IMPORTANT ECONOMIC INCENTIVES

Article by Liam Grimes, Director of Tax, KPMG,
Moderator Professional 2 Advanced Taxation.

The changes introduced in Finance (No. 2) Act 2008 to research and development tax credits and the establishment of the intangible assets regime in Finance Act 2009 together represent an important component in Ireland's knowledge economy. Coupled with the provisions in relation to Key employees, they represent an important step in building the foundations to economic recovery.

RESEARCH AND DEVELOPMENT TAX CREDITS

The changes apply to expenditure incurred in accounting periods commencing on or after 1 January 2009.

Rate of Credit

The rate of the tax credit was increased from 20% to 25%. This applies to all qualifying expenditure on R&D, including, buildings, salaries and other expenditure and also in respect of expenditure on plant & machinery.

Base Year

2003 has been set permanently as the base year for all accounting periods.

Buildings

Previously the credit was only available in respect of buildings that were used for R&D. Now, in respect of accounting periods commencing on or after 1 January 2009, the credit is available in respect of new expenditure on the construction, including refurbishment, of a building, where the R&D activities carried on by a company in that building over a period of 4 years represents at least 35 per cent of all activities carried on in that building. The credit is allowed in proportion of the use of the building for R&D over that 4 year period.

A claw back applies where within 10 years of the accounting period in which the expenditure on the building was incurred, the building is-

1. Sold, or
2. ceases to be used by the company for R&D activities, or
3. ceases to be used for the purpose of the same trade that was carried on by the company at the beginning of the 4 year period referred to above.

Example 1

In the accounting period for the year ending on 31 December 2009, Innovate Ltd incurred expenditure of €2,500,000 in respect of a building. The R&D activities to be carried on by the company in that building over the specified relevant period will represent 50 per cent of all activities carried on in the building or structure for a period of 5 years. Following that period of 5 years, the building will be used largely for manufacturing and R&D activities will account for only 5% of all activities carried on in the building.

The tax credit is calculated as follows:

Allowable Expenditure is €2,500,000 @ 40% = €1,000,000

R&D tax credit is €1,000,000 @ 25% = €250,000

<u>Method of Using Tax Credits</u>

The way unused tax credits may be used is significantly changed. In addition to either carrying forward unused credit or allocating a credit to another group company, the company that incurred the expenditure may-

- Set the unused amount against corporation tax of the preceding accounting period – to create a tax refund.
- Make a claim to have the amount of that excess paid to them by Revenue in 3 installments. Thus the tax credit becomes a payable credit (this option can only be claimed where a company has first offset the credit against the corporation tax of the preceding accounting period, or where no corporation tax arises for that period, and an excess still remains). It is important to note that this is not a repayment of corporation tax but a payable tax credit.

The timing and amount of the payments is as follows:

<u>Instalment 1</u>

The amount is 33% of the excess and will be paid not earlier than the return date for the accounting period in which the expenditure was incurred.

<u>Instalment 2</u>

The remaining balance will be first used to reduce the corporation tax of the next accounting period and, if any excess still remains, a second installment of 50% of that excess will be paid to the company. The payment will be made not earlier than 12 months after the date on which the first installment was paid.

<u>Instalment 3</u>

The balance will be used to reduce the corporation tax of the next accounting period and, if an excess still remains, it will be paid to the company not earlier than 24 months after the date on which the first installment was paid.

There is a limit on the amount of tax credits payable to a company by Revenue. The amount cannot exceed the greater of:

- The corporation tax paid by the company for the 10 years prior to the accounting period preceding the period in which the expenditure was incurred, or
- The amount of PAYE, PRSI and levies, that the company is required to remit in respect of the period in which the expenditure was incurred.

Where the excess is greater than the limit as described above, any amount which cannot be included as a payable credit will be carried forward for offset against corporation tax in the subsequent accounting period. In addition it should be noted that current period credits (2009) must be used first in preference to an excess carried forward from a previous year.

Example 2

Assume that the company's payroll taxes for 31 December 2009 is €500,000.

A/C Pd. 31 December	**R&D Expenditure**	**Tax Credit (R&D expenditure €100,000 in 2003)**		**CT Liability Before R&D Tax Credit**	**CT Liability After R&D Tax Credit**	**Excess**
2008	300,000	(300,000-100,000) @ 20%	€40,000	60,000	20,000	Nil
2009	500,000	(500,000-100,000) @ 25%	€100,000	20,000	Nil	80,000

- The tax credit for 2008 is used to reduce the corporation tax liability 31 December 2008.
- The tax credit for 2009 is first used to reduce the corporation tax liability for 2009. Any remaining excess may be carried forward and set against the corporation tax liability for 2010.
- Alternatively the company may set the excess of the 2009 tax credit against the corporation tax liability of 31 December 2008 and claim a refund of €20,000 for 31 December 2008. Revenue will pay 33% of the excess (33% 0f €60,000) to the company not earlier than 30 September 2010.
- The remaining €40,000 will be paid to the company over the next two years. If the corporation tax for 31 December is €10,000, Revenue will pay €15,000 ((40,000 – 10,000) X 50%) to the company 12 months after the 1st instalment.
- If the company has no corporation tax liability for 31 December 2011, Revenue will pay the remaining €15,000 to the company 24 months after the 1st instalment.
- In example 1 above, the full amount of the tax credit of €250,000 may be used as set out above. The same rules apply to tax credits in respect of buildings as other expenditure.

INTANGIBLE ASSETS

Under the regime capital allowances are given on capital expenditure incurred by companies on the provision of intangible assets for the purposes of a trade so that the normal rules in regard to wear and tear allowances, balancing allowances and charges for expenditure on machinery or plant also apply for capital expenditure on qualifying intangible assets.

Qualifying Assets

To qualify, assets must satisfy 2 tests:

1. They must be recognised as intangible assets under generally accepted accounting practice, and
2. They must be listed as specified intangible assets in legislation.

The definition of intangible assets which qualify for the relief is very widely drafted and includes the following:

- Any patent, registered design, design right or invention;
- Any trademark, trade name, trade dress, brand, brand name, domain name, service mark or publishing title;
- any copyright or related right within the meaning of the copyright and related rights act 2000;
- Know-how, generally related to manufacturing or processing;
- Any authorisation required in order to sell a medicine or product of any design, formula, process or invention for the purposes it was intended;
- Any rights derived from research, prior to authorisation, on the **effects of items covered directly above;**
- Any licence in respect of an intangible asset referred to above;
- Any “non-irish” rights similar to those outlined above; and
- Goodwill to the extent that it is directly attributable to the items set out above.

Capital Allowances

Companies can claim capital allowances based on accounting depreciation of the intangible asset, or they can opt instead for a capital allowance over 15 years. This latter option will usually apply in the case of assets that appreciate or are written down over a longer period, in the accounts. The allowance is available both where the intangible asset is acquired from another company (including a connected company) and where the expenditure is incurred on the development or enhancement of an internally created intangible asset. However, where the intangible asset is acquired from another group company, CGT group relief will not apply. In such a case, the company acquiring the intangible assets can claim an allowance but the transferring company will be liable to corporation tax on chargeable gains.

The normal rules in relation to balancing allowances/ charges apply on the disposal of an intangible asset, except where an intangible asset is disposed of more than 15 years after the beginning of the accounting period in which the asset was first provided for the trade where the disposal does not result in a connected company claiming allowances in respect of capital expenditure on the asset.

Trade of managing, developing or exploiting intangible assets

Importantly, allowances are only available against income from activities which consist of managing, developing or exploiting intangible assets and which are carried on by a company as part of a trade (called a relevant trade). Where these activities include activities comprising the sale of goods or services deriving the greater part of their value from intangible assets, are to be treated as a separate and income from such activities is to be assessed separately. Consequently in such cases the income attributable to managing the intangible property must be segregated from sales income. For example, in the case of the sale of branded products, which carries the brand name, the income can be segregated by distinguishing between the sale price of the product with and without the brand name attached. Accordingly, receipts and expenditure will be apportioned. The amount of net income attributed to the trade of managing the intangible assets should not exceed the amount that would be attributed to a distinct and separate company engaged in the relevant activities if it were dealing with the company availing of relief under the scheme at arm's length.

In many cases many groups of companies will get over this problem by ensuring that the intangible assets are owned by one company in a group and leased to another in return for a royalty payment.

Restriction

The capital allowances together with any interest on loans to buy the intangible assets for any accounting period cannot exceed 80% of the trading income of the trade of managing the intellectual property for that period excluding such allowances and interest.

Any unused capital allowances which are not utilised by virtue of the restriction can be carried forward and used against the relevant trade next accounting period.

KEY EMPLOYEES

This provision was introduced in recognition of the importance of attracting individuals with high skill-levels, for example in the R&D and financial services areas to Ireland. These individuals may, in turn, attract additional business that which will help Ireland to further develop these and other important sectors.

The provision applies where the individual is sent by his or her foreign employer to work in the State for that employer (or an associated company) and the individual continues to be paid from abroad. It applies to individuals who are not Irish-domiciled and who, before they came to the Ireland, had been living and working in a country that is not a member of the European Economic Area and with which the State has a double taxation agreement.

The individuals concerned can have the Irish pay-as-you-earn (PAYE) tax, that is deducted from so much of the foreign employment income as is related to duties exercised in Ireland, reduced - by repayment - to the *greater* of the tax due on either

- €100,000 plus 50% of the income of the employment over that amount, or

- the income from that employment remitted into Ireland. (Any tax deducted by the employer via the PAYE system will be deemed to be a remittance.)