Tax Relief Available in Ireland for Companies Involved in Research & Development

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The Irish Revenue Commissioners have issued 'Revenue Guidelines for Research & Development Tax Credit'.[1] This guide has been updated over the years to take account of successive alterations and enhancements available to research & development (R&D) tax relief in Ireland. Sections 766, 766A and 766B of the Taxes Consolidation Act (TCA) 1997 contain the main provisions and rules around the R&D relief available.[2]

Section 1 Qualifying R&D activities and expenditure

The definition of qualifying R&D activity requires that a claimant company engage in systematic activity which seeks to achieve a scientific or technological advancement and which involves the resolution of scientific or technological uncertainty.

For expenditure qualify expenditure for tax relief, it must be incurred wholly and exclusively in the carrying on by the company of qualifying R&D activities. The following costs are examples of qualifying expenditure:

- ***Employee Costs*** for staff who are engaged in qualifying R&D activities. Where an employee spends a proportion of their time "in the carrying on" of qualifying activity, then that same proportion of his/her emoluments can qualify. Qualifying employee costs include pension contributions, bonus payments, health insurance or other benefits included in the remuneration package.

- ***Materials*** used in R&D activities which may be subsequently sold.

- ***Agency staff/subcontracting out***
    - Sums paid to a university/institute of higher education in a relevant Member State - relief will be restricted to 5% of the expenditure incurred by the company itself on R&D activities or €100,000, whichever is the greater, subject to the company incurring at least the same level of expenditure on qualifying activity which it carries out itself.
    - Sums to another person (not to a university or institute) who is not a connected person - relief will be restricted to 15% of the expenditure incurred by the company itself on qualifying R&D activities or €100,000, whichever is the greater, subject to the company incurring at least the same level of expenditure on qualifying activity which it carries out itself.

[1] The Revenue Research & Development Tax Credit Guidelines was last updated in April 2015 and is available from http://www.revenue.ie/en/tax/ct/research-development.html.
[2] All legislative references in this article are relevant for the 2017 exam cycle. Legislative adjustments in the Finance Acts for subsequent years may alter the guidance provided in this article.

- ***Plant and Machinery*** used in the R&D activities where such expenditure also qualifies for capital allowances. Apportionment is required where the plant and machinery is also used for non-R&D purposes.

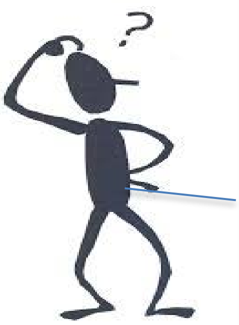
- ***Construction/refurbishment of buildings/structures used for R&D*** where such a building also qualifies for industrial buildings capital allowances and where the R&D activities carried on by the company in that building over a period of four years represents at least 35% of all activities carried on in the building. Apportionment is required where the building is also used for non-R&D purposes. The cost of acquiring the land does not qualify. If the building/structure is sold or ceases to be used for R&D activities within 10 years, any relief given is withdrawn.

Examples of costs which do not qualify as relevant R&D expenditure include:
- Indirect overheads such as insurance, bank charges and interest, staff canteen costs, equipment repairs or maintenance, business entertainment, travel, telephone, shipping, HR costs and recruitment fees.
- Any expenditure which is met directly or indirectly by any grant aid or assistance will not qualify for relief.

Section 2 Calculating the R&D credit

The R&D tax credit is calculated separately from the normal 12.5% corporation tax (CT) deduction that is available for R&D expenditure in computing the taxable profits of the company. The R&D tax credit is calculated as 25% of qualifying expenditure.[3]

Section 3 Ways in which tax relief can be claimed for qualifying R&D expenditure



Software Logics Ltd (SLL) is a computer software company that is involved in ground-breaking software development.

Question - The Finance Director has asked you to outline the ways tax relief can be obtained for qualifying R&D expenditure?

Answer -
1. **SLL can reduce its corporation tax payment for current and preceding accounting periods**
2. **Where SLL has fully offset the credit against the CT of the current and preceding accounting periods, any excess can be claimed as a payable credit in 3 instalments from Revenue**
3. **SLL may surrender its relief to key staff.**

3.1 <u>Reduce CT payment for current/preceding accounting period</u>

The credit is initially used to reduce the liability to CT for the accounting period in which the qualifying R&D expenditure was incurred. Where a company has insufficient CT against which to claim the R&D tax credit in a given accounting period, the tax credit may be credited against the CT for the preceding period. Alternatively, it may be carried forward indefinitely or, if the company is a member of a group, it can be allocated to other group members.

3.2 <u>Claim a payable credit from Revenue</u>

[3] Finance Act 2014 removed the requirement to subtract base year expenditure in calculating claims for accounting periods commencing on or after 1 January 2015.

Where a company has offset the credit against the CT of the current and preceding accounting periods and an excess amount still remains, the company may make a claim to have the amount of that excess paid to it by Revenue in three instalments over a period of 33 months.

- ***Instalment 1*** - 33% of the excess amount becomes payable not earlier than the 21st day of the ninth month following the end of the company's accounting period in which the R&D expenditure was incurred. The remaining balance of the excess amount will then be used to reduce the company's CT liability of the next accounting period
- ***Instalment 2*** - if any of the excess amount still remains, a second instalment amounting to 50% of that amount remaining will become payable not earlier than 12 months after payment of the first instalment. Any part of the excess amount still remaining will then be used to reduce the company's CT liability of the following accounting period
- ***Instalment 3*** - if any part of the excess amount still remains, that amount will become payable not earlier than 24 months after payment of the first instalment.

The amount of payable credits in respect of R&D expenditure in an accounting period is limited to the greater of—

- the aggregate amount of CT paid by the company for accounting periods ending in the 10 years prior to the year preceding the accounting period concerned OR
- the payroll liabilities (PAYE, PRSI and USC) for the period concerned and the preceding accounting period.

Example 1

In the year ended 31 December 2016 SLL incurred €600,000 qualifying expenditure on R&D. SLL has made CT payments in excess of €150,000 in the 10 accounting periods preceding the year ended 31 December 2016. Details of SLL's CT liabilities (actual and projected) are as follows:

Year Ended	CT Liability
31 December 2015	€45,000
31 December 2016	€22,500
31 December 2017	€16,500 (projected)
31 December 2018	€15,000 (projected)

R&D tax credit due in 2016 is €150,000 (€600,000 x 25%).

Option 1 – Use €22,500 of the R&D credit to offset the CT liability for 2016. Balance of €127,500 may be carried forward and used to reduce the CT liability for the 2017 and subsequent accounting periods.

Option 2 - Use €22,500 of the R&D credit to offset the CT liability for 2016. Offset €45,000 of the remaining tax credit against the CT liability for 2015 so that a refund of €45,000 will be due. The excess R&D credit remaining of €82,500 (€150,000 - €22,500 - €45,000) can be used to make a payable credit claim.

Revenue will pay 33% of the remaining credit to the company as a first instalment. That payment of €27,225 (€82,500 @ 33%) will be paid not earlier than 21 September 2017. The excess credit remaining will be reduced to €55,275. €16,500 of the unused credit will be offset against the CT liability for 2017 which is projected to be €16,500. Therefore, an excess balance of R&D credit remains of €38,775.

Revenue will pay 50% of the remaining balance to the company as a second instalment. That payment of €19,388 (€38,775 @ 50%) will not be paid earlier than 21 September 2018.

€15,000 of the remaining unused credit will be offset against the CT liability (projected) for 2018, leaving a balance of unused credit of €4,388. Revenue will pay the balance of €4,388 to SLL as the third instalment, not earlier than 21 September 2019.

3.3 Surrender of R&D Tax Credit to 'Key Employees'

In order to help Irish companies involved in R&D activities attract and retain R&D staff, such companies can now transfer some or all of their R&D credit to 'key employees'. A 'key employee' is an employee who:

- Performs at least 50% of his/her duties in the conception or creation of new knowledge, products, methods and systems **AND**
- Must not be a director of the company or an associated company, and must not be not connected[4] to such a director **AND**
- Must not have an individual holding of more than 5% of the shares of the company or an associated company and must not be connected to a person who has such a material interest.

The amount of the credit that can be surrendered to key employees is limited to the amount the company could otherwise have used to reduce the CT liability in respect the accounting period in which the qualifying R&D activity was carried out.

From the company's perspective, to surrender all or part of the credit it must pay the amount of corporation tax which it could otherwise have reduced.

From the key employee's perspective, he/she cannot have his/her effective rate of tax payable reduced below 23%. The key employee can claim the credit in the tax year following the tax year in which the accounting period of the company that surrendered the credit ends. Where, a key employee cannot use the full amount of the credit surrendered by his/her employer in a tax year, the amount not used can be carried forward to reduce the income tax charged on the employment income of the next tax year and each succeeding tax year until the full credit has been used (provided the individual remains an employee of the company).

Example 2

Paula is a key employee of SLL in the year ended 31 December 2016. SLL has decided to surrender €15,000 of its R&D credit for 2016 to Paula. Paula wants to claim this credit against the tax on her income from SLL in 2017. Her 2017 income and tax for 2017 are as follows:

Salary €160,000
PAYE €54,140

Paula's tax is sufficient to absorb the full credit surrendered by SLL of €15,000. However, Paula's effective rate of income tax must be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate before the credit = 33.84% (€54,140/€160,000).
Effective rate after the full credit = 24.46% ((€54,140-€15,000)/€160,000).
Paula can therefore use the full credit against the income tax on her salary in 2017.

[4] A connected person is a spouse, civil partner or close relative. 'Relative' is a brother, sister, ancestor (grandparent, great-grandparent) and lineal descendants (children, grandchildren).

Example 3

Nigel is a key employee of SLL in the year ended 31 December 2016. SLL has decided to surrender €15,000 of its R&D credit for 2016 to Nigel. Nigel wants to claim this credit against the tax on his income from SLL in 2017. His 2017 income and tax for 2017 are as follows:

Salary €80,000
PAYE €22,140

Nigel's tax is sufficient to absorb the full credit surrendered by SLL of €15,000. However, Nigel's effective rate of income tax must be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate before the credit = 27.68% (€22,140/€80,000).
Effective rate after the full credit = 8.93% ((€22,140 - €15,000)/€80,000).

Nigel can therefore not use the full credit against the income tax on his salary in 2017. He can only use so much of the R&D credit as to give a minimum effective rate of 23%. That is, his tax liability must only be reduced to €18,400 (€80,000 x 23%).

Therefore, only €3,740 (€22,140 - €18,400) can be claimed in 2017. The credit balance of €11,260 can be carried forward for use against income tax on his income from SLL in subsequent years.

Section 4 Relevant time limits for R&D claims

Where a company has maintained the necessary supporting records, a claim to R&D relief may be made by completing the relevant sections of the corporation tax return (form CT1).

All claims for R&D tax credit must be made within 12 months from the end of the accounting period in which the expenditure was incurred. However, expenditure on buildings and structures to be used for R&D is not subject to the same 12 month period. Where qualifying expenditure on the construction/refurbishment of a building spans two or more accounting periods the aggregate expenditure may be treated as having been incurred on the date the building is first brought into use.

Claims for the three instalment payable credits can be paid not earlier than the 21st day of the 9th month following the end of the relevant period, and 12 months and 24 months respectively following that date. While the claim for the first instalment must be made within the 12 month limit, claims for the subsequent instalments are not separately subject to this time limit.

In the absence of a claim for payment the excess will be carried forward for offset against the company's CT liability in the subsequent accounting period.