Irish Tax Institute

Leaders in Tax

Review of the R&D Tax Credit
Fiscal Division
Department of Finance
Upper Merrion Street
Dublin 2

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Review of the R&D Tax Credit

The Irish Tax Institute welcomes this consultation on the R&D tax credit. Our members view the credit as a critical part of both our Foreign Direct Investment (FDI) offering and our system of tax supports for innovative domestic enterprise.

In response to the Invitation for Submissions (February 2013), the Institute consulted with its members in practice and in the corporate sector and we also worked with IBEC to survey industry for their direct feedback on the R&D regime. Almost 250 companies with over 80,000 employees responded to the survey across a variety of sectors and approximately 50 of these companies provided detailed financial data on their turnover, number of employees and R&D spend. We trust that the results of our combined research will be valuable to the Department in carrying out your overall review.

The Institute's key comments arising from this research are summarised below and are explored in more detail in the submission.

The Institute's Key Comments

1. The Institute endorses the regular review of tax expenditures by Government to ensure they are providing value for money for the Exchequer. The figures contained in the Invitation for Submissions show an increase in the gross cost of the credit from €82m in 2004 to €224m in 2010. Two observations occur in relation to these gross cost figures:

    a. The Exchequer figures do not take account of the benefits arising from the availability and use of the credit. Our survey results would suggest that if the total R&D population representing this Exchequer cost was surveyed, the additional economic benefits and tax revenues generated (through corporation tax, VAT, PAYE etc.) would far outweigh the cost of the credit.

b. For every €1 of cost to the Exchequer, the company has spent approximately €3. Therefore, the bulk of the R&D cost is borne by the companies themselves rather than the Exchequer.

Nonetheless, it is important to know that the credit is providing a positive net contribution to jobs and economic activity in Ireland.

2. The (approx.) 50 companies who provided detailed financial data on their activities increased their R&D spend by €318m and their total employment by 20,340 between the years 2003 and 2011[1]. Even within this sample size we can see the substantial increase in R&D spend and jobs that arose during those 9 years. Although we acknowledge that this increase may not be entirely attributable to the introduction and subsequent improvements in the tax credit, it is doubtless a very significant and positive influence on the growth.
3. The companies who responded to our survey stated that, in making R&D location decisions, tax incentives were the second most important (after the availability of qualified staff).
4. The number of small companies in the survey (< 50 employees) claiming the R&D credit, increased significantly from 5 in 2004 to 35 in 2011. This would appear to validate the steps taken in line with the commitment in the Programme for Government to make the credit more attractive and accessible to smaller businesses. These steps include introducing a limited volume basis and the ability to claim a repayment of the credit.
5. The findings above on the R&D tax credit are very positive and demonstrate the value which the R&D community in Ireland attaches to the credit. We would therefore stress the importance of retaining the credit in its existing form; without any diminution or significant change to it. A positive statement to this effect would be very welcome to give business certainty on the tax position, at least for the foreseeable future.
6. As part of this review process, it might also be worth considering an assessment of the IDA and Enterprise Ireland grants, given their close links with the credit.
7. The survey and our direct member feedback also highlighted several important issues which would improve the overall attractiveness and certainty of the regime (without significant cost).

- The current restrictions on **outsourcing** should be reviewed to ensure they are competitive and supportive of current international business models;
- The establishment of an R&D Steering Group involving Revenue, advisers and business could provide a useful forum for discussing and resolving areas of **uncertainty** and differences in interpretation of the law.

[1] Not all of the 250 companies who responded to the survey provided detailed financial data on their activities.

Details of the Survey

As noted above, almost 250 companies employing over 80,000 people in total responded to the survey. Over 8,000 of those employed are engaged either full-time or part-time in R&D activities. The respondents were from a large range of industry sectors, but predominantly from the pharmaceutical and medical devices sectors, as would be expected. About a quarter of the companies were small companies with fewer than 50 employees, and the majority of the companies have been operating in Ireland for over 10 years. Three quarters of the companies have claimed the R&D tax credit at some stage.

Results of our research and Institute recommendations

As outlined in the Key Comments, the companies who answered the survey generally expressed strong support for the R&D tax credit – a very positive outcome which is supported by the economic data on spend and jobs created.

The main recommendations arising from our research relate to initiatives for improving certainty of treatment, the outsourcing rules, and guidance.

Certainty

It is very important that companies who claim the R&D tax credit have a high degree of certainty that, having calculated and claimed the credit on a reasonable basis, they will not see their claims being significantly altered as a result of future Revenue checks or audits. This issue is even more important now where the credit is recognised "above the line" in the company's accounts.

The overall majority of companies in the survey reported a good degree of certainty about the outcome of an audit on their claim. However, one in five companies overall are experiencing a poor degree of certainty on this issue. That is a significant minority and the ratio is increased to one in three amongst the largest companies (> 500 employees) and is increased to one in four for companies who have experienced some form of Revenue intervention in the past 2 years.

The value of our certain 12.5% corporation tax rate regime is well acknowledged and we should strive for the same certainty in other areas of tax especially where international competition is severe, such as R&D. Government Ministers have consistently recognised the importance of certainty in this area – An Tánaiste has noted that *"We have to provide certainty to investors by being clear that our rate of corporation tax is not changing"*[2]. Minister Noonan acknowledged the importance of certainty in his comments on the Government's commitment to the 12.5% rate at Budget 2013: *"Even though this commitment has been stated numerous times, it is worth repeating so that there can be no doubt".*

[2] Media comment, May 2012

The establishment of an R&D Steering Group might be considered, as a way of helping companies achieve better certainty in terms of their R&D claims.

The Steering Group could be established under the auspices of TALC, and could provide Revenue, advisers and business with the opportunity to discuss the practical interpretation and administration of the law and to resolve areas of uncertainty. Issues that could be dealt with might include:

- uncertainties in the area of qualifying and non-qualifying costs,
- the appropriate allocation of overheads between R&D and non R&D activities,
- the amount of credit that can be claimed on buildings used for R&D,
- the outsourcing of R&D,
- the monetised credit in start-up situations, and
- the level of take-up of the "key employee" surrender option.

This is also an approach adopted in the UK, where an HMRC R&D steering group meets regularly with advisers and business.

Outsourcing

Existing legislation allows for the following elements of "outsourced" activities to be included in qualifying R&D:

- R&D work outsourced to universities or colleges, up to maximum of 5% of the project costs. The first €100,000 of such expenditure qualifies, to the extent that it is matched by the company's own R&D expenditure, irrespective of whether that amount is greater than the 5% limit.
- R&D work outsourced to external contractors, up to a maximum of 10% of project costs. Again, the first €100,000 of such expenditure qualifies, to the extent that it is matched by the company's own R&D expenditure, irrespective of whether that amount is greater than the 10% limit.

2 key issues arise in relation to outsourcing:

1. Whether this policy position on outsourcing adequately deals with the international R&D business model in the current environment?; and
2. How this legislative position is interpreted by the State.

1. Are the current outsourcing restrictions appropriate?

   It would be worth reviewing the current limits for outsourced costs in light of the international R&D landscape. We appreciate the policy objective of retaining R&D knowledge and expertise within the Irish claimant companies themselves. However, we believe that a balance can be struck between achieving this objective and reducing barriers to productive R&D activity generally. The practice of outsourcing work on activities such as testing etc is a major feature of much R&D activity and it facilitates the healthy cross-fertilisation of expertise and ideas. This, in turn, helps to foster a "second tier" of innovative spin-off companies in Ireland.

2. Interpretation of the current outsourcing rules

The interpretation of the outsourcing rules is causing quite a degree of difficulty at the moment in the context of external contractors and agency workers. Many multinationals routinely engage both contractors and agency workers where they require only temporary labour or where they do not have the requisite skills in-house. In some cases, the requisite skills may be project-specific and it would be inefficient for the company to engage such individuals as employees. Many businesses feel that genuine R&D carried out by agency workers in particular, should not be regarded as outsourced R&D that is subject to the 10% limit but as R&D work carried out by the company itself. Given the differing views and interpretations on the outsourcing issue, this would be a very useful discussion for the R&D Steering Group referred to above.

International competitiveness

We welcome the inclusion of international comparisons in the Invitation for Submissions. We believe it is important to constantly assess our system's attractiveness in comparison with our main international competitors for R&D investment.

There are many variables to be taken into account in efforts to benchmark against other international offerings, e.g. eligibility of costs, rates of relief, methodology of affording relief (deduction or credit, above or below the line), different systems for different types or sizes of company, outsourcing regimes etc. More broadly, there is a multitude of additional, non-tax, factors taken into account by multinational companies who are making R&D investment decisions, such as the availability a skilled workforce, quality of infrastructure, access to markets etc. In that context, it is difficult to make an objective comparison between Ireland's R&D tax credit system and those of our closest competitors based on headline data rates alone.

Broadly, the view reflected to us during our research was that the current regime is competitive and is not out of line internationally in terms of the scope and the relative benefit of the relief. However, we must constantly monitor developments in the R&D offerings of our competitor jurisdictions. For example, in Budget 2013, the UK announced that the headline rate of the "above-the-line" R&D tax credit introduced from 1 April 2013 would be 10%, increased from the 9.1% rate proposed at Budget 2012. Coupled with the signalled reduction in the corporation tax rate to 20% from April 2015, this increases the attractiveness of the UK as a location for mobile international R&D investment. Finland has also recently introduced a temporary tax incentive for R&D costs for the first time, for the tax years 2013 to 2015.

In addition to the OECD data contained in the Invitation for Submissions, other organisations have published detailed international comparisons on various aspects of R&D offerings in other countries. We attach the relevant links at Appendix I for your information and we would be happy to follow up with the relevant firms if you need any further specific detail.

If there is anything further we can do to assist in this review process, please do not hesitate to contact us.

Yours truly

Martin Phelan
President
Irish Tax Institute

Appendix I

Deloitte 2012 Global Survey of R&D Tax Incentives

http://www.deloitte.com/view/en_CA/ca/services/tax/global-business-tax-services/rd-and-government-incentives/ea3115a228b6b310VgnVCM1000003256f70aRCRD.htm#

Ernst & Young: R&D incentives in the new tax landscape – please find attached.

KPMG: R&D Incentive and Services

http://www.kpmg.com/IE/en/IssuesAndInsights/ArticlesPublications/Documents/Research-Development/EMEA_Brochure7Nov12.pdf

PwC: Global Research and Development Incentives Group

http://www.pwc.com/en_GX/gx/tax/assets/pwc-global-research-development-incentives-group-november-2012-pdf.pdf