Irish Tax Institute

May 2022

Research & Development Tax Credit and Knowledge Development Box

Response to the Public Consultation

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1 About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 32,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, the Taxation Institute of Hong Kong and the South African Institute of Taxation. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education.

2 Institute Recommendations

The Irish Tax Institute welcomes the opportunity to contribute to the public consultation on the Research & Development (R&D) Tax Credit and the Knowledge Development Box (KDB).

In the Institute's response[1] to the public consultation process undertaken by the Commission on Taxation and Welfare in January this year, we highlighted how the R&D Tax Credit can play a critical role in supporting innovation in Ireland's indigenous businesses. The *Report of the SME Taskforce: National SME and Entrepreneurship Growth Plan*[2] identifies enhancements needed to the R&D Tax Credit to incentivise increased investment in innovation by SMEs in Ireland, including redefining the qualification requirements for the R&D Tax Credit. This could be achieved by broadening the definition of innovation to include 'process innovation' and organisational innovation.' We would urge for this to be considered in the context of the current review of the credit.

To help us formulate our responses to the consultation questions posed by the Department of Finance in its consultation paper, the Institute carried out a survey of members and sample businesses in May 2022.[3] The following key recommendations are based on the feedback we received from businesses carrying on R&D in Ireland who completed the survey and from our members who advise such businesses on making R&D Tax Credit and KDB claims. Further details on the findings of the survey are set out in the detailed responses to the consultation questions in the body of this submission.

Institute Recommendations on the R&D Tax Credit

1. Ensuring the R&D Tax Credit is considered a "qualified refundable tax credit" for the purposes of the Pillar Two Global Anti-Base Erosion (GloBE) Rules is of the utmost importance. Consultation with stakeholders in advance of any proposed amendments to the R&D Tax Credit to ensure it is compliant with the OECD Model Rules is key.
2. We recommend condensing the current 3-year R&D Tax Credit refund to one year for all businesses or at the very least for SMEs. Accelerating the refund would provide valuable assistance to smaller companies that tend to be cash constrained. It would also clearly demonstrate that the R&D Tax Credit is a "qualified refundable tax credit" for the purposes of the OECD Model Rules, which in turn would enhance the Irish regime's competitiveness internationally.
3. Many countries are currently improving or introducing new incentives for R&D. Given the mobility of R&D investment, it is critical that the R&D Tax Credit is continually benchmarked against key competitor jurisdictions to ensure Ireland can continue to attract additional R&D investment.
4. We believe the level of qualifying expenditure incurred by a company when R&D is sub-contracted or outsourced to a third-party or university or Institute of Higher Education should be increased, above the current limits of 15% of in-house R&D expenditure or €100,000 (whichever is greater). This would be in keeping with Government policy to foster collaboration between academia and private business.

1 Irish Tax Institute, Response to Commission on Taxation and Welfare Public Consultation, January 2022.
2 Report of the SME Taskforce: National SME and Entrepreneurship Growth Plan, Department of Enterprise, Trade and Employment, January 2021.
3 Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022, based on 109 respondents – 32 were companies based in Ireland and 77 were tax advisers who advise companies on making R&D Tax Credit and KDB claims.

5. Consideration should also be given to amending Revenue guidance on the conditions for agency staff not to be regarded as outsourcing, to reflect the new hybrid working environment.
6. We know from feedback from our survey that there is a certain level of anxiety amongst companies over the potential for Revenue to subsequently challenge R&D Tax Credit claims. While verification of claims by taxpayers is an intrinsic part of a self-assessment system, it is important that Revenue Compliance Interventions are proportionate and conducted in a timely and efficient manner, in the interest of all parties.
7. The introduction of a legislative basis for "technical adjustment" treatment in Finance Act 2021 was a welcome development as it is an important acknowledgement that penalties are not appropriate where a taxpayer has taken due care. Recognition of the appropriateness of this treatment for R&D Tax Credit claims, given the subjective nature of R&D, will be critical in practice.
8. It is vital that the R&D Technical Experts tasked with opining on the science element of claims have the experience of the application of science in a commercial context. Revenue should explore ways to expand the pool of experts undertaking this work to ensure it adequately reflects this expertise.
9. We firmly believe that taxpayers and their advisers should have the opportunity to participate in briefings with R&D Technical Experts, engaged by Revenue, during the review process. This would help to reinforce the independence of the expert and increase the overall transparency of the review of the science element of R&D Tax Credit claims.
10. Revenue guidance relating to overhead costs needs to be simplified. For example, providing for a set percentage of labour overheads in Revenue guidance would help simplify R&D expense claims and provide more certainty to taxpayers.
11. Revenue guidance on the R&D Tax Credit has changed 18 times since the introduction of the credit. While many of the updates have provided more clarity on various aspects of the credit, 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 in particular where the legislation underpinning the guidance has not been amended but Revenue's interpretation of it has altered. Consultation with stakeholders in advance of updates to Revenue's guidance would help to provide more tax certainty for claimants.
12. We believe legislative clarification is necessary to ensure rent is a qualifying cost for the purpose of the R&D Tax Credit. Rent is a substantial cost for most SMEs and the change in Revenue's guidance in July 2020 has significantly narrowed the circumstances in which rent may qualify, which has impacted the attractiveness of the credit for SMEs.
13. Introducing a pre-approval process for first time R&D Tax Credit claims by small/micro companies, to help alleviate the uncertainty over Revenue subsequently challenging a claim on the "accounting test," should be considered in our view.
14. We believe providing SME-friendly guidance, with step-by-step instructions on the claims process and practical studies, together with tips on how to avoid common errors in claims is essential, similar to the approach adopted by HMRC in the UK.
15. Consideration should be given to new targeted measures for R&D in specific priority areas, such as green or energy related R&D. The introduction of such targeted measures could help the Government to deliver its ambitious carbon emission targets.

Institute Recommendations on the KDB

16. Amounts paid for the acquisition of IP that are reflected in the value of the qualifying asset are excluded from qualifying expenditure. We believe companies that acquire IP for use in furthering the R&D carried on by a company should be included in the qualifying expenditure for KDB purposes.
17. There should be more flexibility in the approach to calculate overall income for the KDB in our view. The rules should be adapted to allow profit from an entire IP asset avail of the KDB, not just the portion of the profit related to the patentable element.
18. Robust supporting documentation is required to make a KDB claim, including tracking and tracing the appropriate income and expenditure items to the appropriate qualifying asset. Simplifying the existing significant compliance and documentation burdens in making a KDB claim would enhance the KDB regime, particularly for SMEs.

The Institute would be happy to engage further in this consultation through stakeholder meetings or direct discussions. Please contact Anne Gunnell at agunnell@taxinstitute.ie or (01) 6631750 if you require any further information.

3 The Role of Innovation in Economic Growth

The role that innovation plays in economic growth has been recognised internationally by the OECD and the European Commission. Innovation plays a central role in driving productivity growth and fostering competitiveness in economies.

The European Commission has stated that new knowledge and breakthrough innovation will drive the green and digital transformations that are underway in society and that research and innovation policy will play a key role in responding to the challenges brought about by the COVID-19 pandemic.[4]

Results from the Central Statistics Office 2019-2020 Business Expenditure on Research and Development (BERD) survey show that €3.26 billion was spent on R&D activities by enterprises in Ireland in 2019. This represents an increase of 17.5% compared with actual expenditure in 2017.[5]

Large enterprises (250 or more employees) had the greatest share of R&D expenditure in 2019 with 66.1% of all expenditure, accounting for €2.15 billion of the total spend. Small enterprises (less than 50 employees) spent over €465.1 million on R&D in 2019 which accounted for over 14.3% of the overall spend. While medium-sized enterprises (between 50 and 249 employees) spent €637.8 million in the same period which represented 19.6% of total spend.

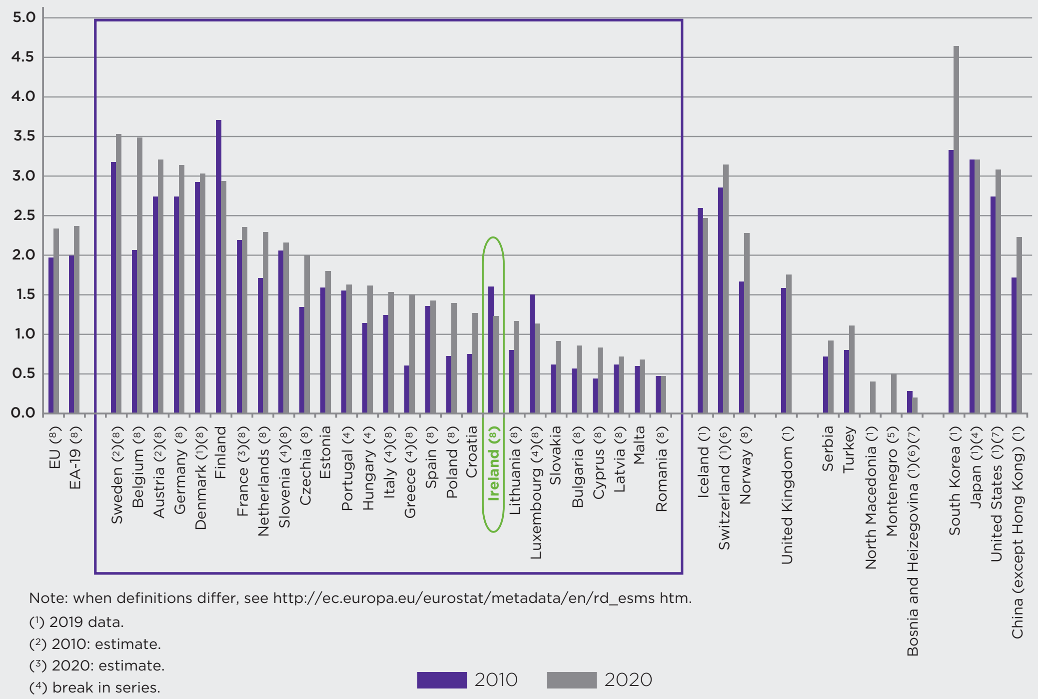
While Ireland's overall expenditure on research and innovation (R&I) has increased in the past decade, its current position as a Strong Innovator on the European Innovation Scoreboard is at risk of being overtaken by other EU Member States, as they improve and invest in their R&I systems. Ireland is no longer one of the ten most innovative Member States, having dropped from sixth place in 2016 to eleventh place in 2021. Similarly for the Global Innovation Index, Ireland's position has fallen from seventh place in 2016 to nineteenth out of 132 countries in 2021.[6]

The European Innovation Scoreboard 2021[7] states the decline in innovation performance for Ireland in the last two years is due to the reduced performance of Government support for business R&D, business R&D expenditures, employment in innovative enterprises, sales of innovative products, and environment-related technologies. In addition, Ireland is showing below average scores on the climate change related indicators due to a low score on the circular material use rate.

R&D intensity for a country is defined as the R&D expenditure as a percentage of GDP. Statistics show that in 2020 the R&D intensity rate for Ireland, at 1.2%, was below the EU average of 2.3%[8]. The highest R&D intensity was recorded in Belgium and Sweden (3.5% of GDP), followed by Austria (3.2%) and Germany (3.1%). Over the last ten years, R&D intensity rose in 24 Member States, however in contrast, R&D intensity decreased for Ireland from 1.6% to 1.2%.

4 European Commission, Research and Innovation Strategy 2020-2024
5 Central Statistics Office, Business Expenditure on Research and Development 2019 -2020, March 2021
6 Department of Further and Higher Education, Research, Innovation and Science Report: Impact 2030: Ireland's Research and Innovation Strategy, May 2022
7 https://ec.europa.eu/docsroom/documents/45919/attachments/1/translations/en/renditions/native
8 R&D expenditure in the EU at 2.3% of GDP in 2020 - Products Eurostat News - Eurostat (europa.eu)

Gross domestic expenditure on R&D, 2010 and 2020 (%, relative to GDP)



Note: when definitions differ, see http://ec.europa.eu/eurostat/metadata/en/rd_esms htm.
(1) 2019 data.
(2) 2010: estimate.
(3) 2020: estimate.
(4) break in series.
(5) 2018 instead of 2020.
(6) 2012 instead of 2010.
(7) 2009 definition differs.
(8) 2019 preliminary data.

Source: Eurostat (online data code: rd_e_gerdtot) and OECD database

Statistics for R&D from the OECD indicate that, prior to the onset of the COVID-19 pandemic, R&D expenditure in the OECD area grew in real terms by 4% in 2019. The OECD average R&D intensity rate for 2019 was nearly 2.5%. Ireland's R&D intensity rate is below both the OECD[9] and EU[10] average.

Ireland has achieved limited progress towards the *Innovation 2020*[11] research intensity rate target of 2.5% of GNP, which rose from 1.55% in 2015 to an estimated 1.63% in 2020[12].

It is clear that the Government must play an important role in developing an ecosystem to foster increased investment in R&D by companies of all sizes. In its *Impact 2030*[13] report, the Department of Further and Higher Education, Research, Innovation and Science notes Ireland's success in strengthening enterprise driven research, development and innovation will directly impact on Ireland's ability to create and maintain a thriving and prosperous economy and grow employment, and to achieve our national goals to create a cleaner, greener economy and society and to maximise the opportunities of digital transformation for the benefit of all our citizens.

The *Impact 2030* strategy aims to drive coordination and cohesion of the national research and innovation agenda. In achieving this agenda, one of the objectives is to ensure that the tax offering for R&D remains competitive and more accessible to SMEs.

9 OECD Main Science and Technology Indicators: Highlights on R&D Expenditure, March 2021
10 R&D expenditure - Statistics Explained (europa.eu)
11 Innovation 2020, Ireland's strategy for research and development, science and technology, December 2015
12 Department of Further and Higher Education, Research, Innovation and Science, Research and Development Budget: 2020 to 2021, December 2021
13 Department of Further and Higher Education, Research, Innovation and Science Report: Impact 2030: Ireland's Research and Innovation Strategy, May 2022

The R&D Tax Credit is an essential element of Ireland's strategy to reach its R&D intensity target of 2.5% of GNI* by 2030[14] (2.2% of GNI* in 2020[15]). The R&D Tax Credit is extremely valuable but there can be undue cost and uncertainty involved in the claims process which can significantly reduce the attractiveness of the credit for SMEs.

The R&D Tax Credit has a vital role to play in fostering private R&D investment in Ireland and the Institute welcomes this opportunity to provide feedback on the policy and operational aspects of the credit to ensure it can be considered best in class internationally.

14 Pillar 2 Impact 2030, Department of Further and Higher Education, Research, Innovation and Science Report: Impact 2030: Ireland's Research and Innovation Strategy, May 2022

15 Department of Further and Higher Education, Research, Innovation and Science, Research and Development Budget: 2020 to 2021, December 2021

4 R&D Tax Credit

The R&D Tax Credit is a very important benefit for all Irish companies carrying on R&D activities and it has been improved in a number of ways since its introduction in 2004. The cost of the R&D Tax Credit to the State is significant (€658 million in 2020 in respect of 1,616 companies)[16] and therefore, R&D Tax Credit claims are closely scrutinised by Revenue.

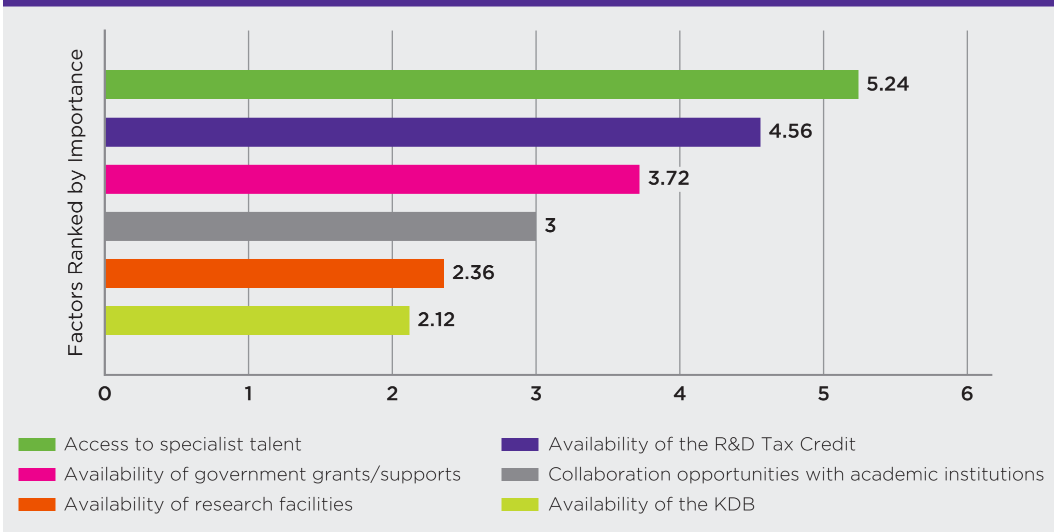
In May 2022, the Irish Tax Institute carried out a survey of members and a sample of Irish businesses[17] to help inform the Institute's response to the Department of Finance. We have set out the findings of this survey in the responses below to the questions in the consultation document.[18]

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

We asked businesses carrying on R&D activities to identify and rank in order of importance the key factors they consider when deciding on whether to base their R&D activity in Ireland.

Access to specialist talent was ranked as the most important (i.e. 5.24 out of 6), with the availability of the R&D Tax Credit as the second most important factor (i.e. ranked 4.56 out of 6).

Key factors considered when deciding on whether to base R&D activity in Ireland

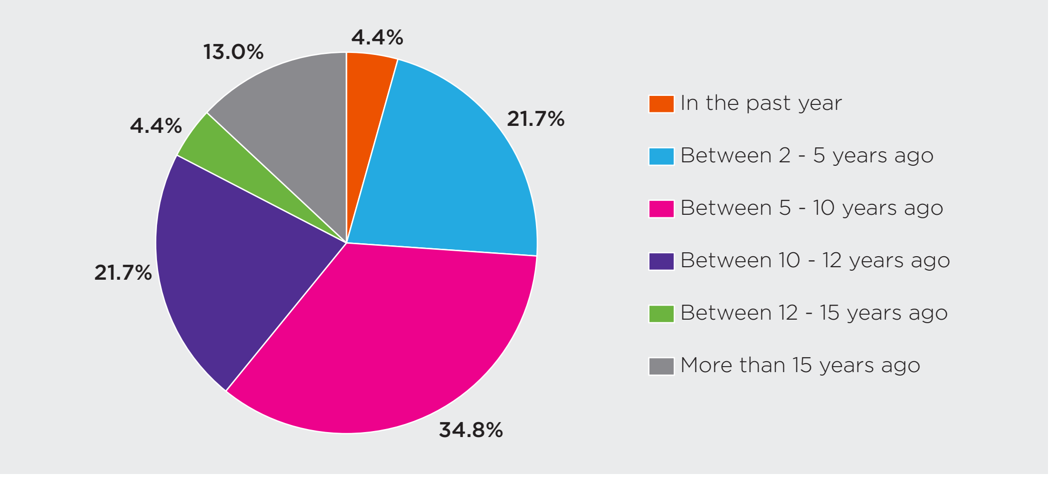


16 Revenue Commissioners: Research & Development ("R&D") Tax Credit Statistics, May 2022
17 Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022, based on 109 respondents – 32 were companies based in Ireland and 77 were tax advisers who advise companies on making R&D Tax Credit and KDB claims.
18 Research & Development Tax Credit and the Knowledge Development Box Public Consultation, April 2022, Department of Finance.

When did you first claim and what prompted you to do so? What do you value about the design of the R&D Tax Credit?

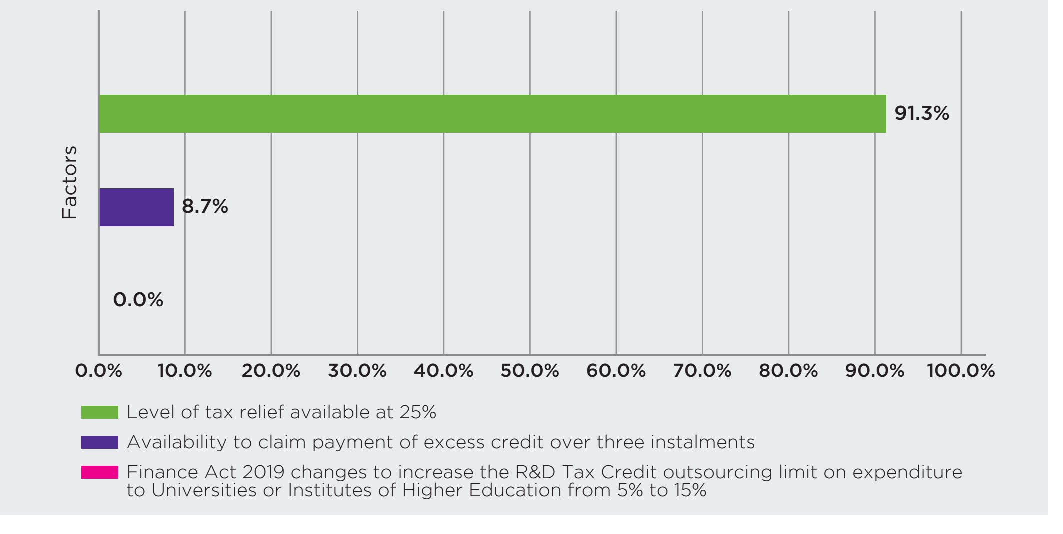
Almost 40% of the businesses that responded to the survey first claimed the R&D Tax Credit more than a decade ago, and for 13% of them it was over 15 years. While over a quarter of the businesses that responded made their R&D Tax Credit claim in the past 5 years.

Timeframe when businesses first claimed the R&D Tax Credit



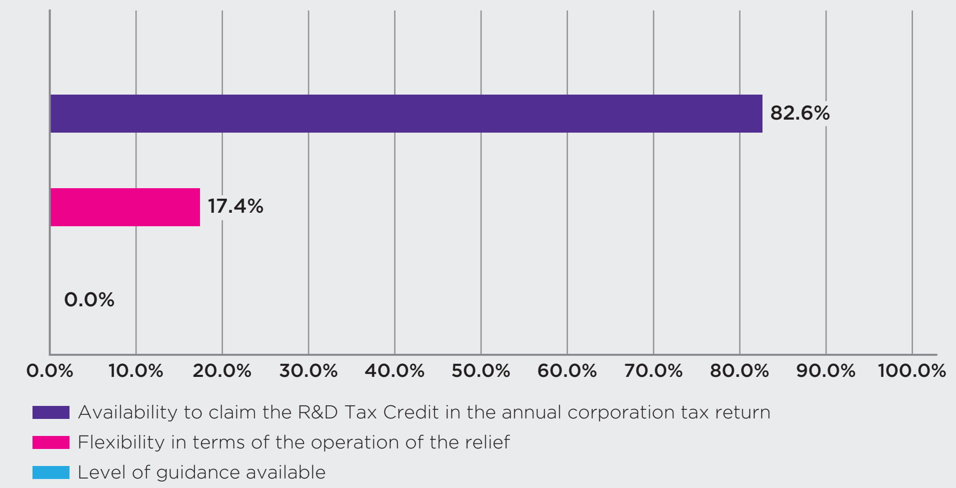
Of those businesses that responded, over 91% indicated that the level of tax relief available at 25% was the key factor that prompted them to claim the R&D Tax Credit.

Key factors that prompted businesses to claim the R&D Tax Credit



In assessing the design of the R&D Tax Credit, 82.6% of respondents indicated they valued the availability to claim the credit in the annual corporation tax return compared with 17.4% who noted flexibility in the operation of the relief or the level of guidance available.

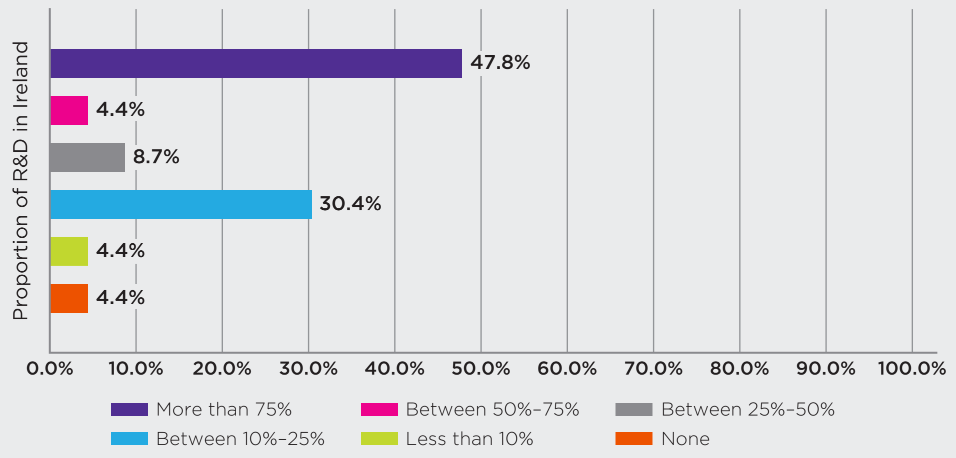
What businesses value about the design of the R&D Tax Credit



In the absence of the R&D Tax Credit, can you say what proportion of your R&D would take place in Ireland?

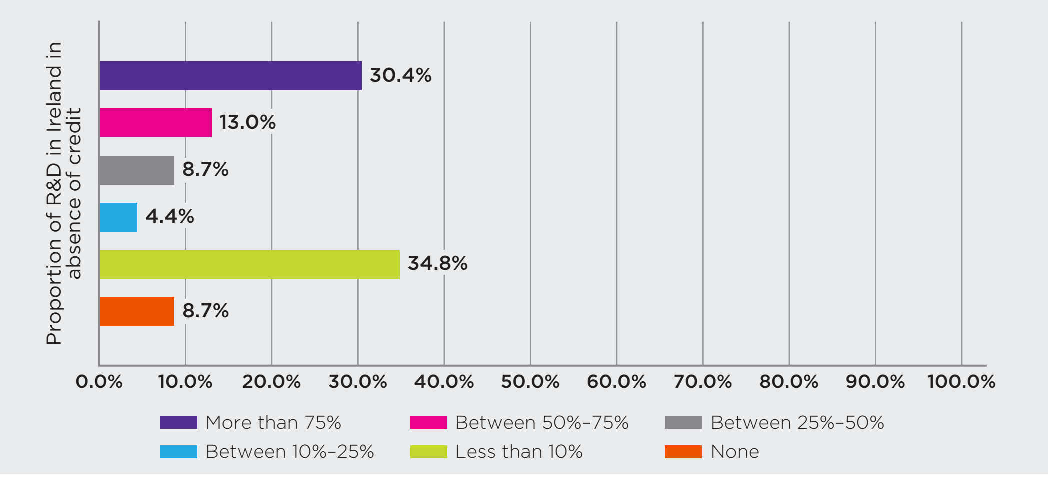
We asked survey respondents to indicate the proportion of their R&D activities that currently take place in Ireland and the proportion that would take place in Ireland in the absence of the R&D Tax Credit.

Proportion of R&D activities that currently take place in Ireland



Interestingly, and in line with the findings of the Institute's 2019 survey on the R&D Tax Credit, there is a significant drop off in the amount of R&D activity that would take place across all businesses, in the absence of the R&D Tax Credit. This further demonstrates the significance of the availability of the R&D Tax Credit in fostering and driving R&D investment in Ireland.

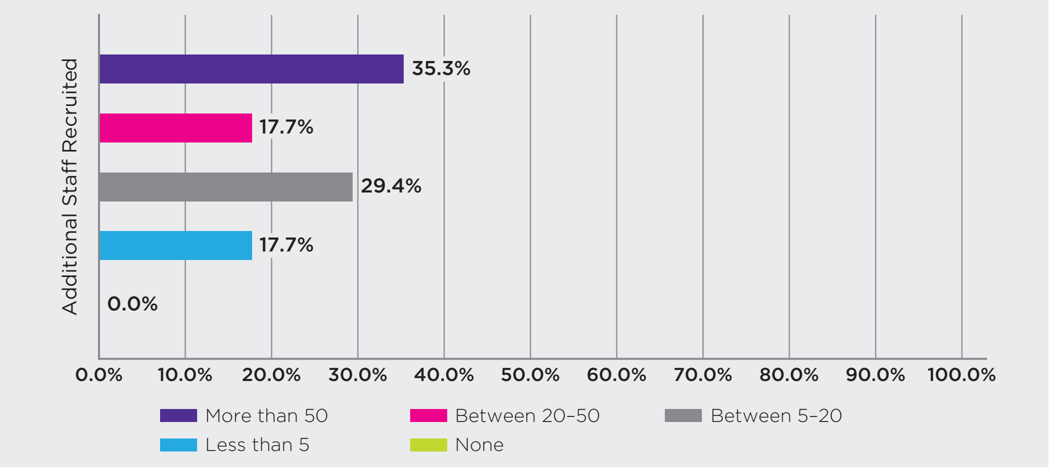
Proportion of R&D that would take place in Ireland in the absence of the R&D Tax Credit



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

The purpose of the R&D Tax Credit is to promote jobs and investment in Ireland by encouraging companies to conduct their R&D activities in the State. 91% of the businesses that completed the survey noted an increase in staff recruitment as a result of conducting R&D in Ireland. The survey findings show a significant increase in the number of additional staff recruited because of the R&D activities undertaken by the businesses in Ireland, with over half confirming recruiting more than 20 additional staff.

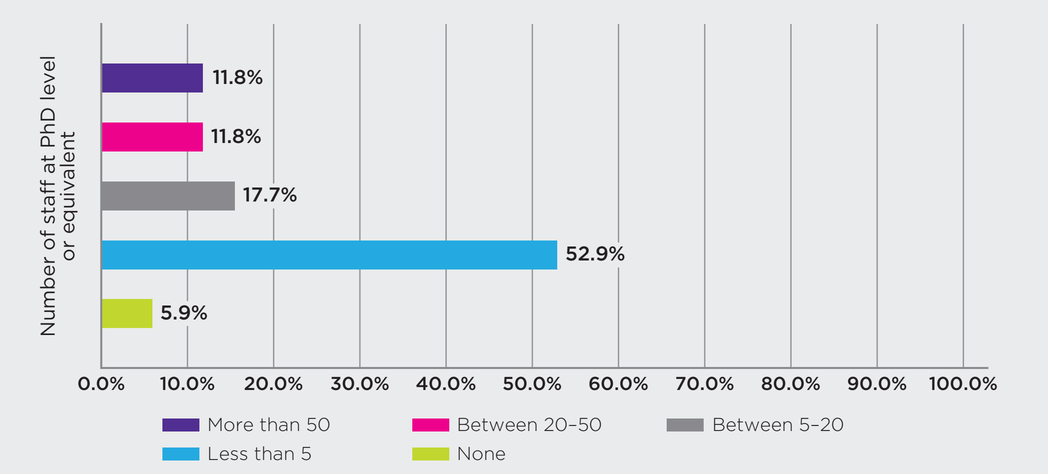
Number of additional staff recruited because R&D activities in Ireland



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

52.9% of respondents indicated they employ less than five R&D staff that are at PhD level or equivalent. While almost 30% indicated they employ between 5 and 50 of such qualified R&D staff and just under 12% noted they employ more than 50.

Number of staff at PhD level or equivalent



It is clear that the R&D Tax Credit is working well for certain companies. However, some limiting factors remain within the regime, which merit further consideration, given the need for the credit to remain competitive going forward in the evolving international tax landscape, coupled with the lower level of take up of it by Irish SMEs.

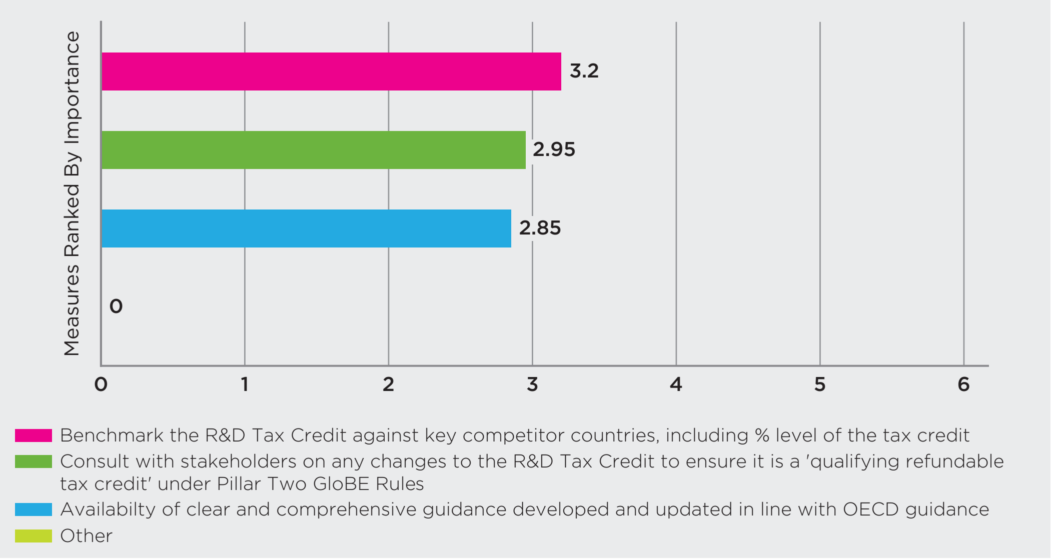
How do you think the R&D Tax Credit can remain competitive in the evolving international tax landscape?

In our survey, we asked businesses carrying on R&D activities to identify and rank in order of importance the key factors they think would help keep the R&D Tax Credit competitive.

Interestingly, the survey respondents ranked the options almost equally, indicating that there is no one factor which will make the R&D Tax Credit remain competitive but instead, several factors are key, including the importance of:

- benchmarking the R&D Tax Credit against key competitor jurisdictions,
- consulting with stakeholders on any changes to the R&D Tax Credit to ensure it is a “qualifying refundable credit” for the purposes of the Pillar Two Global Anti-Base Erosion (GloBE) Rules and
- providing clear and comprehensive guidance on changes to the R&D Tax Credit which is updated on an evolving basis in line with the OECD guidance.

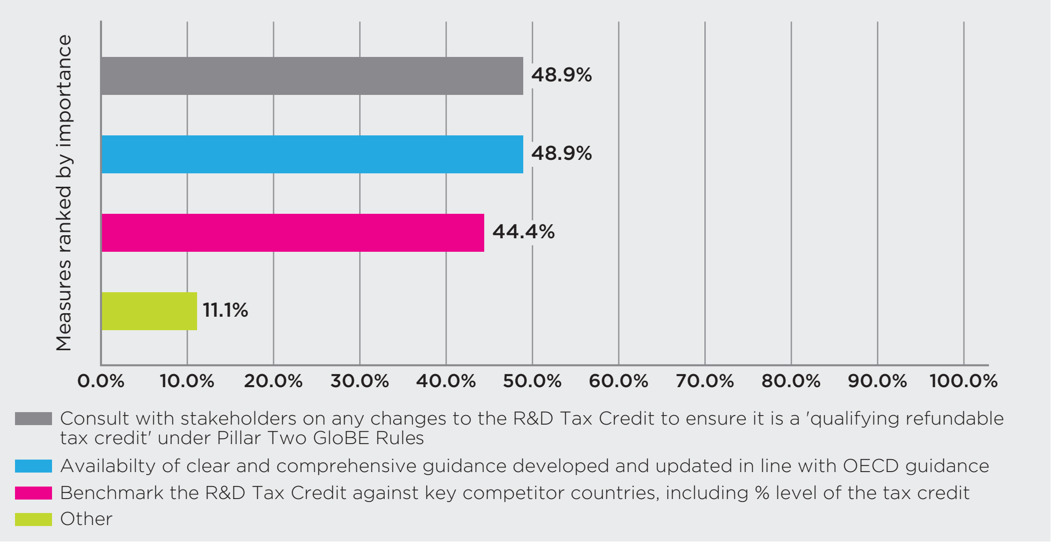
Businesses' opinion on how the R&D Tax Credit can remain competitive in the evolving international tax landscape



We also asked members advising businesses on R&D Tax Credit claims who completed the survey, to identify how the R&D Tax Credit can remain competitive in the evolving international tax landscape.

Consultation with stakeholders on any changes to the R&D Tax Credit to ensure it is a "qualifying refundable tax credit" for the purpose of the Pillar Two GloBE Rules and the provision of clear and comprehensive guidance on changes to the R&D Tax Credit were ranked the highest by tax advisers but closely followed by the importance of benchmarking Ireland's R&D Tax Credit against regimes in competitor countries.

Tax Advisers' opinion on how the R&D Tax Credit can remain competitive in the evolving international tax landscape



Compliance with the Pillar Two Model GloBE Rules

Undoubtedly, ensuring the R&D Tax Credit is considered a "qualified refundable tax credit" for the purposes of the Pillar Two Model Global Anti-Base Erosion (GloBE) Rules[19] is critical for this country's ability to continue to encourage R&D investment in Ireland by in-scope large multinational groups. To meet the criteria of a "qualified refundable tax credit", the credit must be paid as cash or available as cash equivalents within four years from when the company is eligible to claim it.

Under existing legislation, Ireland's R&D Tax Credit is offset against a company's corporation tax liability for a particular year. If the company is not paying enough tax in any year to offset the R&D Tax Credit in full, it can first offset the credit against the corporation tax for the previous period and any balance can either be carried forward indefinitely or can be allocated to another member of the group. If the company exhausts all these options and there is still a surplus credit, it can make a claim to have that excess paid to it in cash by Revenue in three instalments over a period of 33 months.

Even though the Irish rules provide for a cash refund of surplus R&D Tax Credits within the 4-year timeframe stipulated by the OECD Pillar Two Model GloBE Rules, the refund mechanism only applies to surplus credits and often, companies eligible for such refunds do not receive the cash due within the 33-month period, because the relevant refund claim is subject to a Revenue Compliance Intervention.

Therefore, we believe a legislative amendment is necessary to ensure Ireland's R&D Tax Credit is fully compliant with the criteria for a "qualified refundable tax credit" in the OECD Pillar Two Model GloBE Rules, such that refunds are mandated to be paid within the four years even in situations where a claim is subject to an open Revenue Compliance Intervention at the time. Of course, the legislation should include the necessary protections for the Exchequer to provide for a clawback of any amount of the repaid R&D Tax Credit that may be determined to be incorrectly claimed following the completion of the Compliance Intervention by Revenue.

Introduce targeted measures for green or energy related R&D

When considering the main design features of Ireland's R&D regime, noticeable comparisons can be drawn with other EU countries that have introduced targeted measures for green or energy related R&D. In order for Ireland to maintain and improve its competitiveness, consideration should be given to enhancing the R&D Tax Credit to encourage research, development and innovation which will facilitate emissions reductions and the development of new low carbon and carbon neutral products. The introduction of such targeted measures would be in line with the Government's commitment to achieve net-Zero emissions no later than 2050, and to a 51% reduction in emissions by the end of this decade.

Some EU countries already have targeted measures in place for green or energy related R&D. For example[20]:

- **Italy**: Special provision of a higher tax credit rate for technological innovation aimed at 4.0 innovation or ecological transition.

19 The meaning of a Qualified Refundable Tax Credit is set out in Article 10.1 of the Defined Terms in OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD, Paris.

20 OECD R&D tax incentives database, 2021 edition, paragraph 2.1.5

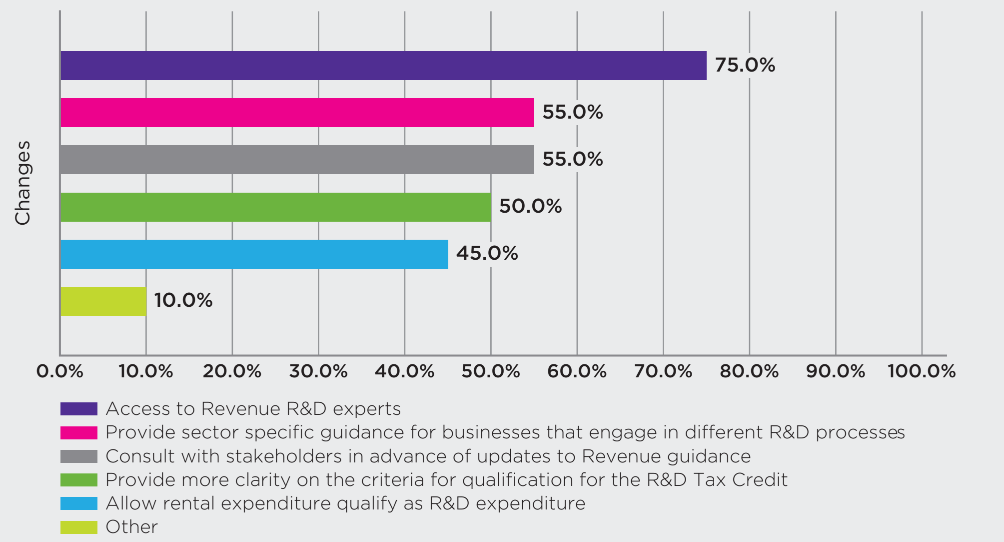
- **Portugal**: Expenses related to the making of eco-design products are increased by 10% upon submission and approval of the project by the Portuguese Environment Agency.
- **Spain**: A higher tax credit rate currently applies to expenses in technological innovation activities aiming at new or relevant improvements in the production processes in the value chain of the automotive industry in Spain.

"There should be a clear and consistent definition of what is defined as R&D across Revenue and State bodies." - Comment by an Irish PLC in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

What changes might help R&D Tax Credit claims to be dealt with more smoothly, while ensuring better compliance? How could the Department of Finance and/or Revenue improve on the quality of information and/or guidance available to companies? If you claim, R&D tax reliefs in other countries, how does the claim process differ and what are your views on this?

In our survey, we asked businesses carrying on R&D activities to identify changes that may help R&D Tax Credit claims to be dealt with more smoothly and 75% of respondents selected access to Revenue R&D experts.

Changes needed to help R&D Tax Credit claims to be dealt with more smoothly while ensuring compliance



55% of respondents also selected the availability of sector specific guidance for businesses that engage in different R&D processes and consultation with stakeholders in advance of updates to Revenue guidance, as changes that could help R&D Tax Credit claims to be dealt with more smoothly.

Furthermore, half of the respondents also noted providing more clarity on the criteria for qualification and 45% also selected allowing rental expenditure to qualify as eligible expenditure for the R&D Tax Credit.

Access to R&D Technical Experts

Revenue appoints and agrees the terms of engagement with R&D technical experts who are tasked with opining on the science element of R&D Tax Credit claims. We understand that Revenue informs such technical experts of the R&D legislation and current Revenue guidance in advance of their review. At the end of the review, the R&D technical experts provide Revenue with a copy of their report and discuss their findings with Revenue. Revenue then provides a copy of the R&D expert's opinion to the taxpayer. Taxpayers and their advisers do not participate in any briefings between Revenue and the appointed R&D technical expert reviewing the relevant claim.

Providing access to Revenue's R&D technical experts was identified by 75% of respondents to our survey as a way in which R&D Tax Credit claims could be dealt with more smoothly. We firmly believe that taxpayers and their advisers should be given the opportunity to participate in briefings with R&D technical experts during the review process, which would reinforce the independence of the expert and increase the overall transparency of the review process.

It is also vital that the R&D technical experts tasked with opining on the science element of R&D Tax Credit claims have the experience of the application of science in a business environment. Feedback from business and tax advisers indicates that the technical experts used by Revenue to opine on the "science test" tend to be from academic backgrounds, which can often result in knowledge gaps, as the technical expert is applying science theory to commercial practices. Revenue should explore ways to expand the pool of experts undertaking this work to ensure it adequately reflects the necessary expertise.

> *"Revenue appoints experts who are most likely academics, this leads to a bias re. applied research as academics tend to look at it from an academic research view. Applied research qualifies under Frascati. Revenue should appoint both an academic expert and an industry-based expert."* - Comment by an Irish SME in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

Availability of sector specific R&D guidance

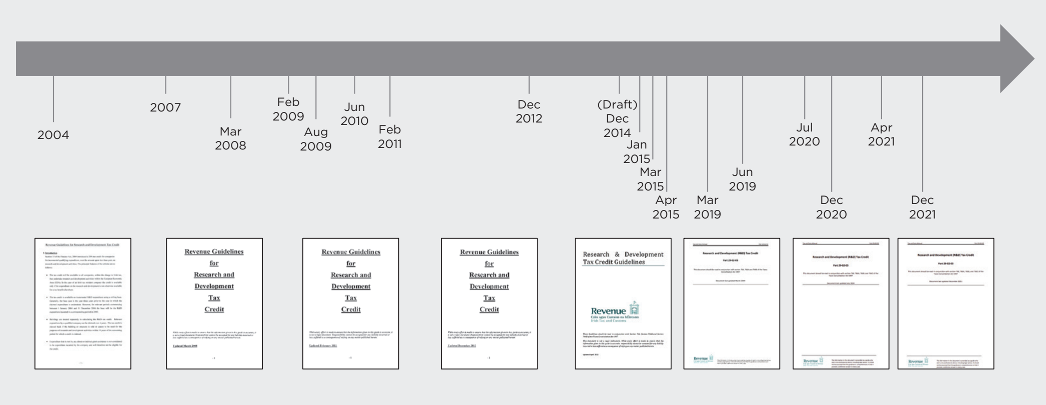
The processes and documentation needed to support a R&D Tax Credit claim can be daunting. This is a particular challenge for business sectors such as food, software and IT, which traditionally do not document their processes and costs to anything like the extent done in highly regulated sectors, such as pharma and financial services.

Industry specific guidance, with detailed practical instances of what qualifies and what does not qualify would be welcome. For example, starting with sector-specific guidance for food production, software and med-tech industries, all of which engage in very different R&D processes. The feedback we received from business in our survey would suggest that uncertainty surrounding what can qualify and how to document such processes, continues to persist in these sectors.

Consultation in advance of updates to Revenue guidance

Revenue's guidance on the R&D Tax Credit runs to 59 pages.[21] Revenue's R&D Tax Credit Guidelines have been updated and amended 18 times since the credit was first introduced.

Revenue R&D Tax Credit Guidelines



Many of the updates to the guidance have provided more clarity on various aspects of the credit. However, 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 regarding R&D Tax Credit claims, in particular where the legislation underpinning the guidance has not been amended but Revenue's interpretation of it has altered. Consultation with stakeholders in advance of updates to Revenue's guidance would help to provide more tax certainty for claimants.

"There is a perceived inconsistency in how Irish Revenue treat certain items, or historically treated certain items which is not helpful for decision-making." - Comment made by a foreign-owned MNC in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

In addition, providing for a set percentage of labour overheads in guidance would help to simplify R&D expense claims and provide more certainty for taxpayers.

Revenue's interpretation of rental costs as qualifying R&D expenditure

In July 2020, Revenue updated their guidance on the circumstances in which rental costs can be considered qualifying expenditure for the purpose of the R&D Tax Credit. Notwithstanding representations from practitioners through the Tax Administration Liaison Committee (TALC),[22] Revenue confirmed their view in guidance that in most cases rent does not qualify as R&D expenditure, but there may be scenarios where rent can qualify

21 Part 29-02-03 - Research & Development (R&D) Tax Credit Guidelines (revenue.ie)
22 The Institute made a submission to Revenue seeking further clarification on the change to the treatment of rent in the Research & Development Tax Credit TDM (Part 29-02-03) in November 2020.

where the expenditure is incurred wholly and exclusively in the carrying on of the R&D activities.[23] This change has significantly impacted the attractiveness of the R&D Tax Credit for SMEs and has substantially narrowed the circumstances where rent may be included as qualifying expenditure on R&D.

Revenue's guidance provides examples of rent incurred on a specialised laboratory or a clean room in order to advance R&D activities which it states may be qualifying expenditure, but the rent of an office space in which R&D activities are carried on is not qualifying expenditure, as the office is "*the setting in which R&D happens and does not itself perform a key function in relation to the R&D process*".

We believe that Revenue's guidance significantly narrows the circumstances where rent may be included as qualifying expenditure on R&D and in our view is contrary to the policy intention of the R&D Tax Credit. The interpretation would also appear to be at odds with Revenue's own guidance on the apportionment of rental costs for the purposes of the KDB. Furthermore, we believe that the change of interpretation has added uncertainty to the Irish R&D regime.

We consider that Revenue's interpretation creates a clear inequity in favour of companies that have the available resources to incur expenditure on the construction or refurbishment of a building or structure for R&D purposes rather than incur a rental cost. Section 766A TCA 1997 provides that where a company acquires a building and incurs expenditure on the refurbishment of the building for R&D purposes, these costs, subject to meeting specific conditions, qualify for the R&D Tax Credit. However, based on Revenue's updated guidance, renting the same refurbished R&D building may not qualify for the R&D Tax Credit even if the same R&D activity is being undertaken in the building.

In our view, legislative clarification is now necessary to ensure rent is a qualifying cost for the purpose of the R&D Tax Credit so the credit can continue to encourage investment in innovation by Irish business. For example, an amendment could be made to the wording of section 766(1)(a) TCA 1997 to refer to "wholly and exclusively for the purposes of R&D activities", rather than "wholly and exclusively in the carrying on by it of R&D activities", to help provide greater clarity and certainty to claimants of the relief in respect of qualifying costs.

Revenue Compliance Interventions on R&D Tax Credit Claims

By their nature, Revenue interventions to verify R&D Tax Credit claims differ from other types of tax compliance interventions. In examining a claim, Revenue will consider whether the activity underpinning the claim met the qualifying criteria for R&D ("the science test") in addition to checking the accuracy of the financial elements of the claim and the claim calculation ("the accounting test").

Whether an activity satisfies the "science test" can be subjective and views may diverge between the company's technical expert, Revenue and an independent technical expert who may be appointed by Revenue to examine the claim during a Revenue Audit. Following extensive engagement between these parties, a company may ultimately agree to amend its R&D Tax Credit claim in some cases. This amendment is generally made by way of a "technical adjustment" to the claim.

A tax-geared penalty is not applied if the conditions for the treatment of an amendment as a "technical adjustment" are met. Broadly, Revenue must be satisfied that the taxpayer has taken due care and did not act carelessly or with deliberate intent. Finance Act 2021 legislated for this treatment, which has been a long-standing Revenue concession with the

23 Research and Development (R&D) Tax Credit, Part 29-02-03, Tax and Duty Manual, April 2021, Revenue Commissioners.

factors used to determine whether the treatment applies being set out in Revenue's Codes of Practice for interventions.

Up to recently, Revenue typically issued an "Aspect Query" to conduct a preliminary check on the validity of an R&D Tax Credit claim, where the company claimant was sent a list of information-gathering queries on their claim. Depending on the outcome of such a check, a more in-depth examination may have been instigated by Revenue through a Revenue Audit where an independent technical R&D expert appointed by Revenue would engage with the company's technical expert to examine the scientific components of the claim.

Revenue revised its approach to Compliance Interventions from 1 May 2022 by introducing a new three-level Compliance Intervention Framework ("the Framework"). The practical implications of Revenue's Framework for the examination of R&D Tax Credit claims are not yet fully clear.

Under the Framework, the issue of "Aspect Queries" has ceased and a new "Level 1" category has been designated for generic queries where Revenue has not conducted any examination of the case.

In addition, Revenue has added a second type of intervention at the equivalent level to a Revenue Audit. This "Level 2 - Risk Review" is intended to be more focused than an Audit but requires the same level of preparation by the taxpayer as on receipt of a Risk Review notification the taxpayer must consider whether a Prompted Qualifying Disclosure for the tax head and period notified is required and respond to Revenue within 28 days.

For example, in the context of a Risk Review notification in relation to a R&D Tax Credit claim for a specific period, not only would the taxpayer and their adviser have to review the R&D Tax Credit claim and supporting documentation but also the corporation tax return for the same period. If the opportunity to make a qualifying disclosure is missed, the taxpayer's details could be published on the List of Tax Defaulters if a settlement arises and the tax element exceeds €50,000.

The proportion of Revenue Compliance Interventions relating to R&D Tax Credit claims that will be conducted at Level 1 and Level 2 in the Framework remains unknown. Given the extensive work involved in preparing for a Level 2 intervention, it is hoped these interventions will only be used in appropriate cases where Revenue has reason to believe a tax default has arisen.

The introduction of a legislative basis for "technical adjustment" treatment in Finance Act 2021 was a welcome development. It is an important acknowledgement that penalties are not appropriate where a taxpayer has taken due care. Recognition of the appropriateness of this treatment for R&D Tax Credit claims, given the subjective nature of R&D, will continue to be important in practice.

"Simplification of the process. For example, in the UK, HMRC's approach is to actively encourage claims almost to the point of asking you why aren't you claiming. However, Revenue's attitude here appears to be more focused on making sure that anything even slightly outside a strict interpretation of the rules is declined." – Comment made by a foreign-owned MNC in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

Restrictions on outsourcing and collaboration

A R&D environment that supports collaboration with the university sector is regarded as the best practice model internationally. Furthermore, businesses carrying out R&D work will often find that some elements or stages of that work cannot be completed in-house and must be outsourced.

However, the Irish R&D Tax Credit restricts collaboration with others. Outsourcing R&D work to third parties and universities is restricted to 15% of the in-house R&D expenditure or €100,000 (whichever is greater). Any outsourcing to a related party (such as another company in the group) prohibits the claim entirely.

Outsourcing to third parties is particularly common in certain industries such as the food, pharmaceutical and biotech sectors and can be of particular importance to the SME sector, which often do not have the in-house R&D capability to carry out all of the necessary R&D activity. Outsourcing can frequently result in quicker and more cost-effective completion of innovation projects. In contrast, there are no outsourcing restrictions under the OECD Modified Nexus Approach for the KDB.

Feedback from our members is that these restrictions on outsourcing can impact the decision to locate R&D in Ireland. However, we recognise that removing these limitations in their entirety could pose the risk of an Irish company setting up and outsourcing all R&D investment to an international location.

However, Ireland's limits on outsourcing are far more restrictive compared to the UK. In the UK, SMEs can claim 65% of the relevant costs of using a subcontractor for their R&D activities. For large companies, subcontracted expenditure cannot be claimed in the UK unless it is directly undertaken by a charity, higher education institute, scientific research organisation, health service body or an individual or partnership of individuals. In calculating the qualifying R&D expenditure, any relevant subcontractor or external staff provider payments are reduced to 65% of the original cost.[24]

In our view, consideration should be given to increasing the amount of outsourcing that can qualify for the R&D Tax Credit, so that the credit in Ireland can compare more favourably with competitor countries internationally. For example, increasing the limit by reference to the percentage of in-house spend to say, 20%/25%, instead of 15%.

Agency Staff

The use of agency staff is considered to be outsourcing for the purpose of computing the amount of qualifying R&D activity and related expenditure and is subject to the limitations on outsourcing outlined above. This rule relates to any individual not remunerated directly by the company for their services.

Revenue allows costs incurred which relate to individual consultants who are hired on a part time or short-term basis to undertake sub-contracted activity to be treated as part of the direct employee costs of the company and not as agency staff, provided that the following conditions are met:

- The individual works under the company's control and direction.
- The individual works on the company's premises.
- The individual must be able to contribute specialist knowledge, which cannot be supplied by the in-house research team, to a specific R&D project being undertaken by this in-house team.
- The engagement period does not exceed 6 months.

This is a welcome concession in Revenue's guidance but feedback from our members suggests that the conditions to satisfy the concession for agency staff often do not reflect the commercial reality of such projects, in particular the requirement for the individual to work on the company's premises and for the engagement period not to exceed 6 months. Requiring an individual to work on the company's premises does not reflect the hybrid nature of the new blended working environment and should be reconsidered.

24 HM Revenue & Customs, Claim Research and Development (R&D) expenditure credit.

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

In our survey, we asked for views on what transition measures or other considerations would be required if the rules relating to how the credit is claimed or distributed were to be altered, for example, regarding the payment or carry-forward of excess credit.

Mandating the payment of R&D refunds to comply with Pillar Two Model GloBE Rules

Respondents noted the importance of implementing the necessary modifications to the R&D Tax Credit to ensure it is considered a "qualified refundable tax credit" for the purposes of the OECD Pillar Two Model GloBE Rules.

As outlined above, we believe the R&D Tax Credit provisions should be amended to legislatively mandate Revenue to pay surplus credits within the timeframe set out in the Model Rules, even where a claim is subject to an open Revenue Compliance Intervention at the time, but subject to a clawback of any amount repaid which is determined to be incorrectly claimed following the completion of the intervention by Revenue. This would ensure that the credit, on a statutory basis, meets the criteria of a "qualified refundable tax credit" for the purposes of the OECD Pillar Two Model GloBE Rules.

Condensing the 3-year R&D Tax Credit Refund to one year

In our response to the Department of Finance's Review of the R&D Tax Credit in 2019, we recommended condensing the 3-year R&D Tax Credit refund to one year for SMEs, as smaller companies tend to be cash constrained and accelerating the refund for them would be very beneficial, with only a timing cost for the Exchequer. This recommendation featured as a key ask again among respondents to our 2022 survey and we have outlined further details on these findings overleaf in response to the consultation question on how to improve the R&D Tax Credit and make it more attractive to SMEs.

However, many respondents noted that consideration should be given to condensing the 3-year R&D Tax Credit refund to one year for all businesses, as this would clearly demonstrate that the credit is a "qualified refundable tax credit" for the purposes of the OECD Pillar Two Model GloBE Rules and it would enhance the competitiveness of the regime internationally.

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

Any business that wants to claim the R&D Tax Credit must be able to satisfy both the "science test" (i.e. the activities under review are consistent with the statutory definition of R&D activities) and the "accounting test" (i.e. the expenditure claimed was laid out on qualifying R&D activities).

Revenue's streamlined R&D validation process for small/ micro companies

In an effort to reduce the administrative burden, Revenue does not seek to challenge the "science test" as part of any validation checks on a R&D Tax Credit claim made by a small or micro company that has already been approved for an Enterprise Ireland, Horizon 2020 or IDA grant for the R&D project, provided the credit claim is no more than €50,000 for any accounting year and the R&D project is undertaken in a qualifying field of science or technology. While this is a welcome simplification measure for small/micro companies, we would recommend that consideration be given to increasing the amount that can be claimed from €50,000 to make the credit more accessible for small/micro companies and start-ups.

The claims process

The "accounting test" (i.e. the record-keeping requirements) still must be passed by small and micro companies. Only those revenue expenses that are incurred by the business wholly and exclusively in the carrying on of R&D activities can qualify for the R&D Tax Credit. This includes salaries and wages of staff directly involved in the R&D activity, cost of raw materials used in the R&D activity and fuel, power, water, etc. used in the R&D process.

The time and resources required to prepare this documentation can deter some taxpayers, and particularly SMEs, from claiming the credit. For them, the compliance cost for the business is greater than the potential benefit of the tax credit.

A R&D Tax Credit claim must be made within 12 months of the year-end. There are 32 separate fields for a R&D Tax Credit claim on the Form CT1 (corporation tax return). However, completing the relevant R&D fields of the Form CT1 is sometimes the easiest part of the process.

In addition, the July 2020 update to the Revenue R&D Tax Credit Guidelines introduced very significant changes to Revenue's interpretation of allowable rental expenses, which has added further uncertainty over R&D Tax Credit claims and has caused anxiety for many SMEs.

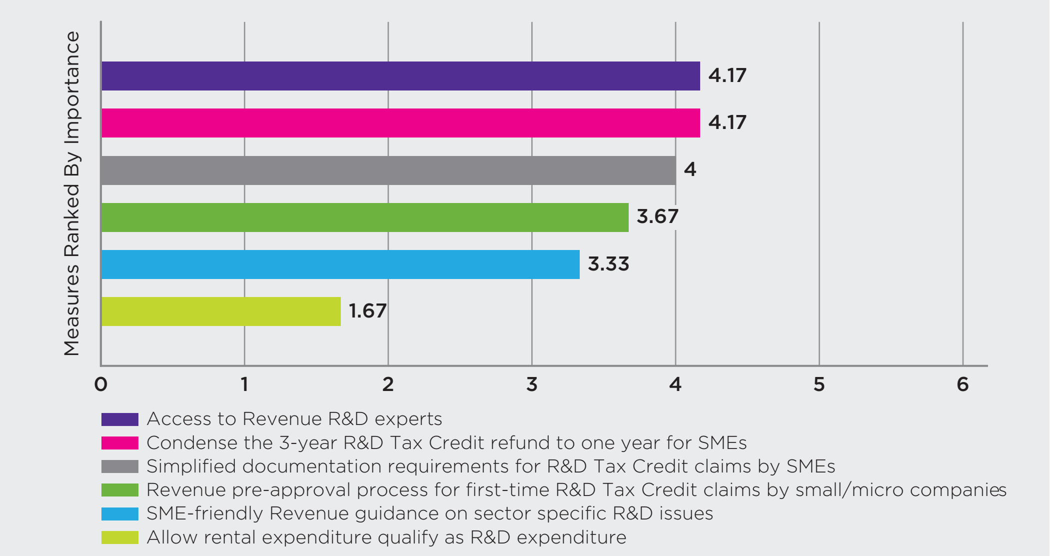
Feedback from our members is that having a 'one size fits all' approach, regardless of the size of the company is not fit for purpose and does not encourage engagement from the SME sector.

In the Institute's survey,[25] we asked SMEs carrying on R&D activities to identify and rank in order of importance the measures that they think could be introduced to improve the level of uptake of the R&D Tax Credit by SMEs carrying on R&D activities.

Condensing the 3-year R&D Tax Credit refund to one year for SMEs and access to R&D experts were ranked as the most important (i.e. 4.17 out of 6 each). Respondents ranked simplifying documentation requirements for R&D Tax Credit claims as the second most important factor (i.e. ranked 4 out of 6).

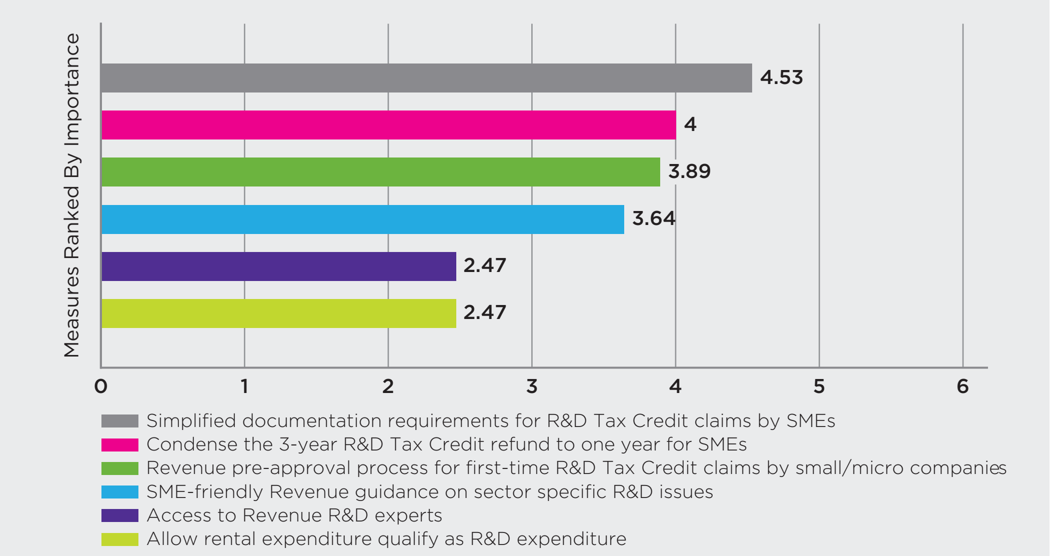
25 Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022, based on 109 respondents – 32 were companies based in Ireland and 77 were tax advisers who advise companies on making R&D Tax Credit and KDB claims.

Measures identified by SMEs that would help improve the uptake of the R&D Tax Credit



We asked members who completed the survey, to identify measures they believed would help to improve the level of uptake of the R&D Tax Credit by SMEs. Simplifying documentation requirements for R&D Tax Credit claims was ranked the most important (i.e. 4.53 out of 6), closely followed by condensing the 3-year R&D Tax Credit refund to one year for SMEs (i.e. 4 out of 6).

Tax Advisers' opinion on measures that would help improve the uptake of the R&D Tax Credit by SMEs

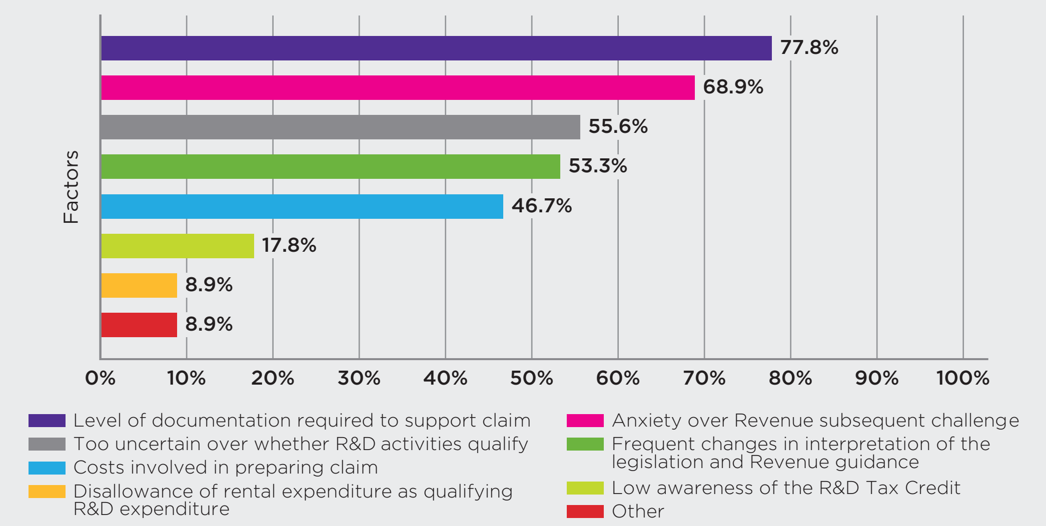


We also asked members who completed the survey, to identify, based on their experience of advising companies on R&D Tax Credit claims, the factors they consider are contributing to the lower level of uptake of the R&D Tax Credit by SMEs.

The level of documentation required to support a R&D Tax Credit claim (by 77.8% of respondents) and anxiety over Revenue subsequently challenging the claim (by 68.9% of respondents) were the key factors highlighted.

Other factors selected included uncertainty over whether the R&D activities qualify for the R&D Tax Credit (by 55.6% of respondents) and frequent changes in interpretation of the legislation and Revenue guidance causing uncertainty for businesses (by 53.3% of respondents). The cost involved in preparing a R&D Tax Credit claim was selected by 46.7% of respondents.

Tax Advisers' opinion on factors contributing to the low uptake of the R&D Tax Credit by SMEs



It is evident form the survey findings that accelerating the R&D Tax Credit refund to one year would greatly improve the attractiveness of the R&D Tax Credit for SMEs. Furthermore, it is clear that streamlining the administrative claims process and alleviating the uncertainty over Revenue subsequently challenging a claim on the "accounting test" would increase the uptake among SMEs.

We would strongly urge **condensing the 3-year refund to one year**, particularly for SMEs, which would be extremely beneficial to these cash constrained businesses, with only a timing cost for the Exchequer.

We also recommend that **Revenue guidance relating to overhead costs should be simplified** as it has become very complex to navigate, particularly for SMEs. This could be achieved, in the first instance, by providing for a set percentage of labour overheads in guidance to help simplify R&D expense claims and provide more certainty to taxpayers.

Consideration should also be given to a **pre-approval process for first time R&D Tax Credit claims by small/micro companies** to alleviate the uncertainty over Revenue subsequently challenging the claim on the "accounting test". In the UK, SMEs making their first R&D claim can qualify for "Advance Assurance". If "Advance Assurance" is granted, HMRC will accept any R&D claims in the first three accounting periods without the need for HMRC to carry out further checks on the claim.

Finally, **SME-friendly guidance**, with step-by-step instructions on the claims process and practical studies, together with tips on how to avoid common errors in claims is needed, similar to the approach adopted by HMRC in the UK.

Section 766B Taxes Consolidation Act 1997 places limitations on the R&D Tax Credit to be paid under section 766 and 766A TCA 1997. Do you consider the limits to be appropriate? What is the impact of these limits on your R&D activities? If you claim R&D tax reliefs in other countries, are similar limitations in place? If so, how do the limitations differ and what are your views on this?

Section 766B TCA 1997 places a limit on the total amount of payable credits in an accounting period in respect of R&D expenditure. Section 766B restricts the repayable credit to:

- the total amount of corporation tax paid by the company in the previous ten years; or
- the total payroll taxes liability of the company in the period in which the R&D expenditure is incurred.

We asked survey respondents to indicate whether they consider the limitations on the payable R&D Tax Credit in section 766B TCA 1997 to be appropriate and whether these limitations have impacted the level of R&D activity carried on in Ireland.

14% of the survey respondents (businesses and advisers) noted that these limitations had restricted the level of R&D activities undertaken in Ireland, while 64% of respondents said the limitations did not impact the level of R&D carried on in Ireland and 22% did not know of the impact of the limitations on R&D activity.

However, some tax advisers when responding to this question noted that the limitations have resulted in some of their clients deciding not to carry out R&D activities in Ireland because they incurred corporation tax losses and had low payroll liabilities in the early critical years and decided to undertake the R&D elsewhere.

Many businesses carrying on R&D activities are in a loss-making position, particularly in the early years of development. Some respondents noted that the limitations in section 766B TCA 1997 impact early stage small/micro companies and start-ups the most, because these businesses tend to reach the payroll cap year on year and the carry forward of the credit is of no real benefit to them. In contrast, the improved cash flow benefit from accelerating the refund of the payable credit, would be extremely valuable to such early-stage companies.

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

We know from our survey findings that access to Revenue's R&D technical experts, condensing the 3-year R&D Tax Credit refund to one year and simplified documentation requirements are key measures that could be taken to improve the uptake of the R&D Tax Credit by SMEs. We have outlined below some specific comments we received from businesses and tax advisers in this regard.

"If approved for a IDA/EI R&D Grant, this should then be automatically accepted as qualifying R&D expenditure for tax credit. (The Grant application should be aligned to Frascati). If approved then by EI/IDA, then Revenue should not be in a position to question it." - Comment by an Irish SME in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

"There needs to be a pre-approval process, the fact that Revenue can go back 6 years and then decide that the R&D Tax Credit application is not valid as in their opinion it does not qualify or part qualify. There needs to be a pre-authorisation and or a decision to question the application within 6 months. Companies must be secure in knowing their investment in R&D is secure." - Comment by an Irish SME in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

"Worry over Revenue scrutiny combined with the lack of resources internally to prepare a claim, evolving Revenue guidelines, and subjectivity as to qualification criteria all add to low uptake." - Comment by a Tax Adviser in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

"It is far too complex and costly for SMEs to make a claim. Some SMEs pay low amounts of corporation tax which limits the refund available, in these cases the refund is less than or equal to the cost of preparation." - Comment by a Tax Adviser in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

"As a small product development company, our sole purpose is R&D and as such it would to helpful to broaden the qualifying spend, as all our activity, rent freight, legal etc is in support of R&D" - Comment by a small/micro company in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

5 Knowledge Development Box (KDB)

As part of its Base Erosion and Profit Shifting (BEPS) project, the OECD developed a Modified Nexus Approach for patent box regimes. Ireland introduced the Knowledge Development Box (KDB) in 2015 applying these rules and adopting the "Modified Nexus Approach", which directly links the patent box (KDB) relief to the R&D incurred.

The consultation document[26] notes that the objective of the KDB is to encourage companies to develop IP in Ireland and thereby engage in substantive operations that have a high value-add for the Irish economy, both in the FDI and indigenous sectors.

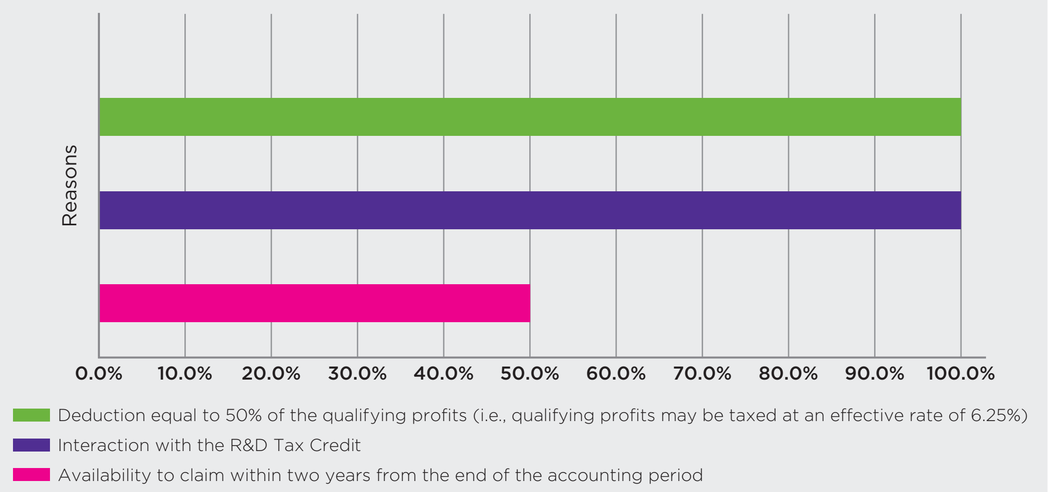
Tax relief under the KDB is given by way of a deduction equal to 50% of the qualifying profit from the qualifying asset, which results in an effective tax rate of 6.25% on the qualifying profit. The KDB applies to income from a qualifying asset that is created from qualifying R&D activities such as:

- a computer programme/ copyrighted software,
- an invention protected by a qualifying patent, and
- Intellectual property (IP) for small companies which is certified by the Controller of Patents as patentable, but not patented.

Companies electing to avail of the KDB must do so within 24 months from the end of that accounting period. It is only available to companies that carried out the R&D, within the meaning of section 766 TCA 1997, which led to the creation of the patent, copyrighted software or IP equivalent to a patentable invention.

The R&D Tax Credit and the KDB are reliefs which are focussed on very different parts of a company's IP lifecycle. The R&D Tax Credit incentivises the development of IP, while the KDB incentivises the commercialisation of the IP. The most recent data available on the KDB shows that in 2020, 17 companies claimed the KDB at a cost of €16.3 million.[27] Two respondents to the Institute's survey[28] claimed the KDB in the last 5 years. The level of tax relief at 6.25% and the interaction with the R&D Tax Credit were the main factors that prompted these companies to claim the KDB.

Key factors that prompted businesses to claim the KDB

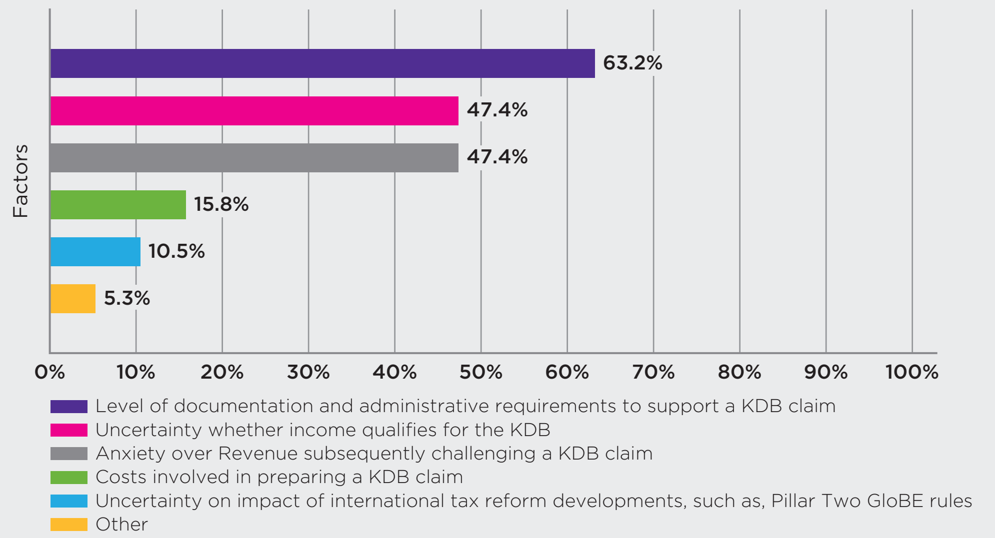


26 Research & Development Tax Credit and the Knowledge Development Box Public Consultation, April 2022, Department of Finance.
27 Corporation Tax - 2021 payments and 2020 returns (revenue.ie)
28 Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022, based on 109 respondents – 32 were companies based in Ireland and 77 were tax advisers who advise companies on making R&D Tax Credit and KDB claims.

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

We asked respondents to identify factors that may be behind the low uptake of the KDB among Irish companies and 63.2% of respondents noted that the level of documentation and administrative requirements to support a KDB claim was the main reason for the low uptake of the KDB to date.

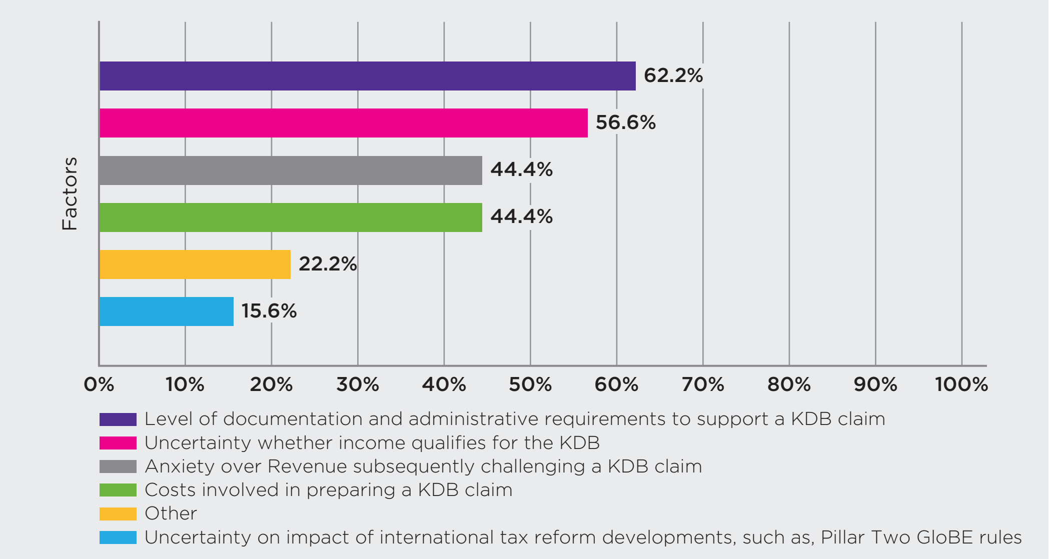
Businesses' opinion on factors behind the low uptake of the KDB among Irish companies



We also asked members who completed the survey, based on their experience of advising companies on KDB claims, to identify factors they believe may be behind the low uptake of the KDB among Irish companies. Similar to the response from businesses, 62.2% of respondents noted the level of documentation and the administrative requirements to support a KDB claim as the main reason for the low uptake.

55.6% of members who completed the survey also noted uncertainty over whether the income arising from a qualifying asset from R&D activities qualifies for the KDB and 44.4% of them considered anxiety over Revenue subsequently challenging a KDB claim and the cost involved in preparing a KDB claim as factors that have contributed to the relatively low uptake of the KDB.

Tax Advisers' opinion on factors contributing to the low uptake of the KDB among Irish companies



Many of our members noted the complexity of the KDB and that misunderstandings can often exist between Revenue and taxpayers regarding the commerciality of the contracts and the patentable products. Comments we received from members completing our survey noted that if a company cannot access specialist services, for example from one of the large accounting firms, then the business tended not to avail of the KDB.

Some respondents noted that their clients who had made a KDB claim had received very detailed "Aspect Queries" from Revenue (Pre-1 May 2022 introduction of Revenue's new Compliance Intervention Framework). The questions in the "Aspect Queries" were considered vast and cumbersome by the taxpayer, which made it difficult to justify making the KDB claim from a cost benefit perspective.

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

We asked respondents to identify any particular elements of the KDB conditions that they have encountered difficulties with and the feedback we received noted the requirement to keep robust supporting documentation to make a KDB claim as an element causing difficulty.

Expand definition of qualifying expenditure

Amounts paid for the acquisition of IP that are reflected in the value of the qualifying asset are excluded from qualifying expenditure. We believe that companies that acquire IP for use in furthering the R&D carried on by a company should be included in the qualifying expenditure.

In comparison, the UK Patent Box regime provides that a company can use the Patent Box regime where it owns or has exclusively licenced-in the patents. If a company holds licences to use others' patented technology, it may use the Patent Box if it meets certain conditions, such as, having rights to develop, exploit and defend rights in the patented invention, one or more rights to the exclusion of all other persons (including the licensor), exclusivity throughout an entire national territory, etc.

Members also noted that the requirement for the developing company to exploit the IP can exclude some Irish groups from making a KDB claim where the IP is developed in one Irish entity but exploited in another Irish entity within the same group, as outsourced costs to related parties which are reflected in the value of the qualifying asset are excluded from qualifying expenditure.

Companies that undertake contract R&D for group entities, from which a qualifying asset results, are not entitled to KDB benefits in respect of the income they earn. Amending the KDB to allow for group claims by Irish group entities could help to remove some of the barriers to entry and would acknowledge the investment in R&D jobs in Ireland, and that the R&D activities are directly leading to the development of IP, the income attributable to which is earned in Ireland.

From a multinational group perspective, the fact that not all R&D is carried out in Ireland means the benefit of making a KDB claim can be significantly reduced. The rules are too restrictive and therefore, the KDB rarely applies to multinational groups which typically carry on R&D throughout the world.

"Patent Box regime is good, however not all patentable IP is patented for commercial reasons .. fix this. (I appreciate not strictly a R&D item). Selling point is it adheres to OECD - this is also its drawback. Other countries are in this space too offering better." - Comment by a foreign-owned MNC in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

Enhance the definition of qualifying income

Revenue guidance notes that where the company sells a product, which has embedded royalties relating to a qualifying asset, then only the portion of the sales price which relates to those embedded royalties will form part of the overall income from the qualifying asset.

In some circumstances, IP income will derive directly from the IP asset (e.g., license or royalty income). However, it is more common for IP assets to be embedded in products and services and in these situations, it can be very difficult to determine the value of the income attributable to the IP asset. This position can be further complicated where multiple and varied types of IP assets are embedded in a single product.

"Many SME companies find it difficult to come up with an estimate of the potential benefit to them under the KDB so that a decision can then be made as to whether to proceed with a claim. This is particularly true where the qualifying asset is IP embedded in a product being sold. Estimating the income attributable to that qualifying asset requires expertise that will often not be available in-house and then if a company also requires input on the R&D aspects of the scheme, there are up-front costs before it is known whether a claim is even going to be made." - Comment by a Tax Adviser in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

We believe that there should be more flexibility in the approach to calculate overall income. The rules should be adapted to allow profit from an entire IP asset avail of the KDB, not just the portion of the profit related to the patentable element.

Simplify the administration of the KDB

Robust supporting documentation is required to make a KDB claim, including tracking and tracing the appropriate income and expenditure items to the appropriate qualifying asset. The extent of the obligation to retain documents to support a KDB claim should be clarified. For example, the KDB overall expenditure is a cumulative calculation, and thereby files and records need to be maintained for the duration of the KDB benefit which could in some cases span 10 to 15 years or more (which is greater than the general documentation retention requirements).

Simplifying the existing significant compliance and documentation burdens would improve the accessibility of the KDB, which would be of particular relevance to SMEs that generally carry out the majority of their R&D activities in Ireland. Simplicity of the KDB regime and certainty of treatment are key priorities for SMEs as they have limited resources to deal with such a complex regime.

How do you think the Irish KDB could develop and remain competitive in the evolving international landscape?

In our survey, we asked for views on how the KDB could develop and remain competitive in the evolving international landscape. Comments received from medium-sized Irish businesses noted that the regime needs to be over-hauled or risk losing R&D investment to the UK. Medium-sized Irish businesses also cited Revenue's approach to Audits and Compliance Interventions, including the narrow definitions and bias towards academic research of the Frascati Manual[29] as a major factor that will dissuade companies from investing in Ireland.

"Broaden the range of IP that qualify, the sunset clause - impacts client's commitment to a claim - given the significant time inputs required in compiling same. The claim process needs to be simplified, obvious from the Revenue stats, that to date the KDB is not very successful. I have many clients interested in claiming, but many pull back once they understand the qualification criteria - very complex. For example, have to do R&D in same entity as make a KDB claim (should be available for Irish group members) - have a joint election akin to the R&D claims." - Comment by a Tax Adviser in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

We also asked respondents to our survey to consider the potential consequences for KDB claimants and the Irish tax system as a whole, having regard to the Pillar Two Model GloBE Rules.

Feedback from our members would suggest that large Irish PLCs or foreign-owned MNC companies are not claiming the KDB because of the restrictions imposed on Irish groups and for acquired IP (as outlined above), which is borne out by the low uptake of the KDB to date.

29 OECD Frascati Manual 2015.

Therefore, we do not think the Subject to Tax Rule (STTR) under Pillar Two will have a significant impact on KDB claimants in practice. However, if any enhancements are made to the KDB following this consultation process, the regime should be monitored on an ongoing basis to determine whether future changes would be required, if the profile and number of claimants significantly alters.

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

In our survey, we asked for views on other measures that could be introduced to support Ireland's indigenous innovation sector to increase productivity growth or the development of patentable advancements. The following are some of the comments we received:

"With regards to productivity there needs to be a super accelerated capital allowance for companies to invest in automation/robotics etc - UK already have this introduced." - Comment by an Irish SME in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

"At the moment stock based compensation is not an allowable cost. A number of multinationals offer staff shares; RSU or options as a method of remunerating staff and also, as a retention tool. It would be positive if this expenditure was allowable for the R and D tax credit claim." - Comment by a foreign-owned MNC in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.

"Make incentives much easier to claim - tie documentation requirements to business operations, not singularly tax claim focussed - reduce taxpayer anxiety over Revenue audit and approach from Revenue to 'come back with something'." - Comment by a Tax Adviser in response to the Irish Tax Institute R&D Tax Credit and KDB Survey 2022, May 2022.