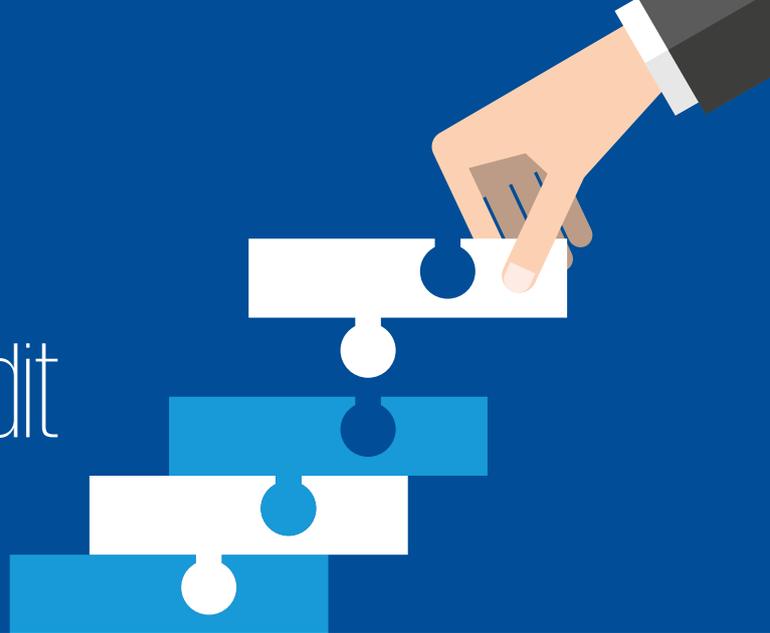


# The research and development tax credit in detail



**Whether you are already claiming the R&D tax credit or just considering your eligibility, it is essential to remember that R&D does not just happen in the laboratory – quite often it is the work a company would consider to be a day-to-day activity: developing a new product; devising or making improvements to a production process; trying out a new material to reduce costs. The list is extensive, and with a potential saving of up to 25% of qualifying expenditure, it is worth checking if your activities meet the criteria.**

## Overview of the R&D tax credit

The R&D tax credit was first introduced in 2004 and since then has been amended and generally enhanced with each subsequent Finance Act.

The tax credit operates on a group basis and is available to companies, within the charge to Irish tax, that undertake R&D activities in the European Economic Area (EEA) or the UK. The credit is available for expenditure which is allowable for a corporate tax deduction in Ireland, or would be so allowable but for the fact that for accounting purposes it is capitalised as an intangible asset.

You could be entitled to a **cash refund** from Revenue worth **25%** of your qualifying R&D spend

## 10 key facts

1. The R&D tax credit is worth up to **25%** of qualifying expenditure.
2. This credit is available **in addition to the trading deduction** available for R&D spend. This can result in a net subsidy of 37.5% (i.e. 12.5% corporation tax deduction + 25% R&D tax credit).
3. **Eligible expenditure** can include expenses (e.g. salaries, materials consumed, overheads etc.) that are deductible for the purposes of computing corporation tax.
4. Expenditure incurred on R&D activities **outsourced** to a third-party or third-level institution can be included in an R&D tax credit claim, subject to restrictions (see below for key points).
5. Expenditure incurred on **Plant and Machinery** (P&M) can be classed as qualifying R&D spend. In order to qualify, P&M must be eligible for wear and tear capital allowances and must be used for the purposes of undertaking R&D activities.
6. Expenditure on construction or refurbishment of a **building** used for qualifying R&D activity may also be classed as qualifying R&D spend. The credit is available for expenditure provided a number of conditions are met, for example the R&D activities carried on in that building over a period of 4 years must represent at least 35% of all activities carried on in the building.
7. Expenditure met by **grant assistance** received from the State, the EU, or EEA does not qualify for the credit.
8. Companies have **12 months** from the end of the relevant accounting period in which to make a claim.
9. Key employees who have been actively involved in R&D activities can benefit from an **employee reward mechanism**, effectively allowing them to receive part of their remuneration tax free (see below for key points).
10. Generally Revenue has 4 years from the end of the year in which the claim is made to commence an **audit**.

All of the above are subject to certain conditions, which companies should investigate thoroughly with a tax advisor prior to submitting an R&D tax credit claim.

At the time of publication, the small & micro companies enhanced regime, which was announced in Finance Act 2019, has yet to receive the required Ministerial order, which is delayed due to Covid-19.

## Use of the credit

- In the first instance, the R&D tax credit can be used to reduce a company's (or group's) current year corporation tax liability.
- Where a company does not have sufficient corporation tax liability in the current accounting period, it can choose to carry the credit back for offset against the corporation tax liability in the preceding period. Any remaining excess can be carried forward indefinitely against future corporation tax liabilities.
- Instead of carrying the credit forward, a company may elect to have any remaining excess credit paid as a cash refund by Revenue over three years (complex rules apply). The amount of money that a company can claim under the above cash back mechanism is limited to the greater of:
  - i. The corporation tax paid by the company during the period of 10 years prior to the previous accounting period, or
  - ii. The sum of the payroll tax liabilities for the period in which the expenditure on R&D was incurred and in the prior period, subject to conditions.

## Outsourcing R&D

Expenditure incurred on R&D activities outsourced to a third party or third level institution can be included in an R&D tax credit claim, subject to certain rules:

- Payment to a third party is limited to the greater of 15% of the company's overall R&D spend or €100,000.
- Payment to a third level institution is limited to the greater of 15% of the company's overall R&D spend or €100,000. For accounting periods ending before 22 December 2019, the relief is restricted to 5%.
- The total amount claimed must not exceed the qualifying expenditure incurred by the company itself in the period.
- The company must notify the third party provider in writing that it cannot also claim the R&D tax credit for the work it has been contracted to carry out. From 22 December 2019, this notification must be

made in advance of making the payment or on the date the payment is made. Where the outsourced activity is undertaken by a person who could not claim the R&D tax credit (for example, an individual, or by a non-resident 3rd party which does not have a branch in the State) then Revenue will accept that a notification is not required in these cases.

## 'Key Employee' reward mechanism

Key employees who have been involved in R&D activities can benefit from a 'key employee' reward mechanism, which effectively allows them to receive part of their remuneration tax free. This is subject to complicated rules and should be investigated thoroughly; some of the key points to note are:

- The employee cannot be a director of, or have a material interest in, the company or be connected to such a person.
- The employee must spend at least 50% of their time on R&D activities (i.e. the conception or creation of new knowledge, products, processes, methods, or systems) and at least 50% of their emoluments must qualify for the credit.
- The amount of credit that can be surrendered to key employees is capped at the amount of corporation tax due by the company before taking the R&D tax credit into account, i.e. the company must be taxpaying.
- The employee's effective rate of income tax cannot be reduced below 23%.
- In the event of a reduction in the credit amount following a Revenue audit, the onus is on the company to repay the credit surrendered to key employees.

## Buildings and structures

- Companies who build or refurbish buildings or structures for both R&D and other activities may claim an R&D tax credit in respect of the portion (as appears to the Revenue to be just and reasonable) of the construction/refurbishment costs that relate to R&D activities.

- A minimum of 35% of the building must be used for conducting R&D activities for the first 4 years.
- The building must be used for R&D for a period of 10 years.
- An R&D tax credit of 25% of relevant expenditure can be claimed in full in the year in which the building is first brought into use for the purpose of the trade.
- The building must qualify for industrial buildings allowances also.

## What is R&D?

While there are many activities carried out by companies that could be considered R&D, identifying and quantifying eligible activities for the purposes of the R&D tax credit can often be quite complex. Revenue guidelines and legislation state that qualifying R&D activities must:

- i. Be systematic, investigative or experimental in nature,
- ii. Be carried out within a Revenue approved field of science and technology,
- iii. Involve basic research, applied research or experimental development,
- iv. Seek to achieve scientific or technological advancement, and
- v. Involve the resolution of scientific or technological uncertainty.

## What fields of science or technology qualify for the credit?

Allowable fields of science and technology include:

- **Natural sciences** – e.g. food science, software development, chemical sciences, biological sciences.
- **Engineering and technology** – e.g. mechanical, material, electronic, electrical, and communication engineering, food and drink production.
- **Medical sciences** – e.g. basic medicine, clinical medicine, health sciences.
- **Agricultural sciences** – e.g. forestry, fisheries, veterinary medicine.

## Examples of activities that could qualify for the R&D tax credit

### MedTech, pharmaceuticals, biotechnology

- Design and development of new production processes for existing medical device products.
- Development of new consumer drug formulations and coating techniques.
- Development of new and improved production processes resulting in higher product yield.
- Development of generic drugs replacement of off-patent applications.
- Design and development of new diagnostic testing methods.
- Acceptance and optimisation of new technologies transferred from parent organisations.
- Development of new test methods, DOEs, etc.

### Software, technology, media, telecommunications

- Software programming.
- Wireless and telecoms applications.
- Development of new communication protocols.
- Internet security and content delivery.
- Advanced mathematical modelling.

### Manufacturing, engineering

- Design and development of plastic moulding solutions.

- Design and development of a new refrigeration unit for food transport.
- Development of a new process for recycling plastics.
- Development of a process for the treatment of waste oil products.
- Development of a software system to monitor and price renewable energy production.

### Food, drink, agribusiness

- Design, development and integration of a new food processing line.
- Development of new products and ingredient formulae.
- Development of new drinks flavours.
- Development and implementation of a new brewing process.

### FinTech

- Development of a new faster trading system.
- Development of software systems to meet reporting requirements.
- Development of an intranet platform using cloud technology.
- Development of enhanced security solutions.

## Common errors

- Eligible activities have been overlooked and your claim may be undervalued.
- Your entitlement to claim has not been established properly; this is a complex tax technical area which interacts with other tax legislation.
- R&D activities have not been properly identified and/or documented in accordance with relevant tax legislation and Revenue guidelines.
- Insufficient supporting documentation in place to justify your claim.
- Incorrect inclusion and/or treatment of certain types of expenditure.
- The claim has been filed with Revenue in an incorrect manner.

## Implications of an incorrect claim

- **Under-claiming** – You may not have claimed the full cash value that you are entitled to and are missing out on a valuable refund.
- **Over-claiming and/or filing an unsupported claim** – If your claim is audited by Revenue, you may be leaving yourself open to repayment of the credit in addition to interest, penalties and, in extreme cases, publication on the list of tax defaulters.
- Revenue is taking an increasingly hard line with respect to issues arising from R&D tax credit claims. It is therefore very important that all claims should be prepared strictly in accordance with the legislation, tax briefings, e-briefs, Revenue Guidance, practice and precedents.

To make sure you are **making the most of your R&D tax credit claim** and are fully prepared for a Revenue audit, **contact our team for a free health check**

## KPMG's R&D Incentives Practice

We prepare R&D tax credit claims on either a contemporaneous or retrospective basis, tailored to each client's requirements. Our bespoke claim methodologies have been tried and tested under a significant number of Revenue audits; we also provide support during Revenue audits of claims prepared without KPMG assistance.



Est. 2004

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



Pre-R&D advice



Claim preparation



Revenue audit support



Appeals / court support



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



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



Revenue audit experience in all sectors.

## Contact us

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