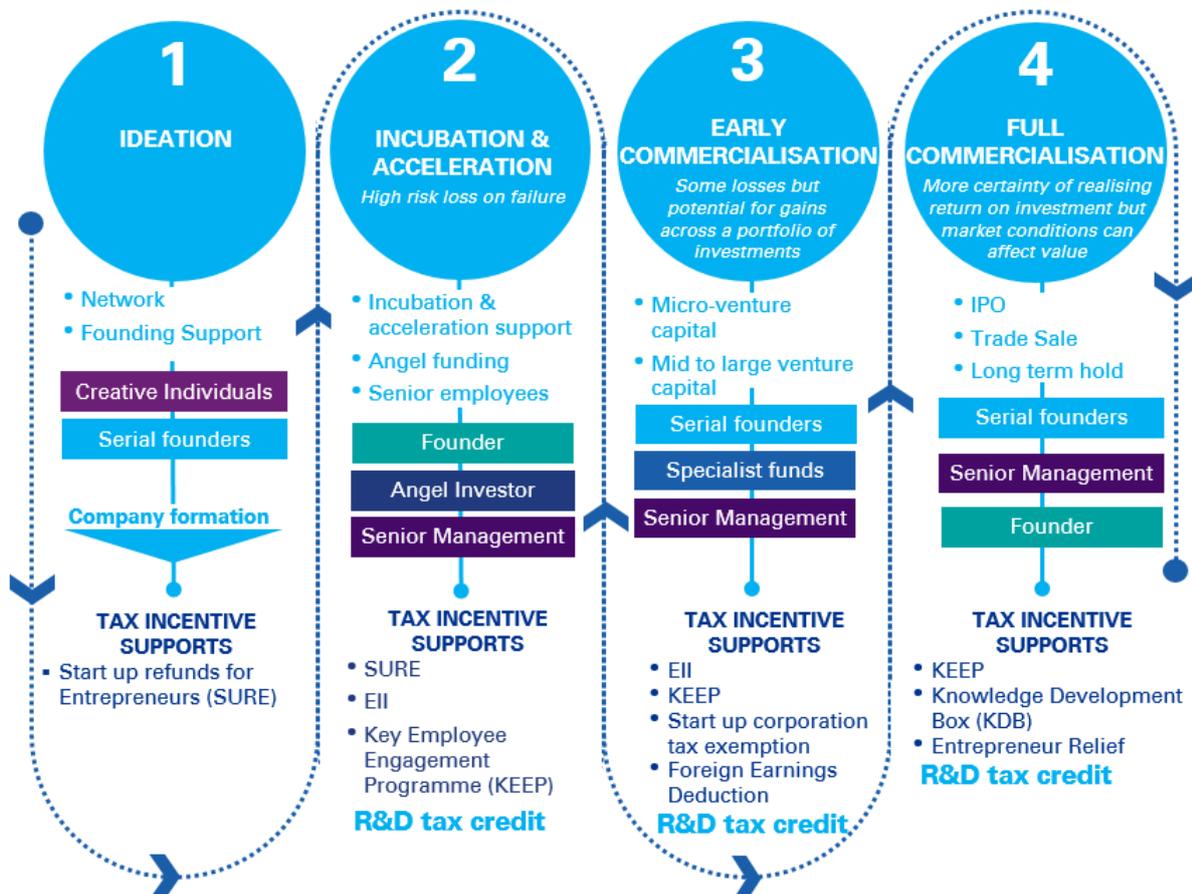
It is the effectiveness of the R&D tax credit in contributing to the company's funding of R&D activities that determines its perceived usefulness and value as a support to continuing R&D activity.

Our findings suggest that the main factors that determine the tax credit's effectiveness in funding R&D activities are:

- the rate of the R&D tax credit,
- the ability to claim the R&D tax credit even if not paying corporation tax (i.e. under the 'cash back' provisions),
- the ease of access and administrative compliance, together with certainty of the availability of the credit for taxpayers.

Our focus in this submission is to explore means of enhancing ease of access and administrative compliance, especially for SMEs, as well as suggesting changes to improve the certainty of availability of the R&D tax credit.

Life cycle of SMEs - Four phases



Feedback and recommendations - Summary

Background

KPMG has taken soundings from businesses claiming the R&D tax credit on the impact of the credit on R&D activities conducted by them. We have set out below a summary of the high level themes emerging from this feedback.

Soundings were taken through discussions at a facilitated workshop and 'one on one' interviews with businesses of different sizes and R&D intensity.

Through these discussions, we have explored the day to day impact of the R&D tax credit on the success (and sometimes failure) of winning R&D projects in Ireland. We have also explored the impact of the tax credit on 'go/no go' decisions related to R&D activities of early stage and R&D intensive companies.

By its nature, this feedback is anecdotal - but we believe it provides important insights on the manner of operation of the R&D tax credit on the ground. These insights are

not available from national statistics on the volume of claims or from macroeconomic data. We have included these insights in our detailed feedback provided to the questions in the consultation in the form of short case study descriptions which capture the experiences of these companies.

KPMG has also reviewed data from a survey¹ we commissioned to explore the circumstances in which a cohort of businesses who have been supported by government R&D grants have not claimed the R&D tax credit. This has allowed us to gain insights on the potential barriers that face businesses in taking full advantage of this important tax incentive.

In making our suggestions for change, we have included technical changes to the R&D tax credit provisions and to other tax supports for R&D activity. We have also suggested administrative changes that we believe could improve the operation of the tax credit and positively affect the perceived certainty of availability of the relief.

These suggestions have drawn on real life insights from the business feedback described above together with KPMG's experience in advising our clients claiming the R&D tax credit.

In this section of our submission, we have summarised the feedback to the consultation questions and our recommendations for change. A more detailed analysis of our findings together with short case study excerpts drawn from the soundings taken from businesses can be seen in the next section of this submission document.

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



Insights drawn from soundings from businesses claiming the R&D tax credit suggest that:

- The **cost of the R&D activity** remains one of the primary factors in decision making relating to R&D location. This assumes that factors such as geographic location are relatively neutral and that competitor locations have equivalent access to necessary R&D capabilities.
- **Payroll costs** are often the highest portion of R&D costs and Irish wage costs are high compared to many European competitor locations.
- **Access to a skilled labour pool and the ability to leverage off deep capabilities in the R&D sector** is important. These deep capabilities are only developed over time if the R&D project team has sustained experience of conducting similar work on past projects.
- **Co-location opportunities** with suitable test environments are important considerations for R&D which is closely linked to the commercialisation of the product / service. This involves access to a production test environment for manufactured product or delivery platforms for software applications.
- The **wider business and research environment in Ireland** is a 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.

¹ KPMG Innovation Monitor 2019:
<https://home.kpmg/ie/en/home/insights/2019/05/innovation-monitor-2019-rd.html>

Q2. In the absence of the R&D tax credit, what proportion of your R&D would take place in Ireland?



In speaking to companies that have longstanding R&D activities in Ireland with a history of R&D tax credit claims, many have advised that the loss of the R&D tax credit as part of their funding would likely result in a gradual decline, rather than an immediate cessation, of their R&D activities in Ireland.

Their feedback is 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 and wither away over time. The Irish operations would become less central to the business with resulting loss of employment and business growth opportunities.

An important incidental effect of the loss of R&D capabilities is the loss of a necessary force of attraction (or nexus) to sustain the location in Ireland of high end production capacity and leading edge platforms to deliver services. These types of business activities create high skilled employment and go hand in hand with R&D activities.

Q3. As R&D is project driven the annual cost to the Exchequer can fluctuate quite significantly. What steps could be taken to improve advance forecasting of claims for Exchequer purposes?



Our soundings provide a range of feedback from businesses which suggest varying capacity to forecast R&D tax credit claims with certainty, year on year, due mainly to the level of uncertainty surrounding future volumes of R&D activity.

The challenges in forecasting eligible expenditure are greater for operational expenditure than capital expenditure.

The uncertainty related to the volume of R&D activities and related R&D operational expenditure, year on year, can arise for a range of reasons:

- Firms that conduct a series of projects often individually won by competing against other locations within the multinational group do not know whether Irish based R&D activities will

occur until a **central decision is made at group level** on the location for the next R&D project.

- Single product companies at the early commercialisation stage are very dependent on access to private **funding sources** as well as the R&D tax credit - failure to secure sufficient private funding or other public supports means no R&D.
- Sectors such as life sciences have high uncertainty surrounding R&D outcomes. This **inherent uncertainty on whether a current R&D project will have a positive outcome** means it is uncertain whether or not the current R&D will progress to the next stage – making it difficult to forecast claim levels, year on year.

The volume of R&D tax credit claims on capital expenditure e.g. on constructing a building or on investment of a significant scale in plant and machinery, can, in some cases, be easier to forecast. This is because of the longer lead in time related to planning and deploying such expenditure.

Looking at capturing forecasted capital expenditure eligible for the R&D tax credit therefore appears to be an area where collection of data at a firm level might yield the greatest proportionate impact on forecasting accuracy.

Q4. In your experience, has your decision to conduct R&D in Ireland resulted in you recruiting additional staff, interns or apprentices?



Findings from our soundings suggest that the decision to conduct R&D activities in Ireland has resulted in the recruitment of additional skilled employees.

Just as importantly, sustained R&D activity has resulted in deepening the R&D capabilities of firms engaged in R&D activities which, in turn, has improved their competitive position in securing future R&D projects.

Deepening and retaining R&D capabilities in Ireland not only influences the capacity of a company to engage in future R&D activities in Ireland but has a wider influence in sustaining high end manufacturing and the delivery of services at the forefront of technology, thereby supporting opportunities for skilled employment in these areas.

The R&D tax credit plays a key role in sustaining employment levels when R&D team members move from one project onto another Irish project where the Irish project team has secured the R&D project in competition to teams located in other regions. Without the R&D tax credit, the ability to win these future projects is diluted.

Q5. The R&D credit allows for limited outsourcing of R&D. Are the limits appropriate? What is the impact of these outsourcing provisions on third level institutions and/or smaller firms?

Increase the current limits on outsourced R&D activities



We suggest that the limit on outsourcing is increased to the greater of (i) 25% of qualifying R&D expenditure or (ii) €200,000 (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 €200,000, 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 proportionate impact on enterprises of a smaller scale which can rely more heavily on access to outsourced services in carrying on R&D activities.

Allow expenditure on agency workers in full rather than subjecting this cost to the outsourcing limits



We suggest that expenditure on agency workers who operate under the direction and control of the company in carrying on R&D activities is not treated as expenditure on outsourced R&D but is eligible for the tax credit in the same manner as R&D activities carried on by employees of the company.

Changing work patterns as well as the inherent uncertainties associated with conducting R&D activities has given rise to firms using agency workers to carry on R&D projects. Expenditure on agency workers, even those working under the control and direction of the company conducting the R&D, is treated as outsourced expenditure in applying the Irish R&D tax credit measures. This can cause firms to breach the outsourced expenditure limits. This is particularly acute in the hi-tech sector as well as for SMEs recruiting agency workers to meet staffing needs for once off or ad hoc projects.

To address this issue, we recommend a legislative change.

Ensure companies to whom R&D is contracted can have certainty over their ability to claim an R&D tax credit



Provide a mechanism, whether in guidance or through a legislative change, that would allow a company providing outsourced R&D services to a contractee to have greater certainty that the R&D tax credit would be available for its R&D activities.

The current approach to avoiding duplication of R&D tax credit claims for outsourced R&D can often mean, in practice, that:

- i. companies who are contracted to undertake R&D activity (the contractor, which is often an SME) cannot claim a credit for their R&D work, and
- ii. the company that has outsourced the work (the contractee) cannot make a claim for expenditure incurred on its R&D activities as it has reached the outsourcing limit.

As a result, neither party claims relief. This potentially operates to reduce the economic spillover benefits to SMEs of providing outsourced R&D activities to larger companies.

We have been made aware of situations whereby the contractor has received notification letters from the contractee (stating that the contractee is claiming the R&D tax credit, in which case the contractor cannot make a claim), on or after the contractor's tax filing deadline. The contractor may have already filed its R&D tax credit claim by the time the notification letter is received.

We recommend that a change is made that would operate to allow a company providing outsourced R&D services to have greater certainty that the R&D tax credit would be available for its R&D activities.

Q6. What are the factors that are relevant to the relatively low uptake of the current credit by SMEs?

KPMG's Innovation Monitor 2019 captured the results from a survey of 100 companies who have received R&D grants from Enterprise Ireland. KPMG explored the reasons why not all of these companies had also claimed the R&D tax credit. This has allowed us to identify potential barriers that face businesses in taking full advantage of this important tax incentive.

To summarise, the main insights from KPMG's Innovation Monitor 2019 survey findings were:

- The **Government and other stakeholders should continue to promote awareness of the R&D tax credit**, particularly among SMEs, with a focus on those aspects which seem to be poorly understood, i.e. the rate applicable, the fact that it can be payable in cash and Revenue guidance in relation to audits of the scientific basis for the R&D activity (the 'science test').
- The **value of the R&D tax credit to SMEs should be enhanced by paying the cash refund over one year instead of three**. For smaller firms, particularly start-ups, three years would seem an unreasonably long timeframe. By contrast, accelerating the payment would entail no

significant additional cost to the exchequer, other than the short-term cost of funds.

- A wider selection of costs – perhaps more closely matching those allowable for Enterprise Ireland grant aid – should be eligible for the tax credit. This would make the R&D tax credit both more financially attractive and more readily understood as it would remove the duplication of effort in estimating eligible costs for R&D grant supports and the R&D tax credit claim for the same activities and expenditures.
- An increase in the €50,000 limit to a €100,000 limit relating to Revenue’s administrative practice of not conducting an audit in relation to the ‘science test’ aspect of R&D tax credit claims where claimants already in receipt of an RD&I grant. This would reduce the compliance burden for SMEs by taking more companies out of the scope of a scientific audit where the ‘science test’ has already been validated through the grant claim process related to the R&D activities.

Q7. Are there ways of improving the current credit system to make it more attractive to SMEs?

Repayable credit

In addition to the change to the treatment of agency workers which is described above, we suggest:



A legislative change to permit SMEs to claim refunds of the R&D tax credit in one year instead of over three years. The SME might be allowed to elect either for the three year refund period to apply or, if a possible cost to the Exchequer is of concern, if an immediate refund is made, the refund amount could be reduced because it is being made upfront.

In this manner, if the cost of the time value of money is of concern, the cost to the Exchequer of providing the refund upfront could be offset by the reduced amount of the refund claim with no additional cost to the State.

Improving certainty of tax credit availability

In summarising the policy options for consideration in relation to improvements that are designed to improve certainty of access to the R&D tax credit from an administrative perspective, we suggest:

12 month ‘look back’ period



A legislative change to allow Revenue discretion to permit claims that narrowly

miss the 12 month ‘look back’ deadline for filing a claim, e.g. within a 4 week period - provided that the claimants meet certain criteria including having made reasonable efforts to meet the 12 month deadline.

Reduce 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 can create practical difficulties in R&D tax credit claims given the rate at which technology moves on and high levels of staff turnover in this sector. 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 has the potential to create uncertainty for the claimant company surrounding the eligibility of the expenditure incurred. To address this, we suggest:



A legislative change to reduce the audit window to two years (from four years) to allow for greater certainty in relation to R&D claims and give companies the confidence to invest the money received in further R&D activity.

Approach to overheads – a safe harbour

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 the carrying on of its R&D activities but these are not funded by the tax credit.

The current IDA/ Enterprise Ireland grant approach permits a claim for (any) overheads in an amount equal to 30% of eligible R&D salaries. For the R&D tax credit, we suggest the introduction in legislation of a safe harbor test that could 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. We suggest:



The introduction of a safe harbour test in legislation to enable the claimant of an R&D tax credit avail of the same approach to calculating overheads as is afforded by an R&D grant from one of the State granting bodies.

Simplifying the ‘science test’ for SMEs



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.

Consistency of application of the 'science test'



We suggest that consideration is given to the provision of further Revenue resources to ensure the consistent application of Revenue approaches to the 'science test' across claimants in different business sectors.

It is suggested that development of a centralised team of Revenue experts in this area could assist as might exploring the opportunities to draw upon international experts to supplement the pool of experts available in Ireland.

Administration of cash refunds for SMEs



We suggest allowing the automatic refund of a cash claim to a compliant taxpayer for claim amounts below a de minimis threshold to speed up the repayment of cash refund claims. The claims would remain subject to audit review.

Q8. Having regard to overall Exchequer cost, what measures could be taken to amend the current relief to improve supports for SMEs carrying out R&D?



Improve the effectiveness of the key employee tax credit mechanism by making the following changes:

- Permit companies eligible for a cash refund to have the option of surrendering part of the refund to eligible key employees through an **employment tax credit**. Do not limit the relief to profitable companies which can offset the credit against corporation tax,

- Remove the requirement that the eligible employee cannot be a director of the company or an associated company so as to **allow scope for the boards of directors of companies to include key R&D personnel**,
- Remove the requirement for a **minimum effective tax rate for the employee** so as to extend the relief to recent graduate hires - the tax credit is already inherently self-funding and neutral from a tax revenues' perspective.

Impact of relief under the Knowledge Development Box (KDB) on the R&D tax credit cash refund

Where the corporation tax liability of a company for a period is reduced by a claim to relief under the KDB, the reduction in the corporation tax liability is ignored for the purposes of computing a cash refund available under the R&D tax credit regime. As a result, a lesser amount is potentially available by way of a R&D tax credit refund to the company. We suggest a higher amount of credit/refund is available by comparing the available tax credit with the actual amount of corporation tax after taking account of KDB relief.



We suggest revising the entitlement of businesses to claim a R&D tax credit refund by allowing a refund amount to the extent the claim exceeds the actual corporation tax payable by the company/group, i.e. after taking into account a reduction in corporation tax caused by KDB relief.

This would mean that the scope for relief afforded for R&D tax credit claims under section 766(4), Taxes Consolidation Act 1997 (TCA 1997) should not be reduced where there is a reduction in corporation tax resulting from a claim to relief under the KDB so that the KDB relief operates in the same way as other credits/reductions in corporation tax.

Feedback and recommendations

Background

In this section of our submission, we have explored feedback we received from soundings taken from businesses claiming the R&D tax credit on the impact of the credit on R&D activities conducted by them. This has been done through discussions at a facilitated workshop and through 'one on one' interviews with businesses of different sizes and R&D intensity.

Through these discussions, we have explored the day to day impact of the R&D tax credit on the success (and sometimes failure) of winning R&D projects in Ireland. We have also explored the impact of the credit on 'go/no go' decisions related to R&D activities of early stage and R&D intensive companies.

By its nature, this feedback is anecdotal - but we believe it provides important insights on the manner of operation of the R&D tax credit on the ground. These insights are not available from national statistics on claim volumes or from macroeconomic data. We have included these insights in our detailed feedback provided to the questions in the consultation in the form

of short case study descriptions which capture the experience and feedback of these companies.

KPMG has also reviewed data from a survey we commissioned to explore the circumstances in which a cohort of businesses who have been supported by government R&D grants have not claimed the R&D tax credit. This has allowed us to identify potential barriers that face businesses in taking full advantage of this important tax incentive.

We have also reviewed international developments in the R&D tax offerings of jurisdictions which compete with Ireland for R&D activities. This was done so as to understand the aspects of R&D tax incentive regimes that prove to be the most powerful in influencing the perceived effectiveness of a regime.

Based on the combined insights from these findings, we have made some suggestions for change. These include technical changes to the R&D tax credit provisions and to other tax supports for R&D activity. We have also suggested administrative changes that we believe could improve the operation of the tax credit and positively affect the perceived certainty of availability of the credit.

These suggestions have drawn on real life insights from business feedback as described above together with KPMG's experience in advising our clients claiming the tax credit.

Environment for Ireland's R&D tax credit regime

Ireland's R&D tax credit regime was introduced in Finance Act 2004. The purpose of the credit is to encourage companies to carry on R&D activities in Ireland in the expectation that more highly skilled and highly paid jobs will be created in Ireland.

Since its introduction in 2004, the regime has remained available for taxpayers and has benefited from incremental improvements. This certainty of availability of the tax credit is one of the hallmarks of the regime that has supported its take up as well as underpinning the perceived value of the tax credit in securing investment in R&D projects in Ireland.

Ireland's R&D tax credit regime was one of the first regimes internationally to afford an 'above the line' accounting benefit to claimant companies. The cash refund (or 'cash back') mechanism which is aligned with this accounting treatment was introduced in 2009.

Ireland's relatively high concentration of its supports for R&D on the R&D tax credit incentive means that in evaluating Ireland's tax incentive supports for SMEs, which is one of the focus areas of this consultation, it is important to consider the fit and effectiveness of the R&D tax credit regime for SMEs.

International environment for R&D tax incentives

The different mix of R&D supports adopted by countries makes it difficult to carry out international comparisons of the effectiveness or impact of R&D tax incentives.

Ireland has a relatively high concentration of supports delivered through the R&D tax credit incentive. In contrast, even within Europe, countries have made very different policy choices related to their mix of R&D supports for private R&D activity. For example, a country such as Germany, up to very recently, has not provided tax incentives for R&D expenditure but focuses instead on providing grant aid and other supports for R&D activity².

The different design features and mix of tax based and grant support make it difficult to find data to make international comparisons of the costs/benefits of R&D supports in economic terms due to the different mix of tax incentives and grant aid found across jurisdictions internationally.

The international environment for the use of tax incentives to support investment in R&D continues to be competitive with countries using tax incentives to support R&D investment³. A KPMG survey of EMEA

² KPMG International EMEA R&D Incentives Guide, February 2017. Page 20 on Germany

³ OECD. Tax Policy Reforms 2018. OECD and Selected Partner Economies. Pages 75-76 provide overview insights on tax policy

changes related to R&D incentives, showing evidence of countries worldwide continuing to include R&D tax incentives as part of measures to attract and sustain investment.

R&D incentives published in February 2017⁴ finds that countries with R&D tax incentives continue to refine their R&D tax incentive offerings which has resulted in an increasing harmonisation in the scope of expenditure which is eligible for R&D tax incentives.

Even Germany has recently moved to introduce a modest level of refundable R&D credit to supplement its extensive grant aid supports⁵.

In October 2018, New Zealand's government announced improvements to its R&D tax incentive measures for which the government has set aside c.NZ\$1 billion with a target of achieving R&D spend of 2% of GDP over the next 10 years⁶.

As part of a package of corporate tax reform measures, Switzerland has also announced R&D tax incentives as part of a mix of tax incentives that will apply at the federal and cantonal levels to attract and sustain innovation rich business investment⁷.

Features such as including outsourced expenditure in eligible expenditure which may have distinguished Ireland's regime in the past are now being included in the regimes of other countries' regimes⁸.

Ireland's inclusion of capital expenditure on assets used in R&D activity as part of eligible expenditure means it is one of the most competitive regimes in international comparative terms.



With increased international harmonisation of the design features of R&D tax credit/relief regimes, the main aspects of comparison across R&D tax incentives focus on:

- ✓ the comparative rate of the R&D credit/relief,
- ✓ the ease of access and administrative compliance, together with
- ✓ certainty of the availability of the tax credit for taxpayers.



The purpose of the R&D tax credit is to provide funding support for R&D activities. Its effectiveness in driving the conduct of R&D activity depends to a large part on the confidence of the claimant that the tax credit will be available.

Factors such as complexity of access and administrative compliance as well as inconsistencies in determining the scope of R&D activities eligible for the tax credit undermine the certainty of the availability of the tax credit.



⁴ KPMG EMEA R&D Incentives Guide, February 2017. Page 5 of the summary section of the report.

⁵ Tax news media reports in April and May 2019 confirm the progress through parliament of a German Ministry of Finance bill originally dated 12 April 2019, containing R&D tax incentives (Entwurf eines Gesetzes zur steuerlichen Förderung von Forschung und Entwicklung). The amount of the research credit is the cost of personnel engaged in the qualifying activities, with maximum eligible expenditure of €2million. The R&D tax credit is 25% of the previously determined basis. The maximum amount of the available R&D tax credit is €500,000 per fiscal year. The available credit for qualifying taxpayers will be assessed and determined after the end of each fiscal year and paid to the beneficiary within one month after the assessment. The research allowance is tax exempt and does not affect the overall amount of deductible business expenses.

⁶ IBFD reported that on 3 October 2018, the New Zealand Minister of Research, Science and Innovation and the Minister of Revenue announced the design of what they called the government's "ramped up" research and development (R&D) tax incentive.

In response to consultation, the measures include a form of refundable tax credit for start-ups and loss-making businesses in the first year of the tax incentive which is introduced as a temporary measure that will

mirror the current R&D tax loss cash-out scheme, with the objective of having a more comprehensive form of refunds in place for the 2020 tax year.

Other key features of the incentive include: a credit rate of 15% (initially, 12.5%); a minimum R&D expenditure threshold of NZD 50,000 (initially, NZD 100,000) per year; a NZD 120 million cap on eligible expenditure (no change); a definition of R&D that ensures that the credit can be accessed more easily across all sectors, including the technology sector; and the inclusion of state-owned enterprises, industry research cooperatives and minority-owned subsidiaries of crown research institutes, tertiary education organizations and district health boards. The government has set aside NZD 1 billion for this incentive and is working to increase R&D spending to 2% of GDP over the next 10 years.

⁷ Swiss voters approved on 19 May 2019 a suite of corporate tax reform measures which include cantonal R&D tax incentives in the form of a 150% super deduction for qualifying R&D expenditure.

⁸ KPMG International, EMEA R&D Incentives Guide, February 2017, Page 5 and The Department of Finance, Review of Ireland's Research and Development (R&D) Tax Credit 2013, Page 71.

We have set out below our detailed responses to the eight questions in the consultation document on the R&D tax credit regime. Throughout this section, our feedback and recommendations are supported by Case Studies which capture the experience of different businesses. Insights from feedback are highlighted by using the Magnifying Glass symbol, while our recommendations are highlighted with a ‘thumbs up’ symbol.

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

Feedback from soundings taken from businesses as described above suggests that the cash flow impact of the 25% tax credit has the greatest impact in improving the comparative competitive position of an Irish R&D team competing for an R&D project.

Competition for R&D projects can occur within multinational organisations where different R&D teams compete for new R&D projects. Early stage companies also compete to raise monies from external investors to fund R&D activities.

R&D expenditure which is revenue in character for tax purposes can also be deducted in computing the taxable profits of the company and lead to a saving of corporation tax at a rate of 12.5% if the company is profit making. The cash flow impact of this deduction is deferred until the timing of corporation tax payments by the company.

When putting together a competitive budget for an R&D project, the cash flow benefit of the 25% R&D credit has the most impact.



The **cost of the R&D activity** remains one of the primary factors in decision making relating to R&D location. This assumes that factors such as geographic location are relatively neutral and that competitor locations have equivalent access to necessary R&D capabilities.

Payroll costs are often the highest portion of R&D costs and Irish wages costs are high compared to many European competitor locations.

In a series of short case studies and insights from real life feedback which are set out below, it can be seen that the R&D tax credit has made a major difference in offsetting the sometimes higher costs of workers in Ireland so that an Irish based R&D team can compete on more equal ground with other project teams based in lower cost locations.

Case Study 1:

“Tax is the last thing on our minds when we present proposals for R&D activities in Ireland. By this, we mean that we know that cost competitiveness will be one of the primary factors on R&D location choice. We think of the 25% R&D tax credit as reducing the budgeted cost of the R&D.”

A large multinational software company based in Dublin

Case Study 2:

“The R&D tax credit continues to be an important factor in determining where we hire in Europe. We recently went through an evaluation with our Head Office to add another engineering team from our software division to our west of Ireland site. Once we factored in the R&D tax credits, our costs in the west of Ireland were lower than our other engineering site in Romania. This is a potential 27 person team initially starting in Q2 2019 once we obtain internal approval.”

A multinational software company located in the west of Ireland

Case Study 3:

“When it comes to cost, the credit is often the difference between projects being delivered in Ireland or not. The credit supports a virtuous circle, i.e. projects/companies may set up in Ireland, this helps generate the competencies and capabilities needed to develop a solution which in turns fuels further investment. It should be noted that as leadership in US companies is continuously changing, there is a constant need for Irish based R&D projects to deliver both from a cost and outcome perspective.”

Large multinational software company located in Galway

Case Study 4:

“The cost of carrying on R&D is the fundamental consideration for us along with the availability of necessary skill sets. The funding provided through the combination of R&D grants and the R&D tax credit means that we have a competitive basis for carrying on R&D activity here that would not be feasible otherwise. The cost of R&D is a critical element of running any business. In a multinational business environment, the R&D component can be carried out in any part of the world with technology transfer to global manufacturing sites. However, having R&D close-coupled to a co-located manufacturing site provides the opportunity for

seamless technology transfer from R&D to manufacturing. The benefits of R&D tax credits and other R&D grants available in Ireland provide the opportunity for a synergistic relationship between R&D and manufacturing; enabling the Ireland manufacturing site to be the first site in a global roll-out process. This provides a key competitive edge to the Ireland manufacturing site."

Large global life sciences organisation in the Munster region

The importance of the cost of the R&D project does not diminish the importance of other factors which must be present in the wider environment in order to sustain R&D activities in Ireland. This includes the availability of skilled people to conduct the R&D activities as well as the track record of Irish R&D teams in delivering R&D projects.

Key considerations for locating R&D activity in Ireland include:



Access to a skilled labour pool and the ability to leverage off deep capabilities in the R&D sector are deepened by sustained R&D activity. These capabilities are only developed over time if the R&D project team bidding for a project has sustained experience of conducting similar work on past projects.

Case Study 5:

"As an Irish subsidiary of a large multinational corporation whose Dublin facility is the main research and development centre of the group, we cannot emphasise enough the importance of the R&D tax credit to our operations in Ireland.

When the Dublin based R&D centre was established some 11 years ago, two of the main considerations were the access to a skilled labour force and also cost comparability to other jurisdictions. The progression of this facility to becoming the main research and development centre of the group is due in no small measure to the support received through initiatives like the R&D tax credit. This factor has established the Dublin centre as an integral part of the wider group and essential in all go forward strategies. For our organisation, the continued availability of the R&D tax credit is crucial."

A subsidiary of a large multinational with its main R&D centre in Dublin

Much like the life cycle of a business which is illustrated in the chart in the introduction to this submission, the evolution of new products and services within companies takes a similar path from early stage incubation to full commercialisation. It is at the early stage of commercialisation that Irish R&D teams are typically

positioning themselves to win R&D projects whether within the group or on a standalone basis when raising capital from investors.

Co-location opportunities are important in providing suitable test environments for R&D which is closely linked to the commercialisation of the product / service. An important consideration is access to a production test environment for manufactured product or delivery platforms for software applications.

Case Study 6:

*"While the credit is focused on R&D, R&D doesn't happen in a vacuum. Therefore the credit helps attract other functions such as product management, sales engineering, recruitment, operations and finance. The shift to agile and innovation models is moving towards cross functional engagement - **co-location of activities is now critical to how R&D occurs.**"*

Large multinational software company located in Galway

Similar considerations apply if there is an opportunity to leverage off the **wider business environment** including the presence in Ireland of other firms or organisations with R&D capabilities. This can facilitate conducting R&D on a collaborative basis or drawing upon the capacity of a proven network of providers of outsourced R&D services.

Q2. In the absence of the R&D tax credit, what proportion of your R&D would take place in Ireland?



In speaking to companies that have longstanding R&D activities in Ireland with a history of R&D tax credit claims, they have advised that the loss of the R&D tax credit as part of their funding would not result in an immediate cessation of their R&D activities in Ireland.

Case Study 7:

"Countries across the Globe are aiming to increase their level of R&D activity through both education and incentives. A key part of the incentives in Ireland is the R&D Tax Credit which is both necessary for maintaining the existing R&D missions but also adds to the attractiveness for newer cutting edge R&D activities. The ability to take the R&D Tax Credit above the line which directly impacts the "per employee" cost is key.

If the R&D tax credit were to be removed or reduced it is likely that the opportunities for us to locate R&D activities in Ireland would fall away over time."

A multinational software company based in Dublin

The wider environment in which the R&D activity occurs cannot be replaced overnight. This includes access to a pool of skilled people and other supports and networks which the companies have built over time - whether amongst their peers or in collaboration with universities and other organisations.

However, the feedback to KPMG's soundings is clear that the absence of the credit would mean loss of opportunities to compete effectively for new projects which would enable them to stay at the forefront of new technology developments. The R&D activities would not immediately cease but would reduce and wither away and the Irish operations would become less central to the business over time.

Case Study 8:

"In the absence of the R&D tax credit our costs would not be competitive with our offices in other locations in Europe that have access to a larger talent pool. We have to remain competitive through the R&D tax credit or any other incentives that would reduce our costs and make our location attractive to engineers to relocate to Ireland."

A multinational software company located in the West of Ireland

Case Study 9:

"The abolition of or a significant tightening of the R&D tax credit scheme will cause us to have to look at alternative approaches for future R&D activity. This could include offshoring some of the R&D activity or carrying out certain R&D projects in a jurisdiction that has a more favourable incentive scheme. Our experience with the scheme has been largely positive and the continuation of the scheme is crucial to both maintaining and increasing R&D expenditure in Ireland."

CFO of an Irish Headquartered global company in the software sector



An important incidental effect of the loss of R&D capabilities would also be the loss of a necessary force of attraction (or nexus) to sustain the location in Ireland of high end production capacity and leading edge platforms to deliver services that go hand in hand with R&D activities.

This linkage is not just the case in a highly R&D intensive organisation with hundreds of R&D specialists. It is also

the case for mature Irish businesses operating in more traditional business sectors such as the consumer product and food and beverage sectors. These businesses carry on R&D on an ad hoc basis as part of a continuing process of innovating and developing their core product ranges.

Case Study 10:

An Irish headquartered group manufacturing consumer products has a team of over 50 production engineers based in Ireland. The expertise and capabilities of this R&D team has meant that the company has made ad hoc claims for the R&D tax credit for R&D activity related to product enhancements. It has also enabled the company to sustain its high end production manufacturing in Ireland and to win from competitor locations e.g. the United Kingdom (UK), projects to conduct R&D activities related to product developments for the UK operations.

"Without the capabilities of the R&D engineers in Ireland, we would not be able to sustain the high end production activities in Ireland nor would we successfully win the opportunity to conduct R&D activities for UK based product enhancements."

Irish headquartered group with innovative consumer products

Case Study 11:

"As time has progressed, we have been able to factor in the R&D tax credit into our budgeting process at a global level where senior board members meet and key strategic decisions are made. In many situations, the average cost per head can be 10% greater in Ireland before the R&D tax credit is factored in. The R&D tax credit is therefore a significant differential when pitching Ireland for R&D projects ahead of other jurisdictions in the US and Canada, particularly as the credit can be recognised in the financial statements above the line."

A subsidiary of a large multinational with its main R&D centre in Dublin

Case Study 12:

A US headquartered company in Ireland has placed a number of R&D projects mainly at the developmental stages at a number of sites in Ireland. One of these projects has since been awarded commercial approval and is currently being manufactured in Ireland along with continued developmental activities. In addition to this, a separate site in Ireland has also been chosen to work on this same product to both develop further and manufacture into the future. This win for Ireland is immeasurable and the job creation along with job security for existing roles is key.

"This is just one example. However the majority of times if a key R&D project is won and run by Ireland, the commercial production will follow. This may not

continue for the entire lifecycle of the project but this frees up capacity to support the future pipeline.

The R&D tax credit is key to winning these initial development programmes in Ireland. Sites within the network will internally 'bid' for these projects with Ireland's key competitors being the US, Singapore, Switzerland, etc. Cost, tax, track record and an available skilled workforce are the key factors in the selection for these projects. The credit is a key element to reducing costs above the line and highlighting the cost competitiveness. It is also key to highlight a supportive government towards R&D."

US multinational with a number of large sites in Ireland



Q3. As R&D is project driven the annual cost to the exchequer can fluctuate quite significantly. What steps could be taken to improve advance forecasting of claims for Exchequer purposes?



We understand that forecasting the value of R&D tax credit claims requires firm level data that is simply not possible from macroeconomic flows. The data is available post facto from tax returns but limited insights are available from corporation tax receipts – especially in relation to the volume of future claims for refunds of the 25% R&D tax credit.



KPMG's soundings provide a range of feedback from businesses which suggest varying capacity to forecast R&D tax credit claims with certainty, year on year, due mainly to the level of uncertainty surrounding future volumes of R&D activity.

R&D costs which are eligible for the tax credit can be classified into two broad types - **operational expenditure and capital expenditure**.

The greatest difficulty in forecasting the volume of expenditure eligible for the tax credit arises with operational expenditure.

The uncertainty related to the volume of R&D activity, year on year, can arise for a range of reasons:

- Firms that conduct a series of relatively smaller projects often individually won by competing against other locations within the multinational group do not know whether Irish based R&D activities will occur until **a central decision is made on the location** for the next R&D project.

This uncertainty arises not only for businesses operating in the pharma and life science sectors where smaller parts of wider projects can be done almost anywhere but also in the case of software development activities where specialist teams around the globe continually compete to work as part of an agile development model in developing software products.

- Single product companies at the early commercialisation stage are very dependent on access to private **funding sources** as well as the R&D tax credit – failure to secure sufficient private funding or other public supports means no R&D.

- Sectors such as life sciences have high uncertainty surrounding R&D outcomes. This **inherent uncertainty on whether a current R&D project has a positive outcome** means it is uncertain whether or not the current R&D project will progress to the next stage – making it difficult to forecast claim levels, year on year.

In contrast, highly R&D intensive companies with a long track record of conducting R&D activities across a range of products/services can be more confident that, based on their track record and on the expected volume of global R&D spend that they will win their “fair share” of global R&D projects such that they can forecast their claims within a range of certainty for the year ahead.



The volume of R&D tax credit claims on capital expenditure e.g. on constructing a building or on investment of a significant scale on plant and machinery, can, in some cases, be easier to forecast. This is because of the longer lead in time related to planning and deploying such expenditure.

The pattern of incurring capital expenditure is also likely to be “lumpier” in that significant upfront capital expenditure can be required which is then not repeated at that scale throughout the lifetime of the R&D activity carried on by the company. This type of expenditure can affect the overall volume of claims in any one year much more dramatically as compared with volumes of operational expenditure.

Looking at capturing forecasted capital expenditure eligible for the R&D tax credit therefore appears to be an area where collection of data at a firm level might yield the greatest proportionate impact on forecasting accuracy.

There are different degrees of intensity of capital expenditure related to R&D activity depending on the business sector of the company. For example, there is typically capital expenditure of a limited scale in proportion to the overall R&D spend in the software sector. By far the greatest portion of R&D costs in this sector is payroll costs. Office space is often rented and modest levels of overall project expenditure is incurred on providing capital equipment such as computers and office furniture for the R&D teams.

Where R&D activity is intrinsically linked to a manufactured product or active ingredient, there is likely to be much more intensive capital expenditure incurred as a proportion of overall R&D expenditure. This is more common in sectors such as pharmaceuticals, medical devices and life sciences.

Q4. In your experience, has your decision to conduct R&D in Ireland resulted in you recruiting additional staff, interns or apprentices?



As can be seen in the selection of real life case studies summarised below, the decision to conduct R&D activities in Ireland has resulted in retention of skilled employees, the addition of new R&D work and a deepening of R&D capabilities for the Irish based companies.

Case Study 13:

"We are a large subsidiary company of a US multinational in the life sciences space. We employ more than 5,000 people across multiple sites in Ireland, with more than 600 engaged in R&D activities. Between the years 2013 and 2017, we have increased our R&D investment in Ireland by 30%.

The R&D tax credit is critically important when deciding to locate R&D investment in Ireland, in creating new R&D jobs in Ireland and maintaining existing R&D jobs in Ireland. We constantly face strong competition from other regions, in particular the USA, for large R&D projects. For our Irish operations, the R&D tax credit is vitally important in ensuring our long term sustainability and competitiveness compared with other global jurisdictions.

The R&D tax credit has enabled us to recruit more PhD's and engineering/science interns, providing our organization with the acute expertise required to carry out complex and multi-faceted R&D projects.

To further strengthen the Irish R&D operations, we would like to see more certainty regarding our R&D claims to allow us to confidently factor in the reduced cost of carrying on R&D projects in Ireland due to the availability of the tax credit."

Irish subsidiary of a large US life sciences multinational

Case Study 14:

"We have found the R&D tax credit scheme to be both important and beneficial in promoting and supporting the R&D efforts of various businesses we have been involved with. The existence of the scheme has had a direct bearing on the financial and operational planning for specific R&D projects. This has translated into more resources (substantially employees) being allocated to specific Irish based R&D projects. At different times in the past, this has meant both new jobs and/or sustaining existing jobs."

The company has availed of the R&D tax credit in the past. The nature of the space the company operates in means that it is likely to do so again in the future.

"The existence of the scheme has allowed the company to hire additional employees. The credit was used to allocate more resources (employees) to the projects to accelerate the development effort.

As the company is small and suffering the growing pains associated with start ups, the following amendments would make the scheme more effective:

- Allow the cash refund in one year;
- Process the refund at the start of the year following the submission/filing of the claim;
- Allow a wider selection of costs (support costs that are used to support R&D activities) e.g. HR, finance etc.;
- Increase in the rate of the credit.

Small start-up/enterprise company operating in the e-commerce space with ambitions to trade internationally

Case Study 15:

"The company has availed of the R&D tax credit in the past. The existence of the scheme and the funding provided by it was crucial in bridging the financial gap that allowed the company to undertake certain R&D projects. The scheme had a direct impact in sustaining jobs.

Although the company trades internationally it has chosen to maintain its operational and R&D base in Ireland. The cost of doing business in Ireland is increasing with wage inflation continuing to be a feature of the operating environment. This gives rise to a constant pressure to review the economics of continuing with the status quo.

The financial benefit from the R&D tax credit scheme is used as part of the financial assessment of potential R&D projects. In this regard, the scheme has a direct impact on new jobs and sustaining existing jobs."

CFO of an Irish headquartered global company in the software sector

For firms who have more established and intensive R&D operations, an important impact of conducting R&D in Ireland is the ability to deepen the skills and capabilities of existing R&D teams through engaging in sustained R&D activities.

An R&D specialist in technology areas such as cyber security, etc. with two years' experience of working on R&D related projects is much more valuable and much more influential than a new recruit in sustaining future

business activities in Ireland at the forefront of technology developments.

Winning projects to conduct R&D activities in Ireland does not always result in additional or new employees but helps in sustaining and in deepening the capabilities of existing R&D teams.

The R&D tax credit plays a key role when people move from one project onto another Irish project where the Irish project team has secured the R&D project in competition to teams located in other regions. Without the R&D tax credit, the ability to win these future projects is diluted.

Case Study 16:

“The tax credit enables us to invest in enhancing our existing workforce with additional capabilities and skill sets that enable us to carry out more advanced R&D activities in Ireland. In turn, this acts to demonstrate to the global group that we should be the location of choice for future R&D.”

A multinational software company based in Dublin

The deepening and retention of capabilities in R&D not only influences the capacity of a company to continue to engage in R&D activities but has a wider influence in sustaining high end manufacturing and delivery of services at the forefront of technology in Ireland.

Due to the intrinsic link between R&D activities and the capacity to commercialise new technologies, the absence of R&D capabilities means less likelihood that Ireland will be the location for the eventual delivery of the next evolution of the product or service.

Case Study 17:

“Our manufacturing facility would be at around one third its current capacity if we didn’t have R&D carried out onsite. We are doing R&D in the plant that we would not do without the level of support provided to us from the R&D tax credit. Were it not for the support provided both the R&D and resulting manufacturing work would be carried out at a lower cost location such as China or Singapore.

There were several other locations around the world reviewed, when it came to deciding on where to locate the R&D Centre. In addition to having access to highly qualified personnel and the co-location with a large manufacturing site, the cost of conducting R&D in Ireland was a key metric in the overall global assessment. Being able to clearly demonstrate that a large portion of our R&D program would qualify for R&D Tax credits, together with the opportunity for attracting government grant-aid; was a key factor in the overall decision to locate R&D in Ireland

Having the R&D activities located onsite in Ireland has contributed significantly to preserving the 600+ people working in the manufacturing facility. A large number of our products have been innovated or renovated in the last number of years, with a natural transition from R&D to the local production plant

where the R&D teams and manufacturing teams can manage the transition efficiently. If the R&D activities were located elsewhere it is highly likely that the production of these new innovative products would be carried out at a lower cost location in Asia or elsewhere, with the consequence of commercial manufacturing also taking place in those locations.”

Large global life sciences organisation in the Munster region

Q5. The R&D credit allows for limited outsourcing of R&D. Are the limits appropriate? What is the impact of these outsourcing provisions on third level institutions and/or smaller firms?

Outsourced R&D

a. The current limits on outsourced R&D activities

For companies which engage in R&D activities and rely on outsourced R&D services to bridge gaps between in-house resources and more specialist resources available outside the organisation, the current limits for outsourced R&D services can often be quite restrictive.

Sometimes these activities must be carried out by a third party for independence reasons or they require skills and equipment that are prohibitively expensive for the company to invest in such as toxicology studies, nutritional analysis, etc. For these companies the current 15% or €100,000 limit on outsourced expenditure to third parties (non-universities) is too low and can negatively impact on the cost of the overall project and hence the ability to carry out the project in Ireland.

Case Study 18:

“Our R&D requires specialist input from companies/ individuals who have specific expertise and technical capabilities that are too expensive for us to develop internally ourselves. This expertise is an intrinsic part of our R&D effort which simply could not happen without it. However, due to the present limitations on outsourced R&D we can only claim a credit on less than a third of our outsourced R&D spend. This acts to dilute the support provided by the credit for our R&D efforts and impacts Ireland’s cost effectiveness as a location for R&D when we compete for globally mobile investment. It would make the approval process internally easier if we could justify the specialist outsourcing by it being included in the R&D tax credits. We would like to see an increase in the limit from 15% to at least 25%.”

A multinational software company located in the West of Ireland



We suggest that that the limit on outsourcing to third parties (non-university) is increased to the greater of (i) 25% of qualifying R&D expenditure or (ii) €200,000 (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 €200,000, 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 proportionate impact on enterprises of a smaller scale which can rely more heavily on access to outsourced services in carrying on R&D activities.

b. Expenditure on agency workers under the outsourcing limits

Under Ireland's R&D tax credit regime, the current interpretation of the measures is that the costs of agency workers recruited on a temporary basis (even if operating under the control and direction of the inhouse R&D team) are treated as costs of outsourced services.

However, new models of working and the practice of hiring specialist contractors on a temporary basis to meet the demands of R&D projects can mean greater reliance on agency workers. This presents particularly acute limits on eligible payroll costs in certain sectors. For these companies, heavily reliant on agency workers, either the 15% cap or the treatment of such workers as outsourced R&D services should be changed.



We suggest that the latter approach is adopted which is to develop the concept under Irish legislation of an externally provided worker which would not be considered to be engaged in outsourced services activities where the worker operates under the direction and control of the in-house team. Suggested legislative changes are set out in Appendix 1 to this submission.

This would also increase the competitiveness of the Irish regime in comparison to the UK regime for companies which use temporary workers as part of their business arrangements.

Insights drawn from soundings taken from businesses operating across business sectors suggests that the prevalence of agency workers in R&D activities is driven by a number of factors. These include:

- A comparatively small pool in Ireland of deeply specialist resources. This can mean hiring in foreign specialists on a temporary basis in order to meet skills gaps.
- For smaller companies, where the R&D project is core to the future commercialisation of the business, there may not be a need long term for the same volume of workers to engage in ongoing R&D activities. The flexibility to recruit on a temporary basis means that

the company need not overstaff for its future business needs.

- The inherent uncertainty of R&D outcomes means that, in sectors such as life sciences, the ability to recruit and sustain R&D activities is inherently dependent on outcomes from the first phase of the R&D. Where the current project does not produce positive outcomes, the R&D may cease or the direction of development may take another path requiring different specialists. An inherent part of managing this uncertainty is to recruit temporary workers for the span of the R&D project.
- The dynamics of demand and supply for workers with highly specialist skills combined with changing work patterns, means that in certain cases, workers have their choice of projects to work on. Changing work patterns means that skilled workers do not have an expectation or intent of working long term for a particular company. Instead, in managing their career over their working lifetime, such workers can choose to work on a project and then move to another project that attracts their interest and allows them to develop their personal range of skills.

Case Study 19:

"We operate in the eCommerce space and employ a large team of highly skilled software developers who carry out R&D projects in Ireland. Our company has been making R&D tax credit claims over the last number of years and the credit is vital to our operations in Ireland. One element of the R&D tax credit which we believe should be enhanced is around outsourced expenditure.

The outsourced expenditure limits applied to the R&D tax credit are too restrictive and in our case significantly impacts our R&D claims each year.

Third party vendors

For a wide range of reasons, not least of which is the often limited availability of suitable talent, along with the personal employment preferences that many individuals have, employment is offered on a flexible basis. An increase to the 15% limit on outsourced expenditure should be considered and the €100k limit should be updated to at least €200k to allow for the increase in costs since the €100k limit was introduced. An increase would provide greater certainty in relation to expenditure which we incur on payments made to highly skilled third party vendors who carry out R&D on our behalf.

Agency workers

We are often required to contract with individuals/agencies where the individual would work under the control and direction of our company. This would be very common for companies operating in the software space where many people have a preference to work on a more flexible and shorter term basis.

In other cases, in software development there is a need to develop a 'once off' feature or functionality, which

requires a team to be taken on at short notice. In order to obtain the right people with the right skills and on a timely basis, we are obliged at times to engage with agency staff providers and individual contractors.

It would be a positive improvement to the credit if payments made to agency staff providers and individual contractors where such individuals carry out R&D activities 'hand in glove' with the claimant company would be allowed in full rather than under the outsourcing restrictions."

A privately owned Irish company based in Dublin



Provide a mechanism, whether in guidance or through legislative change, that would operate to allow a company providing outsourced R&D services to a contractee to have greater certainty that the R&D tax credit would be available for its R&D activities.

The current approach to avoiding duplication of claims can mean, in practice, that neither party claims the R&D tax credit for certain work and the contractor can often be barred from claiming a credit for their R&D activity at the last minute/ after a claim has been made (having incurred the compliance costs of making the claim).

c. Companies to whom R&D is contracted and certainty on their ability to claim a R&D tax credit



The outsourcing provision operates by requiring the purchaser of the outsourced service (the contractee) to notify the service provider (contractor) that the payment made to the contractor is one which will form part of the contractee's R&D claim and that contractor may not make a claim with respect to the activities carried out by the contractor.

There is no deadline imposed on the contractee to advise the contractor on their intended tax credit claim. This approach in the legislation to avoiding duplicate claims for the same service can often mean in practice (as experienced by KPMG as agent assisting our clients prepare such claims) that:

- i. companies who are contracted to undertake R&D activity (the contractor, which is often an SME) cannot claim a credit for their R&D work where they have received a notification from the contractee, and
- ii. the company that has outsourced the work (the contractee) cannot claim for it as they have reached their outsourcing limit.

We have been made aware of situations whereby the contractor has received notification letters from the contractee (stating that the contractee is claiming the R&D tax credit, in which case the contractor cannot), on or after the contractor's tax filing deadline. The contractor may have already filed its R&D tax credit claim by the time the notification letter is received.

In addition, the notification letters received by the contractor often do not set out the quantum of expenditure to be included in the contractee claim as purchaser of the service - in which case, the total amount of the expenditure would be excluded from the claim.

This issue is particularly acute for SMEs and can reduce the impact of the R&D tax credit on the capacity of the SME service provider to avail of the R&D tax credit and use it to expand its R&D capacity or ability to compete on equal terms for future R&D projects.

Case Study 20:

"As an Irish headquartered plc, certainty around the R&D tax credit is vital to our global organisation and our operations in Ireland. Our company employ over 500 people in Ireland many of whom are highly skilled and involved in R&D activities in drug development and manufacturing.

For certain projects, we carry out R&D activities on behalf of other companies. In one instance, we received a notification hours prior to the R&D tax credit filing deadline from the contracting company stating that it was making an R&D tax credit claim (under the sub-contracting rules) for R&D work undertaken by us. Fortunately, the notification was received prior to us making our R&D claim and we were in position to make the relevant adjustment to our R&D claim calculation before the claim was filed. However, it could easily have been the case that the notification was received after we had filed our R&D tax credit claim and reduced our tax payable amounts.

A workable solution to the potential issue above would be welcomed."

Irish headquartered pharmaceutical company

Q6. What are the factors that are relevant to the relatively low uptake of the current credit by SMEs?

The overview of the life cycle of an SME that is illustrated at the beginning of this submission highlights that the R&D tax credit should be available to support business development from the incubation stage through to early stage and full commercialisation of the business.

This potential broad application of the R&D tax credit is one of its most powerful attributes as a tax incentive – but why is it being underused by SMEs?

In 2019, KPMG commissioned Red C Research to conduct a survey of companies which have availed of Enterprise Ireland R&D grants. The survey included 100

participants. The survey results can be viewed in the KPMG Innovation Monitor 2019 report.⁹

The survey participants should all potentially be claiming or intending to claim the R&D tax credit for their expenditure on R&D. The survey findings are that this is not the case. Only 55% of the companies surveyed had claimed the R&D tax credit since it was introduced in 2004.

While not all of the companies surveyed would necessarily have qualified for the R&D tax credit due to differing eligibility criteria between the R&D tax credit and R&D grant supports, our findings suggest that there are many companies who would qualify but who have not claimed the R&D tax credit.

The grant support and R&D tax credit should be regarded as part of a continuum of support for R&D – both of which are potentially available to an SME. Survey responses indicated a level of confusion in relation to:

- the qualification criteria,
- the application processes,
- the value, and
- the rules governing the two support instruments.

An analysis of the survey results suggests varying degrees of familiarity with the R&D tax credit and the administrative process involved in claiming the tax credit. For example, there was a perception by survey respondents that the Enterprise Ireland grant was a straightforward support to claim. One survey participant pointed to the Enterprise Ireland application form as being 10 pages in length with the R&D tax credit form comprising 300 pages. This response is also an example of the misconceptions which abound in relation to the R&D tax credit – there is no “application form” for the credit.

Perceived value is also an issue. A number of the companies surveyed were unaware of the fact that the R&D tax credit is worth 25% of the qualifying spend in addition to the 12.5% corporation tax deduction that is available.

There also appears to be **a lack of clarity around how the R&D tax credit is paid out.** The fact that the R&D tax credit is payable in cash to companies that are not paying corporation tax did not appear to be widely understood.

Comments made by survey participants suggested that Enterprise Ireland grant requirements are less strict than those of the R&D tax credit – whereas an analysis of the respective eligibility criteria for the two supports suggests that there is not a significant divergence between the eligibility requirements for the two supports.

The comments report in positive terms the degree of support and assistance received from Enterprise Ireland development advisors.



These comments are important in light of the findings from the survey that a quarter of respondents said that Enterprise Ireland required them to implement changes to how they documented time or activity for the purpose of claiming grant aid.

The survey findings suggest that the additional burden of claiming the grant aid is at least partially offset by the assistance received from Enterprise Ireland development advisors.

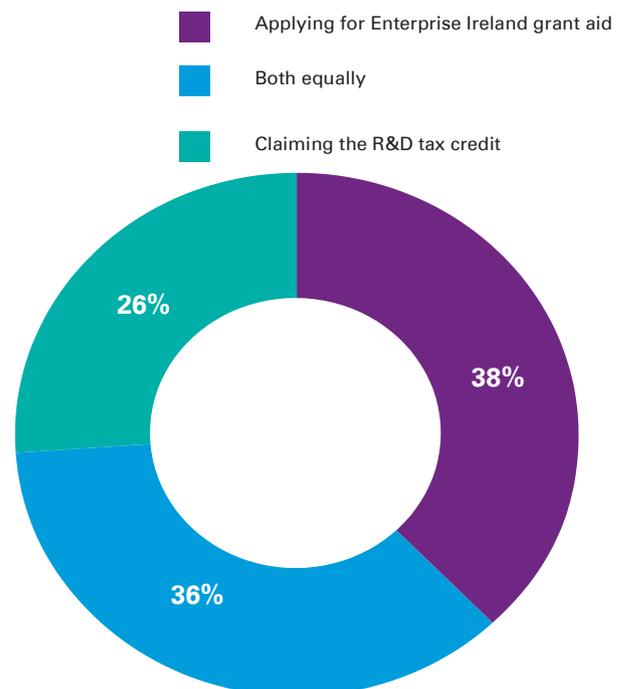
In summary, these findings suggest that it could be helpful in increasing the uptake of the R&D tax credit amongst these types of more R&DI intensive companies if the conditions for claiming R&D grants and the R&D tax credit could be streamlined.

Many of the companies surveyed expressed the view that claiming the R&D tax credit could expose them to an audit of the ‘science test’ by Revenue. In some cases at least, they may not have been aware of the guidance issued by Revenue which has indicated that claims valued at less than €50,000 would not be subject to scientific audit once the firm was already in receipt of Enterprise Ireland RD&I grant support.

If we look at the responses of survey participants, just a quarter of firms claiming both the tax credit and Enterprise Ireland grant aid said the tax credit involved a lower administrative burden.

Survey participants were asked:

In your view, which of the following has the least administrative burden?



⁹<https://home.kpmg/ie/en/home/insights/2019/05/innovation-monitor-2019-rd.html>



These findings suggest that greater familiarity with the R&D tax credit and its benefits may encourage increased uptake and, in turn, stimulate additional R&D activity.

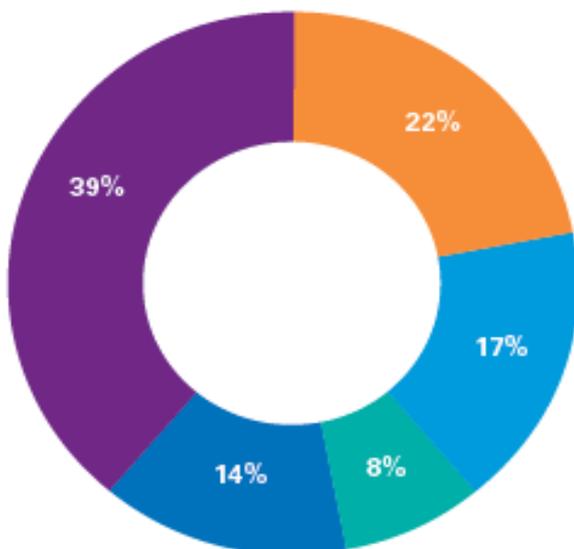
Furthermore, an increase in the value of the scheme to smaller, early stage companies by making the credit payable in one year rather than over three years to non-tax paying companies, as called for by several respondents, could enhance the perceived value and attractiveness of the scheme.

The survey participants were also asked directly which of a number of listed improvements to the R&D tax credit they would most like to see. An overview of the survey responses to this question is set out in the diagram below.

Survey participants were asked:

Which of the following suggested changes to the R&D tax credit would you most like to see?

- Broader spectrum of costs that could be included in the claim for SMEs
- A higher rate of tax credit
- Quicker access to cash, i.e. full refund in year one or over two instalments
- Higher limit for third party spends
- Don't know



The greatest number of respondents suggested they would most like to see a wider selection of costs being eligible for the R&D tax credit – perhaps more closely matching those allowable for Enterprise Ireland grant aid. We consider that this alignment in eligible costs would make the R&D tax credit both more financially attractive and more readily understood.



The findings from the KPMG survey suggest that:

- The Government and other stakeholders should continue to promote awareness of the R&D tax credit, particularly among SMEs, with a focus on those aspects which seem to be poorly understood, i.e. the rate applicable, the fact that it can be payable in cash and Revenue guidance in relation to audits of the scientific basis for the R&D activity.
- the value of the credit to smaller companies could be enhanced by paying it over one year instead of three years.
- a wider selection of costs – perhaps aligned with those eligible for Enterprise Ireland grant criteria – should be eligible for the tax credit.

Q7. Are there ways of improving the current credit system to make it more attractive to SMEs?

As can be seen from the weight of evidence from findings presented from the feedback soundings and the survey responses, certainty of access to the tax credit is the main driver of the impact of the credit in securing and sustaining R&D activities in Ireland.

One of the factors that improves certainty of access to the tax credit is receiving the benefit in one step instead of over a phased basis. Payment of the refundable tax credit in one tranche instead of a deferred basis was one of the requests from the Enterprise Ireland R&D grant recipients surveyed above.

Inclusion of the tax credit in a budget has the impact of reducing the R&D project costs. This impact is greatest where the amount of the 25% tax credit can be included as a positive cash flow at an early stage of the project. The cost of R&D is evaluated on a discounted cash flow basis and R&D tax credit refunds arising in later years are heavily discounted and therefore have less impact on budgeted costs and on the overall competitiveness of the project cost.

Case Study 21:

“As an Irish start-up company whose sole activity was undertaking R&D in the drug discovery space, cost control and early stage supports for R&D were crucial. The R&D tax credit and more specifically, the availability of the R&D credit as a cash refund has been crucial to our existence in Ireland as we are still in an R&D phase and have not become profit making. The R&D tax credit has enabled the company to survive.

That said, it would be hugely beneficial for start-up companies such as ours if the refundable element of the R&D tax credit could be repaid in one instalment

instead of three. This would put SMEs and start-ups who may be solely in an R&D phase on an even footing with larger tax paying corporations many of which recognise the full benefit of the tax credit in the year the claim is filed. Cash flow is extremely important for companies like ours and even though the tax credit claims were modest (under €100k per annum), earlier receipt of the cash refunds would make a disproportionate (positive) impact.”

Irish owned start-up in the life sciences sector

Repayable credit

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, and not on a phased basis over nearly 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.

Recognising that this acceleration in funding has a potential cost for the State (being the cost of funds associated with making an earlier refund), we suggest that the SME might be allowed to elect either for the three year refund period to apply or if an immediate refund is made and the potential small additional cost to the State is of concern, the refund amount could be reduced because it is being made upfront.



We suggest a legislative change to permit SMEs to claim refunds of the R&D tax credit in one year instead of over three years. The SME might be allowed to elect either for the three year refund period to apply or, if a possible cost to the Exchequer is of concern, if an immediate refund is made, the refund amount could be reduced because it is being made upfront.

In this manner, if the cost of the time value of money is of concern, the cost to the Exchequer of providing the refund upfront could be offset by the reduced amount of the refund claim with no additional cost to the State.

Improving certainty of tax credit availability

The KPMG Innovation Monitor 2019 survey discussed in response to Question 6 above captures the importance placed by the business community on one of the qualitative aspects of the regime which is the hallmark of certainty.

The suggestions which we have made below address the question of certainty of availability of the tax credit. This

is of particular importance to SMEs who have less capacity to absorb the impact of uncertainty than larger firms.

a. 12 month look back period

Currently, companies must make an R&D tax credit claim no later than 12 months after the year end in which the qualifying R&D expenditure was incurred. This results in an inability for a taxpayer to make any amendments to prior claims where they have discovered errors or under/over claims. The legislation does not afford any authority or discretion for Revenue to afford even a modest period of grace to taxpayers who narrowly fail to make the claim within the 12 month deadline period.

An extension of the ‘look back period’ would be a welcomed improvement to the administration of the R&D tax credit scheme. Even a modest period of grace of say, four weeks, beyond the deadline for a claim, which can be permitted in certain circumstances, could assist in moderating the sometimes harsh consequences of just failing to lodge a claim on a timely basis. It is suggested that policy makers should set out the intended scope of application of the grace period in broad terms to include, for example, failures due to sickness, absence or other reasonable cause¹⁰.

The suggested objective is to afford the tax credit to claims lodged within the grace period for a taxpayer who has made reasonable efforts to comply with the deadline and which has a compliant history or to take into account the additional practical challenges that can be faced by first time claimants.

By giving legislative authority, Revenue would have the capacity to exercise administrative discretion. Suggested wording for such legislative change is included in Appendix 1.



We suggest a legislative change to allow Revenue discretion to permit claims that narrowly miss the 12 month ‘look back’ deadline for filing a claim, e.g. within a four week period, provided the claimants meet certain criteria including having made reasonable efforts to meet the 12 month deadline.

b. Reduce 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

¹⁰ These criteria mirror those under which the tax Appeals Commission can exercise its discretion to permit late appeals.

'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 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.

c. Approach to overheads

Indirect supporting activities and ancillary activities essential to a company's R&D were previously regarded by Revenue as qualifying R&D expenditure.¹¹ Revenue's current approach is to restrict allowable overheads to a small number of items including "power consumed in the R&D process."

Case Study 22:

"As a highly innovative Irish owned company which researches and develops first in world engineering products, the R&D tax credit is a significantly important element of our operations in Ireland. The credit ensures that many R&D projects continue to be carried out in Ireland and this in turn results in many manufacturing jobs staying here. In prior years we've also made a significant capital investment in R&D in Ireland through the design and construction of our new Research and Development facility.

One element of the R&D tax credit which we believe should be both simplified and enhanced is around overhead costs. We also claim RD&I grants through Enterprise Ireland and as part of the grant funding, 30% of the qualifying staffing costs is allowed to be taken into the grant calculation to account for overheads."

Irish headquartered group with innovative consumer products

Revenue continue to closely monitor R&D tax credit claims through their intervention processes. IDA and Enterprise Ireland RD&I Grants typically include the following costs amongst eligible expenditure: personnel costs, an allowance for overheads (30% of defined eligible personnel costs), the cost of related consultancies, the cost of materials, equipment and buildings, travel and subsistence costs.

The Tax Strategy Group paper 03/15 proposed that qualifying expenditure for the R&D tax credit be aligned with costs eligible for the then available R&D Capability Grant schemes.

We suggest that the effectiveness of R&D tax credit claims could be improved by making it more certain that the treatment of overheads would be aligned with that which

applies in R&D grant aid applications. We suggest that to achieve this a legislative change is made to provide for a 'safe harbour' option for a claimant which would allow general overheads to be eligible for the R&D tax credit e.g. at a percentage of 30% of qualifying R&D staffing costs, similar to how RD&I grants operate.

The Canadian SR&ED scheme operates a similar 'safe harbour' approach with 55% of R&D staffing costs allowed for overheads but with the option to claim specific overhead costs should this be the company's preference (e.g. for overhead/ utility intensive industries).

Should a taxpayer wish to include a higher amount of overheads in its claim and exceed this safe harbour approach, it would be able to do so based on the general principles of the R&D tax credit and subject to providing evidence in support of that claim.

We believe that this would greatly simplify and reduce the complexity of administration of the tax credit for the cohort of companies also eligible for grant aid supports.

Although allowing a safe harbor basis for claiming the tax credit for overheads which is aligned with the approach used for RD&I grants could benefit larger companies, this alignment should have the greatest proportionate impact on SMEs.

As noted in the findings from KPMG's survey of companies claiming Enterprise Ireland RD&I grants, one of the barriers to such grant recipients also claiming the R&D tax credit appears to be the perceived complexity and administrative burden associated with also claiming the R&D tax credit.



We suggest the introduction of a safe harbour test in legislation to enable the claimant of an R&D tax credit to avail of the same approach to calculating overheads as is afforded by an R&D grant from one of the State granting bodies.

The current grant approach is 30% of qualifying R&D salaries. Should the R&D tax credit claimant wish to claim a higher amount, they could do so on production of supporting evidence.

d. Simplifying the 'science test' for SMEs

The release of Revenue eBrief No.17/17 which announced a change in Revenue practice to align the R&D tax credit with Enterprise Ireland and IDA R&D grants in respect of the scientific technical aspects of R&D projects was a welcome development in simplifying 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

¹¹ This was explicitly stated in all editions of the Revenue Guidelines for R&D tax credit until the publication in Feb 2013 of the "2012 edition" of the Revenue Guidelines.

administrative relief is also confined to companies which are small or micro enterprises.

The KPMG Innovation Monitor 2019 survey responses which we have discussed in our response to Question 6 above, suggest that SME claimants of grant support perceive that stringent criteria attach to the 'science test' in the context of an R&D tax credit claim – even though a broadly equivalent test applies for R&D grant eligibility. Grant claimants may be unaware of Revenue's administrative practice in relation to the 'science test'.



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.

e. Consistency of application of the 'science test'

In our experience in advising companies making R&D tax credit claims, some areas of the administration of the R&D tax claim process can give rise to the inconsistent treatment of equivalent claims to the R&D tax credit. One of the areas of greatest judgement is related to the 'science' test where Revenue auditors seek to form a view, with the assistance of appointed external technical experts, as to whether a company's R&D activities are qualifying or not. Inconsistencies in the views of experts and the challenges of recruiting experts who operate in the development area of the R&D project under review remain a continuing administrative challenge in the operation of the tax credit.

On 23 May 2019, Revenue published eBrief No.104/19 as part of the annual process of seeking applications for independent R&D experts to review the science test aspect of R&D tax credit claims. Those wishing to join the independent expert panel must hold a PhD in a relevant field of science or technology, or equivalent industry experience. We would be hopeful that the continued broadening of the panel to include those with industry experience would facilitate smoother R&D audits as most of the R&D undertaken in Ireland is experimental/development in nature, and is not basic or applied research which is more the field of expertise of experts from academia who have made up most of the panel of experts to date. However, since the first update to the panel requirements in 2017 we have not experienced a marked change in the profile of Revenue appointed technical experts.

At the same time, Revenue also published an update to Tax and Duty Manual Part 29-02-05, which provides clarity on the role of the independent expert, how they are appointed, the briefing they receive and who should attend this, and what is expected in terms of the expert's report. This information provides for a more transparent audit process and enables companies to better

understand what to expect during an audit of the 'science test'.

With the comparatively small pool of independent experts available in a market of Ireland's size, it remains challenging to recruit independent experts with industry experience to review claimants' eligibility for the 'science test'.



We suggest that consideration is given to provision of further Revenue resources to ensure the consistent application of Revenue approaches to the 'science test' across claimants in different business sectors.

It is suggested that development of a centralised team of Revenue experts in this area could assist as might exploring the opportunities to draw upon international experts to supplement the pool of experts available in Ireland.

f. Administration of cash refunds for SMEs

Our understanding of the Irish approval process for release of R&D tax credit cash refunds for SMEs is that claims for refund require manual Revenue intervention before the claim can be authorised for payment. This can take time to process and leads to delays where Revenue resources are not available to process the claim and authorise release of the cash refund amount.

By comparison with the UK, it should be noted that HMRC have a target of processing 95% of tax credit claims (either making payment or contacting the claimant) within 28 days of receiving the claim.



We suggest that consideration be given to allowing the automatic refund of a cash claim to a compliant taxpayer for claim amounts below a de minimis threshold of, say, €50,000.

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.

Q8. Having regard to overall Exchequer cost, what measures could be taken to amend the current relief to improve supports for SMEs carrying out R&D?

Our response below recognises that tax incentives alone cannot deliver the wider supports which we believe are important in sustaining R&D activity in Ireland. These include continuing policy initiatives that link up strategic developments for new technologies e.g. in relation to the AI space, that seek to build and deepen the linkages between academic research and for commercialisation of that research in Ireland and which foster peer to peer

networks for collaboration and development of early stage R&D.

A common requirement for the success of many of these wider supports is ensuring that persons trained in R&D, qualified Irish graduates and post graduates are retained in Ireland and are available to Ireland to form part of a skilled workforce for R&D activities.

Also important in developing a wider environment that sustains R&D activity is ensuring that SMEs can participate in and benefit from spillovers of knowledge by working with larger organisations – whether in collaborative R&D or as part of a network of outsourced service support for R&D activities. All of this comes down to the ability to procure and retain skilled personnel in what can be a very small and competitive labour pool where there is a high degree of mobility of individuals internationally.

We suggest that the [key employee mechanism could be overhauled](#) and amended as described below both to enable:

- SMEs to appoint and recruit key (a small number of) employees.
- larger organisations to include younger graduates amongst their workforce which may not be able to contribute as effectively to the outcome and delivery of the R&D projects but which can contribute to the retention of these skills and their development in Ireland.

Key employee relief mechanism

The policy intent behind the key employee relief is to provide a mechanism for companies to incentivise key employees who are engaged in the company's R&D activities. Part (or all) of the company's R&D tax credit may be transferred to the employee. However, in our experience, there are a number of complex rules around the key employee mechanism and therefore this is largely unused.

The 2013 Department of Finance's Review of Ireland's R&D Tax Credit found that only 12 companies availed of the key employee mechanism in 2011. We have not seen statistics that suggest that there has been a higher take up of the key employee tax credit in the period since that date.

This initiative could be much more useful for companies, especially in the SME sector, in helping secure and retain key employees engaged in R&D activity. It is focused on the main R&D cost for business which is payroll cost. The relief in its current form is flawed - it simply does not work.

The relief is perceived generally by companies as being difficult to apply, overly restrictive and is high-risk (given the cost falls to the employer company and not on the employee in the event of an over-claim).

The relief also requires that the claimant company is paying corporation tax. This precludes early stage companies just emerging from the start-up phase which

still have not generated sufficient taxable profits to recover losses carried forward. These companies are often at the greatest risk of loss of R&D personnel as they have the least resources and capacity to pay that 'something extra' to retain their research personnel. If the R&D tax credit is capable of being encashed through refunds of payroll tax liabilities, there is no reason why it should not also be eligible for use by the employer to surrender to fund an employment tax credit for an eligible employee.

We suggest that it should be possible to preserve the intended tax revenue neutrality of the provisions but not to limit eligible R&D tax credits for surrender to a key employee solely to R&D tax credits which are capable of being offset against corporation tax of the employer company.

Currently, the eligible employee is precluded from being a director of the company (now or in the past) or from being a director of an associated company. We suggest removing the requirement that the eligible employee cannot be a director of the company or an associated company so as to allow scope for the boards of directors of companies to include key R&D personnel. An example of such an individual could be a director of R&D or a chief technology officer.

The provisions require that the eligible employee has a minimum effective income tax rate of 23%. This does not take into account Universal Social Charge (USC) and Pay Related Social Insurance (PRSI).

The minimum effective tax rate requirement means that the benefit of the income tax credit for key R&D employees would not have any benefit for a single person earning approximately €61,000 (€81,000 for a married person) or lower. This effectively means that, in reality, the relief does not give any incentive to Irish business to hire young Irish scientists given that the standard pay ranges offered to such individuals would not be sufficient to exceed the minimum effective tax rate threshold and thus would not result in any financial benefit being delivered.

The relief would be more powerful in generating employment in Ireland and in aligning with the wider policy objectives of increasing the skills base in Ireland to support R&D activities if it could also operate to support employment in Ireland of new science graduates and post graduates rather than see them go abroad for suitable employment. This would also be aligned with policy objectives of enhancing the competitiveness of SMEs with high growth potential and of sustaining jobs in Ireland. The reality is that commercial factors and maintenance of equivalent pay policies across cohorts of employees will mean that businesses are not likely to choose to use the benefit of the employee credit to an extreme for an individual employee where it could be used to deliver benefits across a wider spectrum of pay ranges for new hires to undertake R&D activity.

We suggest that consideration is given to removing the requirement for a minimum effective tax rate for the employee - the relief is already inherently self-funding and neutral from a tax revenues' perspective.



We recommend improving the effectiveness of the key employee relief mechanism by making the following changes:

- Permit companies eligible for a cash refund to have the option of surrendering part of the refund to eligible key employees through an [employment tax credit](#). Do not limit the relief to profitable companies which can offset the credit against corporation tax,
- Remove the requirement that the eligible employee cannot be a director of the company or an associated company so as to [allow scope for the boards of directors of companies to include key R&D personnel](#),
- Remove the requirement for a [minimum effective tax rate for the employee](#) so as to extend the relief to recent graduate hires - the relief is already inherently self-funding and neutral from a tax revenues' perspective.

Impact of relief under the Knowledge Development Box (KDB) on the R&D tax credit cash refund

Where the corporation tax liability of a company for a period is reduced by a claim to relief under the KDB, the reduction in the corporation tax liability is ignored for the purposes of computing a cash refund available under the R&D tax credit regime. As a result, a lesser amount is potentially available by way of a R&D tax credit refund to the company. This lesser amount is the excess of the tax credit over the corporation tax amount before the reduction caused by KDB relief.

This becomes particularly relevant where the value of the KDB relief exceeds the R&D tax credit. This is illustrated in the following example:



Example

Corporation tax liability before KDB relief - €800,000

Effect of KDB relief - €700,000

The corporation tax payable after taking into account KDB relief is €100,000.

R&D tax credit - €400,000

In the absence of the provision outlined above, a company might expect to claim a refund of €300,000, being the excess of the €400,000 R&D tax credit over the €100,000 corporation tax liability.

However the impact of the provision above is that there is no refund available.

This issue becomes more significant where there are losses carried forward or other reliefs available to the company which reduce the amount of corporation tax payable.

We suggest that it is not necessary to restrict the entitlement of businesses which have made a claim to relief under the KDB regime to obtain relief by way of a cash refund claim.

The relief under the KDB and the R&D tax credit target fundamentally different stages of activity in the business cycle. They are however mutually reinforcing as seen from the insights in feedback to earlier questions which highlights the increasing co-dependence of co-location of R&D activities and high end manufacturing as well as leading edge technology platforms in exploiting the output of R&D activities.

The target of the KDB is to provide taxpayer relief once successful R&D activity has resulted in qualifying income arising to the company from completed R&D activity. The R&D tax credit relief is designed to afford cash tax savings to companies engaged in R&D activities. In our view, the objective and effectiveness of the R&D tax credit in supporting continuing R&D activity in Ireland is undermined where the taxpayer is penalised for successful exploitation of the output of past R&D activity.



We suggest revising the current restriction on the entitlement of businesses to a R&D tax credit refund to allow a refund claim for the amount that the claim exceeds the actual corporation tax payable by the company/group.

This would mean that the scope for relief afforded for R&D tax credit claims under section 766(4), TCA 1997 should not be reduced where there is a reduction in corporation tax resulting from a claim to relief under the KDB so that the KDB relief operates in the same way as other credits/reductions in corporation tax.

Appendix 1: Suggested legislative changes

We have set out below suggested changes to the R&D tax credit legislative provisions arising from recommendations set out in our submission. These are highlighted in red text in the excerpts from the relevant provisions that are set out below.

766 Tax credit for research and development expenditure.

(1) (a) In this section—

“*authorised officer*” means an officer of the Revenue Commissioners authorised by them in writing for the purposes of this section;

“*EEA Agreement*” means the Agreement on the European Economic Area signed at Oporto on 2 May 1992 as adjusted by the Protocol signed at Brussels on 17 March 1993;

“*expenditure on research and development*”, in relation to a company, means expenditure, other than expenditure on a building or structure, incurred by the company wholly and exclusively in the carrying on by it of research and development activities in a relevant Member State, being expenditure—

(i) which—

(I) is allowable for the purposes of tax in the State as a deduction in computing income from a trade (otherwise than by virtue of *section 307*), or would be so allowable but for the fact that for accounting purposes it is brought into account in determining the value of an intangible asset, or

(II) is relieved under *Part 8*,

(ii) on machinery or plant (other than a specified intangible asset within the meaning of *section 291A* treated as machinery or plant by virtue of *subsection (2)* of that section) which qualifies for any allowance under *Part 9* or this Chapter, or

(iii) which qualifies for an allowance under *section 764*,

but—

(I) expenditure on research and development shall not include a royalty or other sum paid by a company in respect of the user of an invention—

(A) if the royalty or other sum is paid to a person who is connected with the company within the meaning of *section 10* and is part of overall income from a qualifying asset within the meaning of *section 769G*, or

(B) to the extent to which the royalty or other sum exceeds the royalty or other sum which would have been paid if the payer of the royalty or other sum and the beneficial recipient of the royalty or other sum were independent persons acting at arm’s length,

(IA) expenditure by a company on research and development shall not include any amount of interest notwithstanding that such interest is brought into account by the company in determining the value of an asset,

(IB) expenditure on research and development shall not include—

(A) except as provided for in subparagraphs (vii) and (viii) of *subsection (1)(b)*, any amount paid to another person to carry on research and development activities, or

(B) expenditure incurred by a company in the management or control of research and development activities where such activities are carried on by another person,

and “in the carrying on by it of research and development activities” shall be construed accordingly, and

- (II) expenditure incurred by a company which is resident in the State shall not be expenditure on research and development if it—
- (A) may be taken into account as an expense in computing income of the company,
 - (B) is expenditure in respect of which an allowance for capital expenditure may be made to the company, or
 - (C) may otherwise be allowed or relieved in relation to the company,
- for the purposes of tax in a territory other than the State;

“externally provided worker”, in relation to an individual is an individual who is not a director or employee of the company, who personally provides, or is under an obligation personally to provide, services to the company and is subject to (or to the right of) supervision, direction or control by the company as to the manner in which those services are provided and the provision of those services does not constitute the carrying on of activities contracted out by the company.

[This definition is linked to later suggested changes which excluded the cost of externally provided workers from the outsourced expenditure limits and which expressly treat the costs of externally provided workers as costs of R&D conducted by the company itself.]

“group expenditure on research and development”, in relation to a relevant period of a group of companies, means the aggregate of the amounts of expenditure on research and development incurred in the relevant period by qualified companies which for the relevant period are members of the group: but—

- (i) expenditure incurred by a company which is a member of a group for a part of a relevant period shall only be included in group expenditure on research and development if the expenditure is incurred at a time when the company is a member of the group, and
- (ii) expenditure on research and development incurred by a company which has been included in group expenditure on research and development in relation to a group shall not be included in group expenditure on research and development in relation to any other group;

“key employee” has the meaning ascribed to it by *section 472D*;

“qualified company”, in relation to a relevant period, means a company which—

- (i) throughout the relevant period—
 - (I) carries on a trade,
 - (II) is a 51 per cent subsidiary of a company which carries on a trade, or
 - (III) is a 51 per cent subsidiary of a company whose business consists wholly or mainly of the holding of stocks, shares or securities of a company which carries on a trade or more than one such company,
- (iii) carries out research and development activities in the relevant period,
- (iv) maintains a record of expenditure incurred by it in the carrying out by it of those activities, and
- (v) in the case of a company which is a member of a group of companies that carries on research and development activities in separate geographical locations, maintains separate records of expenditure incurred in respect of the activities carried on at each location;

[....]

(b) For the purposes of this section—

- (i) 2 companies shall be deemed to be members of a group if one company is a 51 per cent subsidiary of the other company or both companies are 51 per cent subsidiaries of a third company: but in determining whether one company is a 51 per cent subsidiary of another company, the other company shall be treated as not being the owner of—
 - (I) any share capital which it owns directly in a company if a profit on a sale of the shares would be treated as a trading receipt of its trade, or
 - (II) any share capital which it owns indirectly, and which is owned directly by a company for which a profit on a sale of the shares would be a trading receipt;
- (ii) *sections 412 to 418* shall apply for the purposes of this paragraph as they would apply for the purposes of *Chapter 5 of Part 12* if—
 - (I) “51 per cent subsidiary” were substituted for “75 per cent subsidiary” in each place where it occurs in that Chapter, and
 - (II) *paragraph (c) of section 411(1)* were deleted;
- (iii) a company and all its 51 per cent subsidiaries shall form a group and, where that company is a member of a group as being itself a 51 per cent subsidiary, that group shall comprise all its 51 per cent subsidiaries and the first-mentioned group shall be deemed not to be a group: but a company which is not a member of a group shall be treated as if it were a member of a group which consists of that company;
- (iv) in determining whether a company was a member of a group of companies (in this subparagraph referred to as the “*threshold group*”) for the purposes of determining the threshold amount in relation to a relevant period of a group of companies (in this subparagraph referred to as the “*relevant group*”), the threshold group shall be treated as the same group as the relevant group notwithstanding that one or more of the companies in the threshold group is not in the relevant group, or vice versa, where any person or group of persons which controlled the threshold group is the same as, or has a reasonable commonality of identity with, the person or group of persons which controls the relevant group;
- (vi) expenditure shall not be regarded as having been incurred by a company if it has been or is to be met directly or indirectly by grant assistance or any other assistance which is granted
 - by or through—
 - (I) the State or another relevant Member State, or
 - (II) any board established by statute, any public or local authority or any other agency of the State or another relevant Member State;
- (vi) where a company—
 - (I) incurs expenditure on research and development at a time when the company is not carrying on a trade, being expenditure which, apart from this subparagraph, is not included in group expenditure on research and development,
 - (II) begins to carry on a trade after that time, and
 - (III) makes a claim in respect of expenditure incurred at a time referred to in clause (I),

the expenditure shall be treated—

- (A) for the purpose only of *subsection (5)*, as incurred at the time the company begins to carry on the trade, and
- (B) for the purposes of *subsection (2)*, as it would if the company had commenced to carry on a trade at the time the expenditure was incurred, and the amount of any credit computed thereon shall be carried forward in accordance with *subsection (4)* and treated as an amount by which the corporation tax of the first accounting period which commenced on or after the time the company begins to trade is reduced;

(vii) where in any period a company—

- (I) incurs expenditure on research and development, and
- (II) pays a sum (which excludes amounts paid to externally provided workers) to a university or institute of higher education in order for that university or institute to carry on research and development activities in a relevant Member State,

so much of the sum so paid as does not exceed the greater of 5 per cent of that expenditure or €100,000, shall, to the extent that it does not exceed the expenditure referred to in clause (I), be treated as if it were expenditure incurred by the company in the carrying on by it of research and development activities;

(viii) where in any period a company—

- (I) incurs expenditure on research and development, and
- (II) pays a sum (not being a sum referred to in clause (II) of subparagraph (vii) and excluding sums paid to externally provided workers) to a person, other than to a person who is connected (within the meaning of *section 10*) with the company, in order for that person to carry on research and development activities, and notifies that person in writing that the payment is a payment to which this clause applies and that the person may not make a claim under this section in respect of such research and development activities,

then, so much of the sum so paid as does not exceed the greater of 15 per cent of that expenditure or €100,000, shall, to the extent that it does not exceed the expenditure referred to in clause (I), be treated as if it were expenditure incurred by the company in the carrying on by it of research and development activities and expenditure incurred by that other person in connection with the activities referred to in clause (II) shall not be expenditure on research and development.

[The two changes seek to exclude the costs of externally provided workers from the outsourced expenditure limits. This effectively treats these costs in the same way as employee costs.]

- (ix) A research and development centre used by a company which is a member of a group of companies will be treated as being in a separate geographical location to another research and development centre used by the company or another company which is a member of the group if it is not less than a distance of 20 kilometres from that other research and development centre.
- (x) expenditure incurred by the company on externally provided workers who carry on R&D activities will be deemed to be expenditure incurred by the company in the carrying on by it of research and development.

[As noted above, this change is suggested so as to expressly provide that the costs of externally provided workers form part of expenditure incurred by the company on R&D.]

- (1A) (a) Where expenditure is incurred by a company on machinery or plant which qualifies for any allowance under *Part 9* or this Chapter and the machinery or plant will not be used by the company wholly and exclusively for the purposes of research and development, the amount of the expenditure attributable to research and development shall be such portion of that expenditure as is just and reasonable, and such portion of the

expenditure shall be treated for the purposes of *subsection (1)(a)* as incurred by the company wholly and exclusively in carrying on research and development activities.

- (b) Where, at any time, the apportionment made under *paragraph (a)*, or a further apportionment made under this paragraph, ceases to be just and reasonable, then—
 - (i) such further apportionment shall be made at that time as is just and reasonable,
 - (ii) any such further apportionment shall supersede any earlier apportionment, and
 - (iii) any such adjustments, assessments or repayments of tax shall be made as are necessary to give effect to any apportionment under this subsection.

[....]

- (5) Any claim under this section shall be made within 12 months from the end of the accounting period in which the expenditure on research and development, giving rise to the claim, is incurred. **A relevant Inspector of Taxes may accept that a claim has been made within the above mentioned 12 month period where the claim is made within one month of that date and the claimant company can provide evidence to the satisfaction of the Inspector that the claimant was prevented by absence, sickness or other reasonable cause from making the claim within the 12 month period.**

[This change is suggested to afford discretion to Revenue to permit late claims for relief subject to the claimant meeting certain conditions. The suggested conditions mirror those afforded the Tax Appeal Commissioners in exercising their discretion to permit late appeals.]

- (6) (a) The Minister for Enterprise, Trade and Employment, in consultation with the Minister for Finance, may make regulations for the purposes of this section providing—
 - (i) that such categories of activities as may be specified in the regulations are not research and development activities, and
 - (ii) that such other categories of activities as may be specified in the regulations are research and development activities.
- (b) Where regulations are to be made under this subsection, a draft of the regulations shall be laid before Dáil Éireann and the regulations shall not be made until a resolution approving the draft has been passed by Dáil Éireann.

[....]



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