The Consultative Committee
of Accountancy Bodies-Ireland

Chartered Accountants Ireland
The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Institute of Certified Public Accountants in Ireland

Response to the Public Consultation on the Research & Development Tax Credit and the Knowledge Development Box

May 2022

About CCAB-I

The Consultative Committee of Accountancy Bodies–Ireland is the representative committee for the main accountancy bodies in Ireland. It comprises Chartered Accountants Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland, and the Chartered Institute of Management Accountants.

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Introduction

The Research & Development (R&D) tax credit is a fundamental tax policy tool both for fostering growth in indigenous companies and encouraging global capital to invest in the local Irish economy. Ireland first introduced its R&D tax credit offering in Finance Act 2004. Since then, the credit has brought success both in terms of encouraging research and innovation, and subsequent returns to the Exchequer by way of jobs created. According to Revenue's statistics[1], the value of R&D expenditure against which tax relief was claimed was €3.1 billion in 2020. The companies using R&D relief paid €5.6 billion of net corporation tax receipts which is a considerable proportion of the €11.6 billion collected in corporation tax in 2020[2]. Of the €3.1 billion in expenditure, €2.6 billion was by foreign owned multinational companies.

The R&D tax credit has the potential to be one of the country's most pro-enterprise tax reliefs. However, it is vital that the tax credit is best in class internationally both to support indigenous growth and encourage international investment. Ireland's R&D tax credit must continue to evolve to meet the needs of the diverse businesses engaging in innovative and cutting-edge R&D activities on the island.

The two key areas identified by the CCAB-I where change would greatly improve the attractiveness and accessibility of the R&D tax credit are:

- From an international perspective, making the R&D tax credit fully refundable in the year it arises regardless of whether there is insufficient corporation tax liability in the current or preceding accounting year. This would be a cash-flow rather than a cost issue for the Exchequer.
- From a local perspective, simplifying the rules for SMEs engaging in R&D activities. Presently, many SMEs are discouraged from claiming the R&D tax credit due to complex and onerous compliance requirements.

In May 2022, the CCAB-I conducted a survey of members working in practice and industry with professional experience claiming the R&D tax credit. One of the key findings of our survey is the call for simplified documentary requirements for SMEs as part of a broader simplification of the regime for SMEs. In particular, the CCAB-I is of the view that the requirements set by Revenue both in terms of scientific merit and documentation are not appropriate for SMEs.

Regarding the refundability of the tax credit, professional accountants have raised the impact of recent changes to the U.S. tax regulations, which go beyond the OECD Global Anti-Base Erosion (GloBE) rules. From a U.S. investor's perspective, the R&D tax credit must be made fully refundable for the credit to benefit those investors. Foreign Direct Investment (FDI) is a key driver of growth in Ireland and the R&D tax credit is a key tool for attracting investment of global capital. Therefore, the CCAB-I recommends the acceleration of repayment of the refundable tax credit.

Overall, the R&D tax credit is a proven tax relief which is well regulated from Revenue's perspective. Therefore, the recommendations of this submission can be achieved with a certain measure of confidence that the overall return to the Exchequer from any changes implemented will be positive.

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[1] Corporation Tax –2021 payments and 2020 returns, Revenue Commissioners analysis 2022
[2] End-2020 Exchequer Returns, Department of Finance

Question 1

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

Ireland's skilled, educated workforce is one of the main factors in the decision matrix of a business considering the location of R&D activities. In addition, the stable political environment combined with the straightforward rules for establishing and governing companies, make Ireland an attractive location for carrying on business.

In tandem with the above, Ireland's R&D tax credit offering is an extremely important tool for attracting investment into Ireland. Coupled with other government supports (such as Enterprise Ireland grants), the R&D tax credit is a fundamental aid to companies innovating in the local and global economies.

In terms of attracting investment into the country more generally, the 12.5 percent corporation tax rate remains a cornerstone of Ireland's tax policy.

Question 2

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?

Our members operate in diverse sectors and so their reasons for first making a claim are many and varied. For companies with multinational operations, the Irish R&D tax credit is congruent with international tax conventions and comparable reliefs offered by our global trade partners. For indigenous companies, the ability to claim a refundable tax credit is a key cash-flow support.

The CCAB-I acknowledges that the R&D tax credit contributes overwhelmingly positively to research and innovation in the country. It is a key driver of employment and a key tool in attracting FDI and maintaining Ireland's competitiveness as a destination for investment.

Question 3

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

Recent changes to the U.S. tax regulations which go beyond the GloBE rules will impact upon the ability of Ireland's R&D tax credit to remain competitive. As a result of these changes, U.S. investors require that the Irish R&D tax credit is made fully refundable. While such a change would result in a cash-flow adjustment for the Exchequer, it should not result in any additional cost for the Exchequer.

Professional accountants have advised that if the current rules for repayment of the refundable credit remain in place, then from 2022 onwards U.S. investors may not look to Ireland in the first instance. This would have a detrimental impact on Ireland's economy. A study carried out by the National Treasury Management Agency in 2018 found that investment by foreign entities into Ireland has been critical to Ireland's economic success in the last 30 years. The US has been at the heart of this, accounting for 29 percent or €232 billion of the total investment in 2016. [3]

The study also found that Ireland's reliance on the US is abnormal to other countries in Europe.

If the credit was to be made fully refundable in one tax year and this change was to be made by way of Finance Act 2022, we recommend that this change is communicated well in advance of publication of the Budget 2023 or Finance Act 2022 to give prospective investors the opportunity to factor this into their decision to base R&D activities in Ireland. Further detail is provided in our response to Question 9.

Question 4

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

As already noted, he R&D tax credit is one of several factors considered by businesses locating their R&D activity in Ireland and in many cases, it can be the deciding factor when considering different locations. While it is difficult to quantify how much R&D activity would be carried out in Ireland if the R&D tax credit was not available, CCAB-I believes that R&D activity would reduce in Ireland in the absence of a workable tax credit.

In a global economy, companies can carry out R&D activities in locations all over the world. Most advanced economies operate with robust tax incentives for R&D. As such, R&D activity could migrate to other established R&D hubs if Ireland's R&D tax credit does not keep up with the advancing needs of these business.

Question 5

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?

Our members have noted that staff recruitment at both the highly skilled level of PhD and third-level graduates, and recruitment of support and administration staff is in many instances funded by the R&D tax credit. In addition, the R&D tax credit generates further support and administration jobs in R&D companies to support these highly skilled workers. The view of professional accountants is that this aspect of employment creation may not be fully reflected upon in past economic reviews of the tax credit. The pervasive impact of the credit is seen as significant to the funding of support level jobs.

Given the positive impact the R&D tax credit has on promoting high quality jobs, the CCAB-I's view is that the rules regarding outsourcing work to subcontractors and third-level institutions should be relaxed to further the impact of the R&D tax credit on employment. While increasing the limits on subcontractors and third-level institutions may not generate additional employment in the claimant company, it should result in more overall activity in the economy. This measure would particularly benefit SMEs who financially may not be able to hire employees to carry out the R&D work at a particular time.

[3] Impact of the US economy on Ireland: A quantitative and qualitative analysis, National Treasury Management Agency

Question 6

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

As mentioned above, our members operate in diverse sectors. As such, number of R&D staff at PhD level or equivalent will vary accordingly. The R&D tax credit does fund the recruitment of highly skilled staff.

As noted in our answer to Question 5., the view of professional accountants is that the current limitations on outsourcing are too restrictive for the SME sector. This has a knock-on impact on third-level institutions. SMEs may not have the resources to employ PhD level staff. As such, a relaxing of the outsourcing restrictions for SMEs could result in more opportunities in the SME sector for individuals at PhD level or equivalent.

Given the availability of quality, world-leading researchers in Irish third-level institutions, the easing of the outsourcing limitations opens up the opportunity for more collaboration between our academic and commercial sectors.

Question 7

Section 766B Taxes Consolidation Act 1997 places limitations on the R&D 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?

In general, the payroll limits in place are considered adequate and, in our members experience, they apply infrequently in established companies. However, in circumstances where the limits have applied to restrict the refundable tax credit, the calculations are difficult, and the examples provided in current Revenue guidance are considered hard to follow and cumbersome, particularly for SMEs.

The limits also result in many start-up companies, particularly in the technology sector, being unable to receive a refund of the R&D tax credit, as they outsource their R&D activities to sub-contractors. With a view to easing the cash-flow burden in such circumstances, consideration should be given to allowing the payments to sub-contractors to be treated, solely for the purpose of the payroll liabilities limit, as notional payroll liabilities.

Question 8

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?

For a group entity with innovation at the forefront of its activities, it can be the case that the administrative cost and burden associated with making a claim for smaller projects within the group is such that potentially qualifying activities are excluded.

Our members support the introduction of a group claim mechanism, whereby a single entity within the group could be nominated to document that the scientific and accounting tests have been met for qualifying projects. A similar option is presently operated by HMRC in the UK. Where a company claims the R&D tax credit in the UK on four or more projects, detailed descriptions must only be provided for at least 3 projects (up to a maximum of 10), which between them cover 50 percent or more of the total qualifying R&D costs.

The view of professional accountants is that a similar approach could be implemented in Ireland. The option to make a group claim works on the basis that the evidence of existing systems and procedures within the group from the projects already documented in detail should be sufficient to provide the tax authorities with appropriate assurances that the risk associated with the group's entire claim is acceptable. At the same time, this approach ensures that mere administration does not act as a deterrent in making a claim for smaller projects.

Question 9

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?

Sections 766 & 766A Taxes Consolidation Act 1997 provide that the R&D tax credit must initially be credited against the corporation tax liability of the claimant company for the accounting period in which the relevant expenditure is first incurred. A company then has the option of carrying the relief back to the immediately preceding accounting period and crediting the relief against corporation tax arising in that year, thereby generating a refund. If there are insufficient corporation tax liabilities in the current and preceding years, the company may claim to have the excess repaid to them by Revenue in three instalments over 33 months from the end of the accounting period in which the expenditure was initially incurred (with the amount of excess credits refundable to the company limited to the greater of the corporation tax payable by the company in the 10 years prior to the preceding year, or payroll liabilities remitted in the current and preceding years). Any unused credit may be carried forward and credited against the corporation tax liabilities of subsequent accounting periods.

As noted already in this submission, the CCAB-I recommends accelerating the repayment of the refundable R&D tax credit from 33 months to 12 months. It is acknowledged that this will require a cashflow adjustment for the Exchequer. As such, the CCAB-I suggests that existing claims could be administered 'as-is,' with the 12-month repayment option applying to new claims only.

SMEs and the R&D Tax Credit

Question 10

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 militate against the introduction of a targeted element to the existing tax credit?

Minister Donohoe, in Budget 2020, provided for the introduction of a number of enhancements to the R&D tax credit for micro and small companies in particular which included an increase in the rate of credit and an enhanced method of calculating the payable credit. These measures were introduced subject to a Commencement Order pending State Aid approval from the European Commission. Such measures have not been introduced but would be welcome.

In terms of encouraging SMEs to claim the R&D tax credit, the CCAB-I's view, informed by our members, is that the following measures would greatly improve the uptake of the relief among SMEs:

- Simplification of the documentation requirements for SMEs.
- Simplification of the qualification criteria for SMEs.
- A pre-clearance system for first time claimants operated by Revenue.
- Improved Revenue guidance targeted at SMEs and sector specific activities.
- Offer an enhanced rate for small and micro companies of 50 percent.

Documentation requirements

Simplification of the documentation requirements for SMEs is consistently raised among professional accountants as a barrier to claiming the R&D tax credit. Unlike many larger companies, SMEs and start-up companies in particular often lack the financial resources to engage professional advice to prepare the appropriate documentation stipulated by Revenue. A reduced documentary requirement for SMEs would address a key factor currently prohibiting SMEs from considering an R&D tax credit claim. This should be achievable in a manner which preserves the integrity of the tax credit.

Qualification criteria – allocation of credit to employees

In terms of simplification of the qualification criteria, the view of professional accountants is that SMEs could benefit if the option to allocate the R&D tax credit to key employees was redesigned. Presently, the limitations make the option practically inaccessible. To make a surrender to an employee, the company must be profit-making, and the employee cannot be a director or a shareholder. Further, for SMEs any clawback falls on the company. This financial risk further discourages companies from even considering this option.

Qualification criteria – carry back of losses/changes in accounting policy

Many companies may change their accountancy policy or there may be an error in the accounts. This often necessitates amending prior year tax returns, as is also required where trading losses are being carried back. There is a lack of flexibility within the R&D provisions such that these amendments to historic tax returns may have knock-on implications on R&D cash refunds/amounts claimed in that particular year. Equally these amendments in tax returns related to accounting policies/loss carry backs may affect carry forward of R&D tax credit cash instalments available in future years. Further clarity around this would be welcome.

Qualification criteria – limits on subcontractors

In addition, the limitations on costs incurred on subcontractors and engaging third-level institutions should be relaxed for SMEs. Smaller companies must outsource R&D activities due to resourcing restraints. In contrast, larger companies tend to self-limit outsourcing so that the entitlement to tax credits is maintained. In the latter case, this can result in poorer quality outcome than if external staff had contributed. In the former case, it can result in the opportunity to innovate not being realised.

Pre-clearance system

Beyond simplifying and improving the rules for SMEs, professional accountants are of the view that the Revenue Commissioners should be given the resources to offer pre-clearance to first time claimants. In the UK, HMRC provide an "Advance Assurance" for SMEs which has brought much needed confidence to start-up SMEs. Advance Assurance gives companies a guarantee that R&D claims will be accepted for the first three accounting periods without enquiries by HMRC if the claim is in line with pre-agreed criteria with HMRC. This gives a company certainty that a project will qualify for the R&D tax credit. Therefore, the company will be able to devote its resources to conducting R&D activities rather than dealing with tax enquiries on the science test, accounting test and documentation obligations.

Telephone access to an expert in the Revenue Commissioners in the operation of the compliance of the R&D tax credit tailored to start-ups and the SME sector would be of great assistance in ensuring that a start-up or small company has confidence that they have met the requirements for a valid claim.

Enhanced Revenue guidance

In conjunction with instituting an "Advance Assurance" option for SMEs, as well as a dedicated telephone service, the view of professional accountants is that the utility of the Tax and Duty Manuals prepared by the Revenue Commissioners could be greatly improved if guidance was targeted at SMEs and sector specific activities. This could include standardised scientific tests garnered from previous experience with taxpayers and include practical, worked out examples of R&D tax credit claims.

Enhanced credit for small and micro companies

Lastly, in Finance Act 2019, the Government announced the introduction of a 30 percent R&D tax credit for small and micro businesses. We understand that this is still subject to a Commencement Order pending State Aid approval from the European Commission. The CCAB-I acknowledge the impact of the public health restrictions in progressing the approval, however we are calling on the government to now give effect to these changes.

The CCAB-I's recommendation is that the government should further increase the rate to 50 percent of qualifying expenditure for small and micro companies. In line with our recommendations later in this submission and conscious of State Aid restrictions, this further enhanced credit could apply to small and micro enterprises innovating in the area of sustainability and 'green' technology.

Question 11

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

The CCAB-I's recommendation to accelerate the refund of R&D tax credits in line with U.S. tax regulations will also greatly benefit SMEs. Many SMEs experience cash-flow difficulties in the early stages of their R&D cycle. The infrastructure is already in place to provide this additional support to SMEs when they most need it. Further, given that the R&D tax credit is proven in its effectiveness as a tax relief, it is an appropriate policy measure for encouraging productivity and growth of Irish SMEs.

The Knowledge Development Box (KDB)

Question 12

Do you have any views as to how Ireland's KDB could develop in the evolving international tax environment? *In responding to this question, please have regard to the Subject To Tax Rule (STTR) element of the Pillar Two agreement and its potential consequences for KDB claimants and the Irish tax system as a whole.*

The view of professional accountants is that for multinational enterprises who may carry on qualifying activities, the requirements of a valid KDB are seen as being very complicated and onerous. It is understood that many other MNEs consider that the KDB is irrelevant in the context of their particular operations.

For the KDB to become a meaningful policy offering, the rules need to be simplified. Provision also needs to be made for providing a benefit to loss-making companies who may be carrying on qualifying activities.

Question 13

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

In 2016, the number of claimants of the KDB stood at 10 with a cost to the Exchequer of €6.1 million. In 2020, the number of claimants was 17 with a cost of €16.3 million reported[4]. CCAB-I recognises that a claimant company has up to 24 months to make a claim for KDB relief but from engagement with members does not believe that a surge in claimants can be expected in the coming months.

The level of documentation and other administrative requirements to support a KDB claim is viewed as too onerous. When combined with the uncertainty regarding whether activities qualify in the first instance, businesses do not see sufficient value investing time and resources in making a claim.

The view of professional accountants is that while profitable indigenous groups would be the ideal candidates for making a claim, such entities are in short supply.

Question 14

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 of the relief, but which fall outside the current rules? *In replying, businesses should be cognisant of the requirement for the KDB to be compliant with the OECD BEPS Action 5 agreement on the modified nexus approach for IP regimes.*

The CCAB-I believes that the key difficulty with the KDB is the overall complexity of the rules. Given the low volume of claims, it is difficult to provide meaningful insight in relation to specific difficulties.

The CCAB-I notes that it would be helpful if the Revenue Commissioners developed a forum for sharing the experience gleaned from audits conducted on KDB claims. This could provide meaningful insights for companies and advisors considering making a claim and could address the issues around uncertainty of application of the rules.

[4] Corporation Tax – 2021 payments and 2020 returns, Revenue Commissioners

Closing Comments

Question 15

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?

The key issue facing the global economy is that of climate change. The solution to the global climate crisis will be technological. To give Irish companies the best possible opportunities to contribute to the global effort, a further enhanced R&D tax credit could be a reliable policy tool to stimulate our contribution.

For example, the Climate Action Plan 2021 sets Ireland on a path to reach net-zero emissions by no later than 2050 with a target of a 51 percent reduction in overall greenhouse gas emissions by 2030. To support continued economic growth and the expected increase in population, Ireland's electricity supply will need to grow but will need to grow in a greener manner that supports our decarbonisation journey. The Climate Action Plan sets out that the production of renewable energy must increase by 80 percent by 2030. To achieve this, innovative technologies will be required to develop solutions in energy production and storage, and carbon sequestration.

CCAB-I believes that the R&D tax credit should be enhanced to support the development of technology to make renewable forms of energy cheaper and more readily available to businesses and households alike. The R&D tax credit has an established administrative infrastructure that could be refined to encourage research and development in renewable energy. For example, the scope of the tax credit could be extended to include 'sustainability innovation,' thereby widening Revenue's definition of innovation, which will be critical to developing new energy-efficient solutions.

In this regard, the CCAB-I recommends the adoption of a 50 percent R&D tax credit for R&D in the areas of solar, wind, biomass, or hydro energy, and other green technologies. The credit could be further targeted at companies developing patentable advancements in the aforementioned areas.

Yours faithfully,

Peter Vale

Chair, CCAB-I