

This technical query paper was submitted to Revenue via the TALC Direct/Capital Taxes sub-committee following a discussion on the matter at the September 2020 TALC Direct/Capital Taxes sub-committee meeting. The Institute also submitted a second technical query paper to Revenue via the R&D Discussion Group in March 2021, see Appendix II below. These matters were subsequently discussed at the April 2021 TALC Direct/Capital Taxes sub-committee meeting and the discussion will be reflected in the Minutes.



Submission seeking further clarification on the change to the treatment of rent in the Research & Development Tax Credit TDM (Part 29-02-03)

16 November 2020

We refer to the recent discussion at the TALC Direct/Capital Taxes Sub-committee virtual meeting on 3 September regarding the updated Research and Development (R&D) Tax Credit Guidelines -Tax & Duty Manual (Part 29-02-03) and the subsequent clarification provided by Revenue to practitioners on 16 September on the timing of the application of the change to the treatment of rent as qualifying R&D expenditure.

Revenue confirmed the following to us on 16 September:

"In 2015 the R&D guidelines clarified further Revenue's interpretation of what constitutes qualifying R&D expenditure, it states that the phrase "in the carrying on" must be distinguished from "the purposes of" or "in connection with" used elsewhere in the Taxes Consolidation Act 1997. Additionally, it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase "in the carrying on" is narrower in scope. Costs which are not wholly and exclusively incurred in the carrying on of the R&D activity, do not qualify as relevant expenditure.

The wording in the Research and Development Tax Credit Guidelines TDM 29-02-03 of July 2020 goes to clarify specifically that rent is not considered qualifying expenditure for the research and development tax credit.

In line with existing practice to date where rent is apportioned between the research and development trade and another trade it will be necessary to display that this expense was incurred wholly and exclusively in the carrying of the research and development trade activities, and not in connection with or for the purposes of those activities."

The Institute strongly disagrees with Revenue's view that rent is not incurred in the carrying on of R&D activities. As part of this submission, we have set out below three key issues relating to the R&D Tax Credit regime which we would like to raise with Revenue through the TALC Direct/Capital Taxes Sub-committee:

1. Disallowance of rental expenditure as per Revenue's updated R&D Guidelines (July 2020)
2. Implementation of the July 2020 R&D Guidelines
3. S766A TCA 1997 – Covid-19 measures for consideration

1. Disallowance of rental expenditure as per Revenue's updated R&D Guidelines (July 2020)

S766 Tax Credit for Research and Development Expenditure

S766(1) TCA 1997 states that “*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 for a trade (otherwise 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.”

Based on S766A TCA 1997, a company can acquire a building and incur expenditure on the refurbishment of the building for R&D purposes. These costs, subject to meeting specific conditions, will qualify for the R&D Tax Credit. However, renting the refurbished R&D building will now not qualify, even though the purpose of the building has not changed, and the same activity is being undertaken in the building i.e. R&D activity. This creates a clear anomaly.

In accordance with S766A TCA 1997, which does not state that the building must be wholly and exclusively for R&D purposes (i.e. there is no requirement to meet a 100% usage test), instead a de minimis R&D usage test of 35% must be met.

In this regard S766A(1)(a) states “[“*qualifying building*” means a building or structure, which is to be used for the purpose of carrying on by the company of research and development activities in a relevant Member State, where, for the specified relevant period in relation to that building or structure, the proportion of use of the building or structure attributable to research and development activities carried on by the company, as calculated in accordance with subsection (6), is not less than 35%]”.

Furthermore, the legislation specifically allows for an apportionment method to be used where the building is not used wholly and exclusively for R&D purposes. “*Where expenditure is incurred by a company on a building or structure and the building or structure will not be used by the company wholly and exclusively for the purposes of research and development, the proportion of the use of the building or the amount of expenditure, attributable to research and development shall be such portion of the use of the building or the expenditure [as is just and reasonable]*¹.”

Given that costs incurred on constructing or refurbishing a building which a company owns for R&D purposes (assuming the conditions are met) may qualify for a R&D Tax

¹ S766A(6) TCA 1997

Credit, then the question arises as to why the cost of renting a premises to conduct or carry out the same R&D activities would not be deemed to be qualifying expenditure? If there is no facility to conduct R&D, it is difficult to envisage a situation where certain sectors could ever carry on a qualifying R&D activity. Rental costs incurred on a building or structure to facilitate the safe conducting of R&D activities is an essential cost incurred in the carrying on of R&D activities. Various sections of the legislation, and indeed in practice, apportion this cost on a just and reasonable basis to reflect the proportion of usage of the building for a qualifying R&D activity.

The legislation also specifically allows on a just and reasonable basis for costs in relation to plant and machinery to be included in the claim. In this regard S766(1A)(a) states that "*Where expenditure is incurred by a company on machinery or plant which qualifies for any allowance under Part 9 [...] 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 expenditures [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 the carrying on of research and development activities.*"

Similarly, certain types of building costs under S766A are apportioned on a just and reasonable basis in line with S766A(6). In this regard, specific fit out of bespoke labs, of mechanical fit out, electrical fittings etc. of a building would constitute plant and could potentially qualify for inclusion in the R&D Tax Credit claim. Therefore, the building is akin to the piece of equipment which is used for R&D purposes. The hire (or rental) of pieces of equipment used for qualifying R&D purposes would qualify for inclusion in a R&D Tax Credit claim, therefore, it is anomalous that the rent of the building would not also be an eligible cost incurred in the carrying on of R&D activities.

From a technical perspective, Revenue's interpretation of 'carrying on' R&D activities seems to be inconsistent with the construction of the definition of 'expenditure on research and development' contained in S766(1)(a) TCA 1997. The draftsman excluded capital '*expenditure on a building and structure*' from the expenditure incurred by the company '*in the carrying on by it of research and development activities*' (in order to deal with this in S766A). If Revenue's interpretation is correct, the exception is completely superfluous because on Revenue's analysis such expenditure would never be expenditure incurred '*in carrying on by it of research and development activities*' in any case.

Thus, to give some meaning to the exception, it must be possible that capital expenditure on a building would otherwise have been expenditure incurred 'in the carrying on' of R&D. If that is so, there can be no objection to the inclusion of rent of a building within that phrase subject to a just and reasonable apportionment where required.

Leaving aside the legislative analysis, R&D activities must be carried out in a controlled environment and as such, cannot occur, for example, in a carpark. A building supports not only the employees who physically conduct the R&D but provides the infrastructure that is essential for creating a particular sterile environment, temperature or specific specialised conditions that are necessary for R&D activities to be conducted. Without a building or a structure, no R&D activities could be conducted. For example, R&D on the

development of drugs, or the development of software must be conducted in a particular, often bespoke, setting.

Revenue state in the July 2020 R&D Guidelines that *“overheads which are wholly and exclusively incurred directly in the carrying on of the qualifying R&D activity, for example power consumed in the R&D process, qualify for the credit²”*. Lighting, heating, ventilation, power and other essential equipment must be attached to a structure or building and cannot exist in the absence of such a structure or building.

The building is integral to the housing of the infrastructure to enable light, heat, and power to be consumed and R&D activities to be undertaken. The rental costs incurred for such a building in which R&D is carried out are incurred wholly and exclusively in the carrying on of R&D activities or can be apportioned based on the usage of the building for qualifying R&D activities.

Even where other activities are being undertaken in a building the portion of the building which is used for R&D would still be incurred wholly and exclusively in the carrying on of R&D with apportionment of the rental costs on a just and reasonable basis. It is counterintuitive that a proportion of capital costs envisaged in s766 TCA 1997 are deemed to be eligible in the carrying on of R&D activities and yet on Revenue’s analysis rental costs might not. We can see no policy objective for such a distinction.

Finance Act 2010 introduced specific measures in relation to the calculation of the threshold amount for group companies operating in separate locations. S766(1) TCA 1997 defined a research and development centre *as a ‘fixed base or bases, established in buildings or structures, which are used for the purpose of the carrying on by a company of research and development activities.’* This definition clearly shows that the legislative draftsman considered that a building or structure can be ‘used for the purpose of carrying on by a company of research and development’. It is difficult to see how any other conclusion can be reached in light of the clear words used by the statute. It accepts that a building or structure is integral to the carrying on of R&D. Thus, we can see no basis for suggesting that the rental of a building or structure in which R&D activities are conducted cannot be an eligible cost.

Finance Act 2019 Measures

In April 2019, the Department of Finance undertook a Public Consultation on the R&D Tax Credit (this consultation is still being reviewed). As part of the consultation process, there were numerous calls and suggestions on how to enhance the R&D Tax Credit regime for the SME sector³.

Three key questions which were asked in relation to SMEs:

- *“What are the factors that are relevant to the relatively low uptake of the current credit by SMEs?”*
- *“Are there ways of improving the current credit system to make it more attractive to SMEs?”*
- *“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?”⁴*

² [Research and Development \(R&D\) Tax Credit Tax and Duty Manual Part 29-02-03 – July 2020](#)

³ Department of Finance – [Tax Incentives for SMEs Tax Strategy Group -19/05 2019](#)

⁴ [Research & Development Tax Credit Review 2019 – Public Consultation- April 2019 – Department of Finance](#)

On the back of the consultation process, Finance Act 2019 brought about numerous measures to make the R&D Tax Credit regime more attractive to small and micro sized companies. These measures are still (at time of writing) subject to Ministerial Order. Rental costs would be a significant cost to most small and micro sized companies. The further narrowing of the Guidelines is out of kilter with these measures that were introduced in Finance Act 2019. As stated in the Institute's Response to the Public Consultation document "*the combination of the volume of iterations and the change in emphasis to the extent to which a company may rely on the guidance, has added to the uncertainty, for small businesses in particular, regarding R&D tax credit claims*⁵".

Revenue R&D Tax Credit Guidelines

In all the iterations of the Revenue Guidelines we see reference to the wording 'in the carrying on' of R&D activities. This phrase 'in the carrying on' is not defined and over the years these R&D Guidelines have reflected a narrowing of the interpretation of the definition of 'in the carrying on' and the types of costs which could be eligible for inclusion in a R&D Tax Credit claim. There has been no explanation given as to why the interpretation has changed.

From 2008 – 2011 the Revenue Guidelines specifically stated that expenditure incurred by a company in the carrying on of R&D activities would be available for the credit and no types of expenditure were highlighted as disallowable. In fact, these earlier R&D Guidelines stated that; "*overhead costs can be apportioned and the credit will be available for the portion expended in the carrying on of the research and development activity*". These Guidelines explained what types of activities were deemed to have been incurred in the carrying on of R&D activities and included:

"(b) indirect supporting activities such as maintenance, security, administration and clerical activities, finance and personnel activities;
*(c) ancillary activities essential to the undertaking of research and development activities such as taking on and paying staff, **leasing laboratories** and maintaining research and development equipment including computers used for research and development activities"* (emphasis added).

In 2012, the Guidelines were updated and removed the reference to the types of activities which could be included in a claim and were silent in relation to the types of qualifying costs or activities. They stated that "*the phrase in the carrying on must be distinguished from "for the purposes of" or "in connection with" used elsewhere in the Taxes Consolidation Act 1997. Additionally, it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase "in the carrying on" is more narrow in scope.*"

The 2015 Revenue Guidelines for R&D went further than the 2012 Guidelines and specifically highlighted costs which Revenue deemed not to be qualifying costs, as they were not incurred wholly and exclusively in the carrying on of R&D activities. These costs included "*recruitment fees, insurance, travel, equipment repairs or maintenance, shipping, business entertainment, telephone, bank charges and interest*".

⁵ [Irish Tax Institute – Research & Development Tax Credit Review 2019 – Response to Public Consultation – June 2019](#)

In 2019, there were no changes or updates to Section 4 “Qualifying Expenditure” of Revenue’s R&D Guidelines. Since the introduction of the regime there have not been fundamental changes to the definition of R&D and despite the numerous iterations to the Guidelines it is difficult to comprehend that only now in July 2020, that Revenue specifically identified rent as an ineligible cost.

Furthermore, there have been numerous audits and other interventions carried out by Irish Revenue over the years pertaining to R&D. We understand that there have been 791 R&D audits between 2011 and 2016⁶. This would be in addition to the R&D aspect query letters and requests for detailed R&D Tax Credit calculations by Revenue. This would suggest that Revenue is fully aware that rental expenditure forms part of the majority of Irish companies’ R&D Tax Credit claims. Until this matter came to light at TALC, practitioners were not aware of these costs ever being disallowed by Revenue, and indeed there are multiple instances where rental costs have been accepted as a qualifying R&D cost. Therefore, the long-established practice since the introduction of the R&D Tax Credit 16 years ago would support the technical position understood by practitioners and R&D claimant companies alike.

The Institute is concerned that there may be reputational damage amongst the business community (both indigenous SME and MNC sectors alike) caused by the latest change in interpretation. We are also concerned about the potential inequitable situations that this could potentially create, such as:

- In the case of small and micro sized companies where rent is a significant cost.
- Companies that can afford to incur expenditure on the construction or refurbishment of a building or structure for R&D purposes versus those that incur a rental cost.
- Frequent changes in interpretation which creates uncertainty for businesses, as highlighted in our response to the Department of Finance Public Consultation in 2019.

2. Implementation of the July 2020 R&D Tax Credit TDM (Part 29-02-03)

Notwithstanding that we strongly disagree with Revenue’s new approach, the implementation of these Guidelines will lead to confusion and uncertainty regarding the filing position of the R&D Tax Credit claims for FY2019.

Key questions arise on the back of these updated R&D Guidelines:

- Do Revenue expect any company that filed its R&D Tax Credit claim pre-July 2020 based on the Guidelines in place at the time to refile their R&D Tax Credit claims?
- Will Revenue seek interest and penalties on any R&D Tax Credit claims which were overclaimed as a result of Revenue’s change in position?
- Will Revenue seek to apply these R&D Guidelines retrospectively?

As was set out in the Institute’s Response to the Public Consultation in 2019, there were companies carrying on R&D in Ireland who did not seek to claim the R&D Tax Credit. *“The main reason given for not claiming the credit on their R&D expenditure was anxiety*

⁶ [Report on the Accounts of Public Services 2015](#) and [Opening Statement by Mr. Niall Cody, Chairman of the Revenue Commissioners, to the Committee of Public Accounts on 1 June 2017.](#)

over Revenue subsequently challenging the claim, followed by the cost involved in preparing a claim.”

The latest Guidelines add greater confusion when instead clarity and consistency is required in the uncertain and exceptionally difficult market conditions that companies are facing with the Covid-19 pandemic and the likelihood of a ‘no-trade’ deal Brexit on the horizon.

3. Covid-19 R&D Consideration in Relation to S766A TCA 1997

As set out above, under S766A TCA 1997 a company must meet a de minimis R&D usage test of 35% to avail of S766A over a specified period of 4 years. Where this de minimis usage test fails to be met, a clawback of the R&D Tax Credit will occur. As Revenue know, the Covid-19 pandemic has had serious implications for businesses across the country. In a lot of sectors, employees have been working from home since March and are likely to continue to do so until 2021. In other instances, staff have been laid off, or, where feasible put on the Temporary Wage Subsidy Scheme (TWSS).

In the event that 2020 forms part of the 4 year specified period (for calculating the 35% de minimis test), companies are potentially now failing to meet the 35% R&D usage test because of the Covid-19 pandemic. Would Revenue be prepared to review this specified period and bring in some specific Covid-19 reliefs in relation to this? For example, 2020 could be excluded from the specified period, or the specified period could be extended (or reduced) by a year so that the true R&D usage of the building could accurately be calculated?

APPENDIX I

Extracts of the iterations of Revenue's R&D Guidelines from 2008 to 2020 relating to Qualifying Expenditure

March 2008

9. Qualifying Expenditure

9.1 Activities undertaken in-house by the claimant company

The tax credit will be available in respect of expenditure incurred in the carrying on of research and development activities under the usual tax rules relating to such expenditure.

Under these rules expenses such as staff and overhead costs can be apportioned and the credit will be available for the portion expended in the carrying on of the research and development activity.

Allowable expenditure would include the cost of the following activities:

- (a) engineering, design, operational research, mathematical analysis, computer programming, data collection, testing, or psychological research;
- (b) indirect supporting activities such as maintenance, security, administration and clerical activities, finance and personnel activities;
- (c) ancillary activities essential to the undertaking of research and development activities such as taking on and paying staff, leasing laboratories and maintaining research and development equipment including computers used for research and development activities;
- (d) the cost of plant and machinery used wholly and exclusively for R&D activity.

Please also refer to 8 above.

Expenditure on research and development will qualify for the tax credit even though it may be brought into account for accounting purposes in determining the value of an asset.

Interest will not be taken into account as expenditure on research and development for the purposes of the tax credit even though, for accounting purposes, it may be included in the value of an asset.

August 2009

9. Qualifying Expenditure

9.1 Activities undertaken in-house by the claimant company

The tax credit will be available in respect of expenditure incurred in the carrying on of research and development activities under the usual tax rules relating to such expenditure.

Under these rules expenses such as staff and overhead costs can be apportioned and the

credit will be available for the portion expended in the carrying on of the research and development activity.

Allowable expenditure would include the cost of the following activities:

- (a) engineering, design, operational research, mathematical analysis, computer programming, data collection, testing, or psychological research;
 - (b) indirect supporting activities such as maintenance, security, administration and clerical activities, finance and personnel activities;
 - (c) ancillary activities essential to the undertaking of research and development activities such as taking on and paying staff, leasing laboratories and maintaining research and development equipment including computers used for research and development activities;
 - (d) the cost of plant and machinery used wholly and exclusively for R&D activity.
- Please also refer to 8 above.

Expenditure on research and development will qualify for the tax credit even though it may be brought into account for accounting purposes in determining the value of an asset.

Interest will not be taken into account as expenditure on research and development for the purposes of the tax credit even though, for accounting purposes, it may be included in the value of an asset.

February 2011

11. Qualifying Expenditure

11.1 Activities undertaken in-house by the claimant company

The tax credit will be available in respect of expenditure incurred in the carrying on of research and development activities under the usual tax rules relating to such expenditure. Under these rules expenses such as staff and overhead costs can be apportioned and the credit will be available for the portion expended in the carrying on of the research and development activity.

Allowable expenditure would include the cost of the following activities:

- (a) engineering, design, operational research, mathematical analysis, computer programming, data collection, testing, or psychological research;
 - (b) indirect supporting activities such as maintenance, security, administration and clerical activities, finance and personnel activities;
 - (c) ancillary activities essential to the undertaking of research and development activities such as taking on and paying staff, leasing laboratories and maintaining research and development equipment including computers used for research and development activities;
 - (d) the cost of plant and machinery used wholly and exclusively for R&D activity.
- Please also refer to 10 above.

Expenditure on research and development will qualify for the tax credit even though it may be brought into account for accounting purposes in determining the value of an asset.

Interest will not be taken into account as expenditure on research and development for the purposes of the tax credit even though, for accounting purposes, it may be included in the value of an asset.

December 2012 – published 2013

12. Qualifying Expenditure.

12.1

Activities undertaken in-house by the claimant company

The tax credit will be available in respect of expenditure incurred —

1. in the carrying on
2. by it

of research and development activities.

The phrase in the carrying on must be distinguished from “for the purposes of” or “in connection with” used elsewhere in the Taxes consolidation Act 1997. Additionally it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase “in the carrying on” is more narrow in scope.

The requirement that R&D be carried on “by it” denotes that the activities must be carried on by the claimant company and not by another person. Where a company contracts with another person (including a company) for the provision of services, or the performance of activities to be used in connection with research and development activities, expenditure so incurred by the claimant company does not fulfil the requirements of section 766(1)(a) as those activities in respect of which the expenditure was incurred were not carried on “by it” and will the expenditure will thus not be considered to be expenditure on research and development activities carried on by it, except to the extent so treated by the 5% and 10% limits placed on payments to universities and subcontractors respectively as outlined above. Decisions by both the Appeal Commissioners and the Circuit Court, have upheld this view. Finance Act 2012 confirms this point.

Such payments would not include the purchase of utilities (light heat power etc used in the carrying on of R&D), nor would it include materials consumed in the process.

Expenditure on research and development can qualify for the tax credit even though it may be brought into account for accounting purposes in determining the value of an asset.

Interest cannot be taken into account as expenditure on research and development for the purposes of the tax credit even though, for accounting purposes, it may be included in the value of an asset.

January 2015 and April 2015

4. Qualifying Expenditure¹⁷

4.1 Activities undertaken by the claimant company

The tax credit is available in respect of expenditure incurred wholly and exclusively—

1. in the carrying on
2. by it (the company)

of qualifying R&D activities.

The phrase “in the carrying on” must be distinguished from “for the purposes of” or “in connection with” used elsewhere in the Taxes Consolidation Act 1997. Additionally, it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase “in the carrying on” is narrower in scope.

Costs which are **not** wholly and exclusively incurred **in the carrying on** of the R&D activity, including indirect overheads such as recruitment fees, insurance, travel, equipment repairs or maintenance, shipping, business entertainment, telephone, bank charges and interest, **do not qualify** as relevant expenditure.

However, overheads which are wholly and exclusively incurred directly in the carrying on of the qualifying R&D activity, for example power consumed in the R&D process, qualify for the credit.

March 2019 and April 2019

4. Qualifying Expenditure¹⁹

4.1 Activities undertaken by the claimant company

The tax credit is available in respect of expenditure incurred wholly and exclusively—

1. **in the carrying on**
2. **by it (the company)**

of qualifying R&D activities.

The phrase “in the carrying on” must be distinguished from “for the purposes of” or “in connection with” used elsewhere in the Taxes Consolidation Act 1997. Additionally, it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase “in the carrying on” is narrower in scope.

Costs which are **not** wholly and exclusively incurred **in the carrying on** of the R&D activity, including indirect overheads such as recruitment fees, insurance, travel, equipment repairs or maintenance, shipping, business entertainment, telephone, bank charges and interest, **do not qualify** as relevant expenditure.

Overheads which are wholly and exclusively incurred directly in the carrying on of the qualifying R&D activity, for example power consumed in the R&D process, qualify for the credit.

June 2019

4. Qualifying Expenditure²⁰

4.1 Activities undertaken by the claimant company

The tax credit is available in respect of expenditure incurred wholly and exclusively—

1. **in the carrying on**
2. **by it (the company)**

of qualifying R&D activities.

The phrase “in the carrying on” must be distinguished from “for the purposes of” or “in connection with” used elsewhere in the Taxes Consolidation Act 1997. Additionally, it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase “in the carrying on” is narrower in scope.

Costs which are **not** wholly and exclusively incurred **in the carrying on** of the R&D activity, including indirect overheads such as recruitment fees, insurance, travel, equipment repairs or maintenance, shipping, business entertainment, telephone, bank charges and interest, **do not qualify** as relevant expenditure.

Overheads which are wholly and exclusively incurred directly in the carrying on of the qualifying R&D activity, for example power consumed in the R&D process, qualify for the credit.

July 2020

4. Qualifying Expenditure¹⁹

4.1 Activities undertaken by the claimant company

The tax credit is available in respect of expenditure incurred wholly and exclusively—

1. **in the carrying on**
2. **by it (the company)**

of qualifying R&D activities.

The phrase “in the carrying on” must be distinguished from “for the purposes of” or “in connection with” used elsewhere in the Taxes Consolidation Act 1997. Additionally, it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase “in the carrying on” is narrower in scope.

Costs which are **not** wholly and exclusively incurred **in the carrying on** of the R&D activity, including indirect overheads such as recruitment fees, insurance, travel, equipment repairs or maintenance, shipping, business entertainment, telephone, bank charges and interest, **do not qualify** as relevant expenditure.

Rent is expenditure on a building or structure and is excluded from being expenditure on research and development by section 766(1)(a) TCA 1997.

Overheads which are wholly and exclusively incurred directly in the carrying on of the qualifying R&D activity, for example power consumed in the R&D process, qualify for the credit.

From 1/1/2020, capital expenditure on scientific research which qualifies for an allowance under section 765 TCA 1997, is no longer relevant expenditure on research and development.

APPENDIX II



R&D Discussion Group: Feedback on Revenue's interpretation of rental expenditure in the updated Research and Development (R&D) Tax Credit guidelines

22 March 2021

Introduction

We refer to the recent discussion at the R&D Discussion Group virtual meeting on 4 February regarding the updated Research and Development (R&D) Tax Credit Guidelines - Tax & Duty Manual (Part 29-02-03), as updated in July 2020, and the change to the treatment of rent as qualifying R&D expenditure.

Revenue confirmed at that meeting that while they do not consider rent a qualifying cost incurred wholly and exclusively *in the carrying on* by the company of the R&D activity, they clarified that they believe there are certain circumstances in which rent can be qualifying expenditure for R&D purposes. At the meeting practitioners requested that Revenue circulate the draft wording of the R&D TDM to allow for feedback and Revenue circulated this on 16 March. At that meeting Revenue also confirmed the change to the treatment of rent as qualifying R&D expenditure would apply for accounting periods starting on or after 1 July 2020.

Revenue's position on rent as qualifying R&D expenditure

Revenue's draft updated wording in respect of rent in the R&D TDM is as follows:

"Rental expenditure incurred by a company on a space or a facility in which the company carries on its R&D activity will not be regarded as "expenditure on research and development" except in circumstances where it is shown that the expenditure is incurred wholly and exclusively *in the carrying on* by the company of the R&D activity and only to the extent that the expense is incurred in carrying on that activity. To be considered expenditure that is wholly and exclusively incurred *in the carrying on* of the R&D activity, the space or facility to which the rental expenditure relates must be more than merely a setting in which the R&D activity takes place – it must be integral or core to the carrying on of the R&D activity itself such that the expenditure on the space or facility concerned cannot be said to be merely "for the purposes of" or "in connection with" the R&D activity.

An example of where expenditure on the rent or lease of a space or facility could constitute expenditure on research and development is where a company, in the

course of carrying on its R&D activity, hires a specialised laboratory or a cleanroom in order to advance its research or development. If, in those circumstances the space or facility in which the R&D activity takes place is not merely a setting for the R&D activity but rather provides a special environment that not only performs a key function in relation to the R&D activity, but is also core and integral to that activity, the expenditure incurred on hiring the specialised laboratory or clean room would qualify as expenditure on research and development. However, it would only be so regarded to the extent that the expenditure is wholly and exclusively incurred in the carrying on of the R&D activity.

In many cases expenditure incurred in relation to the rent or lease of a space or facility, which is used by a company to carry on an R&D activity, may be expenditure that is incurred for the purposes of, or in connection with, the R&D activity but will not constitute expenditure incurred wholly and exclusively *in the carrying on* of the R&D activity. As such, it will not constitute qualifying R&D expenditure. This will be the case where, for example, a company carries on an R&D activity in a leased office space or manufacturing facility and that office space or manufacturing facility does not itself perform a key function in relation to the R&D process and is not core or integral to the R&D activity – it merely provides a setting in which the R&D activity takes place.”

Institute position on rent as qualifying R&D expenditure

The Institute strongly disagrees with Revenue’s interpretation that rent is not incurred in the carrying on of R&D activities. For example, we would suggest that renting a space or facility to “put a roof over” a software engineer to protect the engineer, the computer, server rooms and importantly, the work, from outside elements can only be considered expenditure incurred in the carrying on of the R&D activity.

How has Revenue determined that industries which require a more specialist environment to perform R&D means that the rental costs are more “wholly and exclusively incurred in the carrying on” than other industries? Revenue state that if a leased space merely provides a setting in which the R&D activity takes place, it will not be qualifying R&D expenditure, however, without this setting the R&D activity cannot take place. It is arguable that any leased space performs a key function in relation to the R&D process and is core or integral to the R&D activity.

Our members have clients who rent premises and equip parts of those office spaces to make a “lab” with very particular hardware and testing equipment to carry out qualifying R&D activities. Revenue’s interpretation would exclude the ability to claim apportioned rental costs for such spaces. By excluding scientific research allowances, Revenue is limiting section 766A TCA 1997 to industrial buildings only, which is not always a direct fit with some R&D construction projects. **We would ask that Revenue’s definition of “wholly and exclusively incurred in the carrying on” of R&D activity is clearly set out to provide clarity for practitioners and businesses.**

From a policy perspective, the regime now diverges where a building is constructed versus leased. The regime incentivises the construction of R&D buildings (under section 766A TCA

1997). This seems to be in contrast with Revenue's interpretation that a building is not integral to the carrying on of the R&D activity, when leased or rented.

As outlined in our submission⁷ to Revenue on 16 November 2020, via the TALC Direct & Capital Taxes sub-committee, based on section 766A TCA 1997, a company can acquire a building and incur expenditure on the refurbishment of the building for R&D purposes. These costs, subject to meeting specific conditions, will qualify for the R&D Tax Credit. However, renting the refurbished R&D building will now not qualify, even though the purpose of the building has not changed, and the same activity is being undertaken in the building i.e. R&D activity. This creates a clear anomaly.

If there is no facility to conduct R&D, it is difficult to envisage a situation where certain sectors could ever carry on a qualifying R&D activity. Rental costs incurred on a building or structure to facilitate the safe conducting of R&D activities is an essential cost incurred in the carrying on of R&D activities. Various sections of the legislation, and indeed in practice, apportion this cost on a just and reasonable basis to reflect the proportion of usage of the building for a qualifying R&D activity.

Indeed, the above view directly contradicts Revenue's own guidance on the Knowledge Development Box regime, which discusses the apportionment of expenditure. An extract from Revenue's current KDB guidance (example 2.14) says

*"The **premises rental costs** can be apportioned to the patented product either based on a square footage allocation key e.g. how much of the site is taken up by the manufacturing department or using the same headcount allocation key as that used for other overhead costs. The company is aware that once it chooses a method of apportionment then that method must be applied consistently, unless there is a change in its business."*

It would therefore appear that the apportionment of rental costs has always been a feature of the KDB regime and there has never been a question as to whether rental costs would be considered expenditure incurred "wholly and exclusively in the carrying on of the R&D activities, i.e. under the same definition used for research and development.

From a technical perspective, Revenue's interpretation of 'carrying on' R&D activities seems to be inconsistent with the construction of the definition of 'expenditure on research and development' contained in section 766(1)(a) TCA 1997. The draftsman excluded capital '*expenditure on a building and structure*' from the expenditure incurred by the company '*in the carrying on by it of research and development activities*' (in order to deal with this in S766A). If Revenue's interpretation is correct, the exception is completely superfluous because on Revenue's analysis such expenditure would never be expenditure incurred '*in carrying on by it of research and development activities*' in any case.

Thus, to give some meaning to the exception, it must be possible that capital expenditure on a building would otherwise have been expenditure incurred 'in the carrying on' of R&D. If that

⁷ [Institute submission seeking further clarification on the change to the treatment of rent in the Research & Development Tax Credit TDM \(Part 29-02-03\), November 2020](#)

is so, there can be no objection to the inclusion of rent of a building within that phrase subject to a just and reasonable apportionment where required.

Ireland's competitiveness is also a major factor that is being impacted. There is an absolute necessity to keep R&D work protected and secure, especially as the market becomes more and more competitive. The need for trade secrets etc. and ensuring information does not become publicly available is very often core to the R&D activities and this can only be achieved in a secure infrastructure. If the interpretations on various cost categories continues to change and narrow, this will add to the uncertainty to the regime. In practice, our members have observed reductions in quantum of companies and value of R&D credits being claimed over the past number of years.

Furthermore, there have been numerous audits and other interventions carried out by Irish Revenue over the years pertaining to R&D. We understand that there have been 791 R&D audits between 2011 and 2016⁸. This would be in addition to the R&D aspect query letters and requests for detailed R&D Tax Credit calculations by Revenue. This would suggest that Revenue is aware that rental expenditure forms part of the majority of Irish companies' R&D Tax Credit claims. Until this matter came to light at TALC, practitioners were not aware of these costs ever being disallowed by Revenue, and indeed there are multiple instances where rental costs have been accepted as a qualifying R&D cost. Therefore, the long-established practice since the introduction of the R&D Tax Credit 16 years ago would support the technical position understood by practitioners and R&D claimant companies alike.

The Institute is concerned that there may be reputational damage amongst the business community (both indigenous SME and MNC sectors alike) caused by the latest change in interpretation. We are also concerned about the potential inequitable situations that this could potentially create, such as:

- In the case of small and micro sized companies where rent is a significant cost.
- Companies that can afford to incur expenditure on the construction or refurbishment of a building or structure for R&D purposes versus those that incur a rental cost.
- Frequent changes in interpretation which creates uncertainty for businesses, as highlighted in our response to the Department of Finance Public Consultation in 2019.

Finally, as outlined above at the meeting on 4 February, Revenue confirmed the change to the treatment of rent as qualifying R&D expenditure would apply for accounting periods starting on or after 1 July 2020. **We would ask for this confirmation to be reflected in the R&D TDM.**

⁸ [Report on the Accounts of Public Services 2015](#) and [Opening Statement by Mr. Niall Cody, Chairman of the Revenue Commissioners, to the Committee of Public Accounts on 1 June 2017.](#)