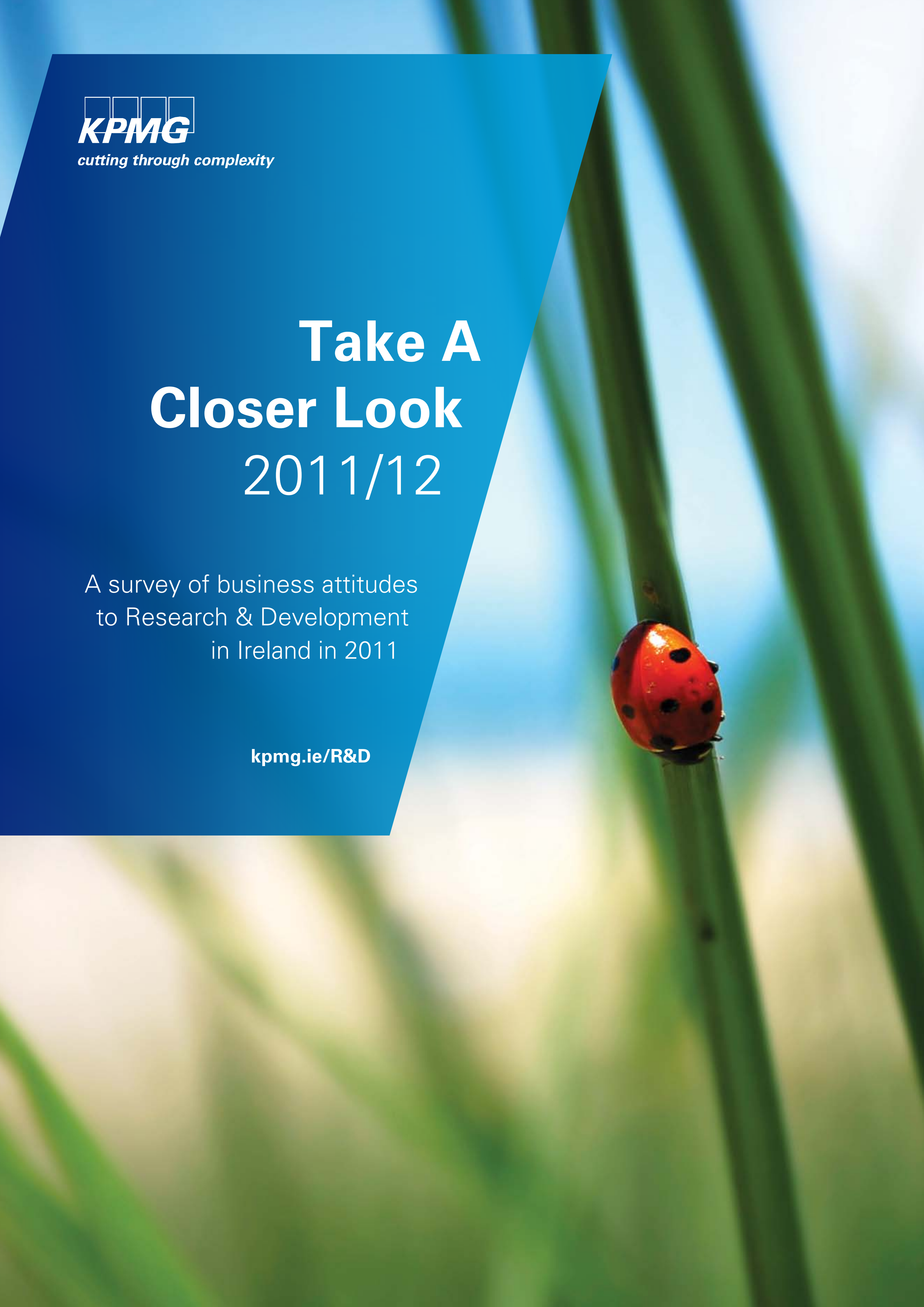

KPMG
cutting through complexity

Take A Closer Look 2011/12

A survey of business attitudes to Research & Development in Ireland in 2011

kpmg.ie/R&D

Foreword

In the context of a challenging global and domestic economy a key question for Ireland is 'what can we do better in order to improve our attractiveness as a place to do business'?

There is near universal support for the principle of encouraging innovation in helping chart a path to sustainable economic recovery and development. Thus for the third consecutive year we have commissioned RedC Research to assess attitudes to Research and Development (R&D) with particular emphasis on the tax treatment of this vital activity.

This report highlights a number of issues, including the potential employment and investment opportunities that may result from some changes in the current legislation. It is important to stress that innovation and R&D is not the preserve of large scale international enterprises and to recognise its role in the development and success of dynamic domestic businesses.

Thus we hope this report will make a contribution to the debate about how best to increase the levels of innovation and R&D in Ireland. We hope in particular that it will help inform government tax policy as to what is the best approach in developing a more supportive environment for R&D.

We also hope it is a useful resource for business, government, academia and everyone with an interest in the development of innovation in Ireland.

Terence O'Rourke
Managing Partner
KPMG in Ireland

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Executive summary

'Take a Closer Look' is a research survey conducted by RedC among a representative sample of Irish business in autumn 2011. The research was commissioned to establish industry attitudes to the current important and valuable R&D tax credit regime and to determine how opinion compares to the findings of the 2009 & 2010 surveys.

This unique piece of research allows us to review attitudes over a three year period in which the Government have given strong commitments to enhance support for innovation in the face of tough economic times. In particular, the authors were interested in establishing:

- The extent to which the credit is being claimed and whether this has changed over the course of the past year
- The extent to which credits may act to influence employment and investment behaviour
- Whether simple improvements to the scheme could encourage further uptake of the scheme and ultimately increase employment and investment in Ireland.

The key findings are outlined under the following headings:

Business environment

In 2011, 24% of companies surveyed feel that the environment for business innovation in Ireland is more attractive than in other countries, while the majority of companies (61%) feel it is the same. This attitude towards business innovation in Ireland is a very positive sign amid the often gloomy outlook associated with current economic circumstances.

Claiming the R&D tax credit

Numbers claiming

In line with the previous two years' results less than one in five companies (i.e. 18% of those surveyed) are claiming the R&D tax credit. The main reason given by respondents for not claiming the credit once again relates to companies believing they are not carrying out the types of activities that could be eligible for the credit. Given the wide range of activities that can qualify, this is a surprisingly low proportion of companies. In addition, 29% of those surveyed have applied for an R&D grant. Given that the qualification criteria for R&D grant funding and the R&D tax credit are broadly similar, it is likely that at least 10% of companies surveyed are unaware that they may be carrying out the types of activities for which they are entitled to avail of the credit.

Reasons for not claiming

The proportion of companies who have not claimed due to lack of awareness has decreased significantly from 18% last year to 6% this year. While more companies may be aware of the existence of the scheme, it is clear, from the noted difference in those that apply for grant and tax credit funding, that they are not aware of whether they could qualify to claim under the scheme. More needs to be done to make Irish businesses aware of the funding that is available to them, and to provide information with respect to the types of activities that can qualify for the credit. This should act to encourage more companies to increase their level of R&D and innovative activity.

Increase in Revenue audits

There has been a rise in the portion of claims subjected to audit since our 2010 report. Over one in five (22%) of companies who had claimed the credit have been subjected to a Revenue audit of their claim, compared to just 6% last year. The results of the survey support our findings that there is a clear step up in both the frequency of audits and the rigor of the audit process. This is a very significant finding and, in light of the implications of 'getting it wrong', highlights the necessity for the claimant to be fully prepared prior to submitting a claim.

Impact of the credit

Investment in Ireland

The key factors rated as 'important' in influencing investment decisions by companies included: access to a skilled workforce (81%); the cost of labour (80%); other direct and indirect costs (74%); and the 12.5% corporate tax rate (72%). Just over one quarter of those surveyed rated the R&D tax credit as an important factor impacting on investment decisions. In addition, in line with the last two years' results, over one in four companies (26%) would expect to see a significant impact on R&D investment if the R&D tax credit were increased from 25% to 35%.

Employment

Almost half of companies surveyed (45%) stated that they would hire more personnel if the tax credit were increased, with little variation between small, medium and large companies. This is a significant increase from the 36% last year who felt that they would increase recruitment if the tax credit was raised. Similar to the last two years' results, there is strong potential for increasing employment if the current level of tax credit increases from the present level of 25% to 35%. 22% of companies also said that they would find it very easy to hire suitable qualified personnel if the credit increased.

Necessary changes to the scheme

Removal of uncertainty

The credit system as it currently stands presents significant uncertainty to claimant companies. Companies are uncertain as to whether they qualify for the scheme. Companies that submit claims often do so without the certainty that their claim will be accepted when audited. This often acts to reduce the effectiveness of the credit as an incentive mechanism and also as a key factor in decision making (i.e. if there is no certainty with respect to whether a claim for the credit will pass an audit, it cannot be factored into investment related decision making). Almost half of those surveyed would be more likely to make a claim for a credit if there was greater certainty provided by the scheme. In addition, 63% of those surveyed felt that Revenue should provide more hands-on support and guidance for companies that wish to claim the R&D tax credit.

Cash refund in first year

At present, a cash refund of the credit is generally paid by way of three instalments over a thirty-three month period. While the cash refund mechanism is undoubtedly a clever and positive element of the credit scheme, an important change is needed to enable companies, particularly SMEs, to access a greater portion of the cash refund in the year in which the claim is made. Almost half of those surveyed felt that this change would encourage them to increase the level of R&D activity they carry out. A quicker return of the credit would allow SMEs a greater opportunity to continue investing in R&D activities at a time when they are being starved of cash flow.

Is the base year method appropriate?

The Irish R&D tax credit regime, unlike most of our international competitors, operates on an 'incremental' basis. This means that a credit is given for R&D spend that is in excess of R&D spend in the 'base' year (i.e. 2003) rather than simply providing a credit for total R&D spend. This is an unequal and inequitable system which penalises companies who have carried out R&D in the past. It is unsuitable for today's climate where R&D budgets are under significant pressure and costs are being cut. A volume based approach (utilised by many competing jurisdictions) allows every cent spent on R&D to qualify when submitting a claim. Over half of all respondents agreed that a volume based approach would be preferable to the current base year approach.

Simpler and more generous scheme for SMEs

Almost two in every three small companies surveyed in 2011(64%) believe that a simplified and more generous R&D tax credit would lead them to increase R&D within their organisation. This is a notable increase on the 2010 figure of 58%.

Putting the survey in context

What is the R&D tax credit?

The research and development (R&D) tax credit was first introduced by the Finance Act 2004. It outlines that any qualified company (or group of companies) with qualifying R&D activities is entitled to a tax credit valued at 25% of the expenditure incurred on these activities, in any given year, to the extent that it is incremental to expenditure on R&D activities in 2003 (the 'base' year).

What do we need the credit for?

The R&D tax credit is an important part of Ireland's portfolio for attracting foreign direct R&D investment within a highly competitive international context, whilst also incentivising innovative activities amongst indigenous companies. It acts in conjunction with other measures to support innovation and employment in high tech activities with a view to making Ireland a leading center for conducting R&D. The primary reasons for a need to increase R&D activities include:

1. The Government aims to establish Ireland as a location for world-class research and innovation. This should act to further drive foreign direct and indigenous R&D investment, increase employment, and increase exports as new products are developed for the international market. R&D activities are a key component of innovation. They are also inherently risky, thus financial support to encourage potentially rewarding risk-taking behaviour is required, particularly in challenging economic times.
2. Developing an innovative European Union. The European Commission Europe 2020 Strategy has set a target for EU countries to invest 3% of GDP in R&D activities by 2020.

How are we doing so far?

The 'EU Industrial R&D Investment Scoreboard 2010' noted that sixteen Irish companies were in the top 1,000 companies for R&D expenditure in the EU in the fiscal year 2009. According to the most recent R&D statistics produced by Forfás in their report *'Business Expenditure on Research and Development 2009/10'*, Irish businesses are continuing to invest in R&D in spite of the recession as they continue to see the importance of bringing new and innovative ideas to the marketplace. This is a positive sign as there can be a tendency to scale back investment in innovation and R&D in recession. Clearly incentives such as the R&D tax credit should be of great benefit to these companies.

With respect to the EU 2020 target, according to the latest statistics published by Forfas, in 2009 Irish expenditure on R&D was 1.77% of GDP (compared to an EU average of 2.01%). While Ireland appears to be heading in the right direction, continued investment will be required for Ireland to meet the EU target of 3% of GDP.

The case for change

KPMG have stated the case for simple, effectively cost-neutral changes that could provide a more effective incentive for large companies and SMEs carrying out R&D in Ireland.

In the 'Programme for Government', the Government stated that it would, subject to a cost-benefit analysis, consider some changes to the scheme for SMEs (such as a "holiday" from the first €100,000 of base year expenditure for smaller compANES and an automatic entitlement to the credit where an R&D grant has been awarded). While we welcome the proposed changes, we feel that they do not go far enough. This survey probes industry's opinion to some of the key changes that we believe are necessary to provide a world-class incentive that is suitable for all companies.

Background and methodology

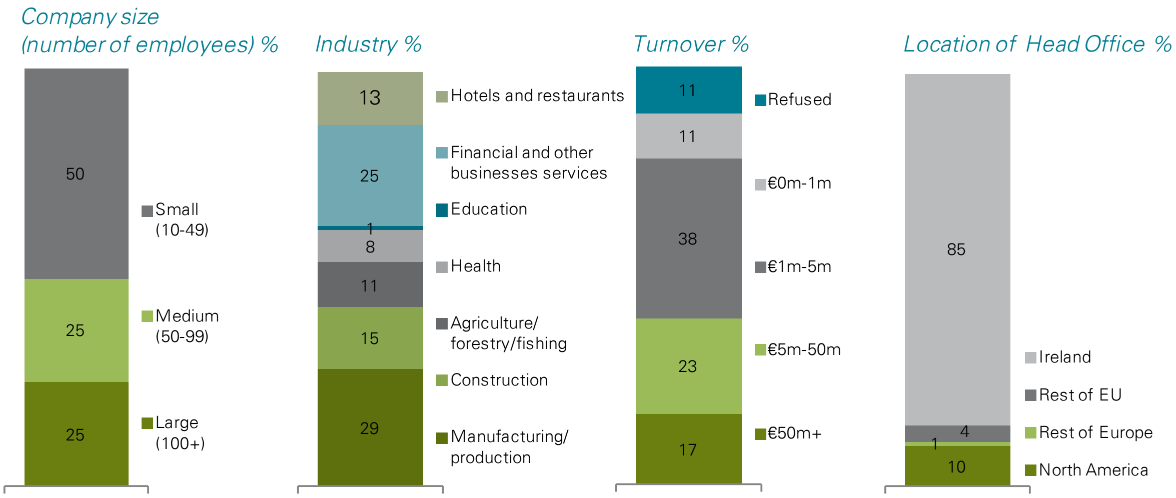
This is the third annual KPMG survey designed to establish the impact of Ireland's R&D tax credit on attracting, retaining and promoting investment in Ireland's economy. We set out to gain a greater understanding of attitudes towards the R&D tax credit regime, to determine how widely understood the R&D tax credit is and to suggest what can be done to improve the regime.

Our research was conducted across a representative sample of Irish business with quotas placed on company size to ensure a nationally representative sample. Thus it is important to note that the survey was not unduly weighted towards traditional R&D sectors such as pharmaceuticals, biotech or medical devices.

- 100 telephone interviews were conducted in Autumn 2011 surveying a wide range of businesses in various sectors from smaller businesses with less than fifty employees to larger firms with over 100 employees
- No business in the research sample had less than ten employees
- Of the businesses surveyed, 60% had a turnover of up to €5m, 23% between €5m and €50m, and 17% of €50m+
- Interviews were conducted with the CEO/Managing Director or the Owner/ Manager of the business.

Analysis of sample

(Base: All businesses – 100)



Survey findings and analysis

Claim process

How many companies have claimed the R&D tax credit?

We set out to discover whether the number of companies claiming the R&D tax credit has increased or remained consistent with the level observed over the past two years. It was also hoped to identify the reasons why some businesses are not claiming the credit, when they may be entitled to do so.

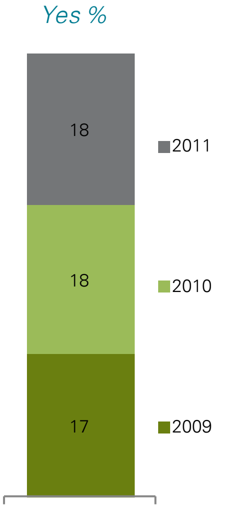
As in 2010, only 18% (17% in 2009) of companies surveyed have claimed an R&D tax credit. Only 14% of small companies (12% in 2010 and 6% in 2009) have claimed R&D tax credits compared to 22% of medium to large sized companies (24% in 2010 and 28% in 2009). However, it is expected that larger companies would be more likely to claim the R&D tax credit considering their greater access to resources.

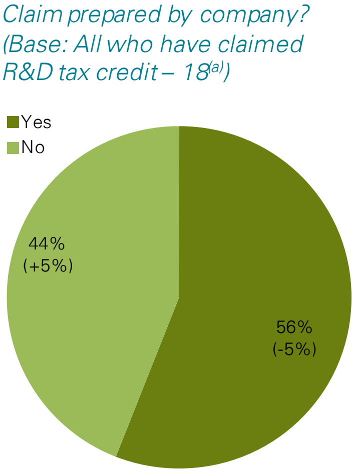
In our experience, most companies in the manufacturing/production and financial services sectors are continuously innovating, developing new, or improving existing products/processes. These activities can often constitute eligible R&D activities. As 25% of respondents are in the financial services sector, and 29% are in the manufacturing/production sector, it remains surprising that only 18% of companies have claimed the R&D tax credit.

In line with the previous two years' results, significantly fewer companies surveyed are claiming the R&D tax credit compared to those who have applied for R&D grant funding (i.e. 18% versus 29%). Given the similarity between the types of activities that qualify for R&D grant funding and R&D tax credits, the disparity between claiming the two types of funding continues to be surprising. More needs to be done to make Irish businesses aware of the funding that is available to them and this in turn may encourage more businesses to consider undertaking R&D projects.

Experience claiming R&D tax credit

(Base: All businesses – 100)





*Less than **1** in **5** companies (**18%**) have ever claimed the R&D tax credit – the same as last year. Of those who have claimed the credit, more than half (56%) have prepared the claim themselves.*

Note: (a) Very small base size.

Reasons for not claiming the R&D tax credit

The dominant reason for not claiming the R&D tax credit appears to be a belief that the credit is not applicable to the company, mainly due to a perceived lack of eligible R&D activity.

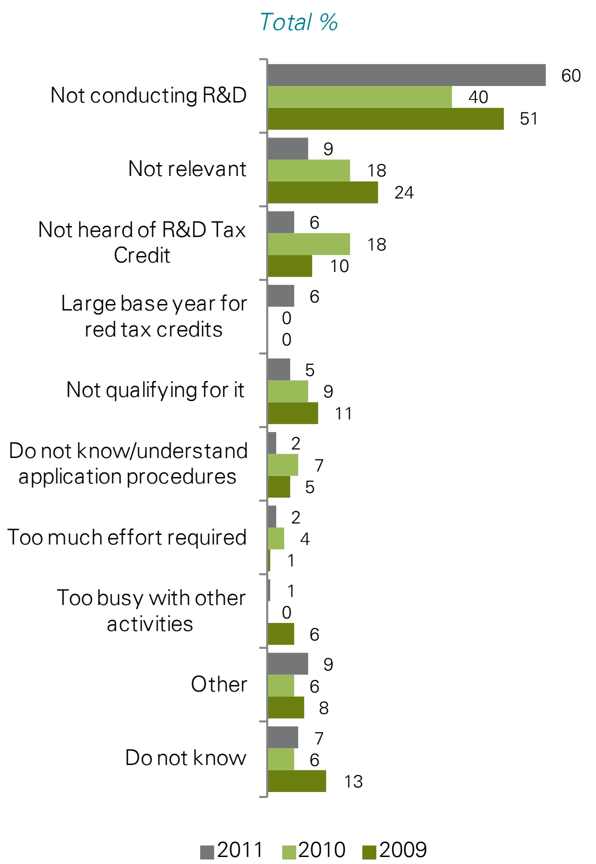
In this year's survey, 69% of respondents believe that the R&D tax credit is either not applicable or not relevant to them. This has increased from the 2010 figure of 58%, while in 2009, 75% of companies believed this to be the case.

In 2010, a major reason for companies not claiming the tax credit was a lack of awareness of the tax credit (18% of companies surveyed had not heard of the tax credit). However in 2011, this figure has reduced by two thirds to just 6%. While this is indeed a positive sign, it is important to note that the level of companies applying for R&D grant funding (which has broadly similar qualification criteria to the R&D tax credit) is over 50% higher than those applying for R&D tax credits. While general awareness of the scheme appears to have increased, perhaps there remains a lack of awareness as to the types of activities that can qualify for the credit. As a result, at a minimum, 10% of those surveyed could be missing out on the R&D tax credits they are entitled to claim.

Based on our experience, it is still very common for companies who are eligible to claim a credit to believe that they are not engaged in qualifying R&D activities. We remain of the belief that the Revenue guidance on what constitutes eligible R&D activities should be re-examined with a view to providing the potential claimant with enhanced, more detailed guidance with respect to the nature of R&D activities and a service which enables the potential claimant to establish whether they are entitled to claim before doing so.

Reasons for not claiming R&D tax credit

(Base: All businesses who have not claimed R&D tax credit – 82)



The main reason for not claiming R&D tax credit remains the perception that it is not applicable to the company due to a perceived lack of R&D activities.

Revenue audits of claims

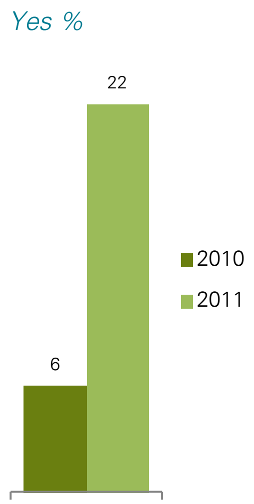
Over one in five of companies who had claimed the credit have been subjected to a Revenue audit of their claim. This is almost a fourfold increase in the portion of claims subjected to audit since our 2010 report. It is clear that Revenue have actively increased their R&D tax credit audit activity over the past year. The findings of this survey reflect the clear change in Revenue's approach to auditing claims.

R&D tax credit audits are conducted in accordance with the Revenue Code of Practice for Audits. Any reduction in the amount of credit available to the tax payer as a consequence of the audit may be subject to the penalties set out in the code. This could result in the repayment of the over-claimed amount in addition to interest, penalties and possibility of publication.

We have found that Revenue is taking an increasingly robust line with respect to issues arising from R&D tax credit claims. It is therefore crucial that the claimant is fully prepared for the occurrence of a Revenue audit of the claim prior to submitting the claim to Revenue.

R & D tax credit claim subject to revenue audit

(Base: All who have claimed R&D tax credit – 18[a])



*More than **1** in **5** companies who had claimed for R & D tax credit have been audited by Revenue.*

Note: (a) Very small base size.

Impact on investment decisions

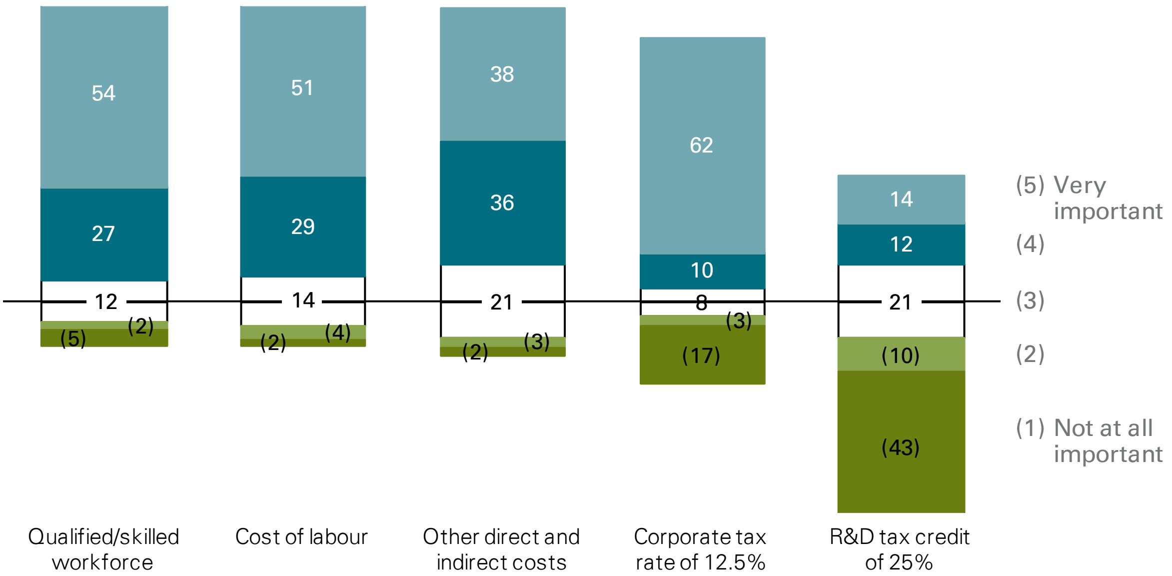
What factors impact on a company's decision to make an investment in Ireland?

- The major factors impacting on a company's decision to invest in Ireland are the access to a skilled workforce and the cost of labour (respectively 81% and 80% of respondents cited that these factors were either important or very important)
- The importance of the 12.5% tax rate for investment decisions remains important in 2011 with 72% of companies rating it as important – a 3% increase from 2010. Given continued speculation concerning a Common Consolidated Corporate Tax Base, we expect that this issue will remain critical to investment decisionss
- Over a quarter of respondents (26%) continue to believe that the R&D tax credit is an important factor when deciding to invest in Ireland.

These results demonstrate that, as expected, the R&D tax credit is not the dominant factor in determining the location of investment within Ireland. It does, however, appear to be an important element of Ireland's offering with respect to undertaking activities within the State.

Based on our experience of working with numerous companies undertaking R&D in Ireland, if a higher level of certainty (associated with both claiming the credit and retaining the R&D tax credits claimed) was provided, the credit would play a much more significant role in the decision to locate R&D investment in Ireland.

Impact on investment decisions



Access to a qualified workforce has the biggest impact on investment decision followed by cost of labour. The R&D tax credit is important to a quarter of all companies.

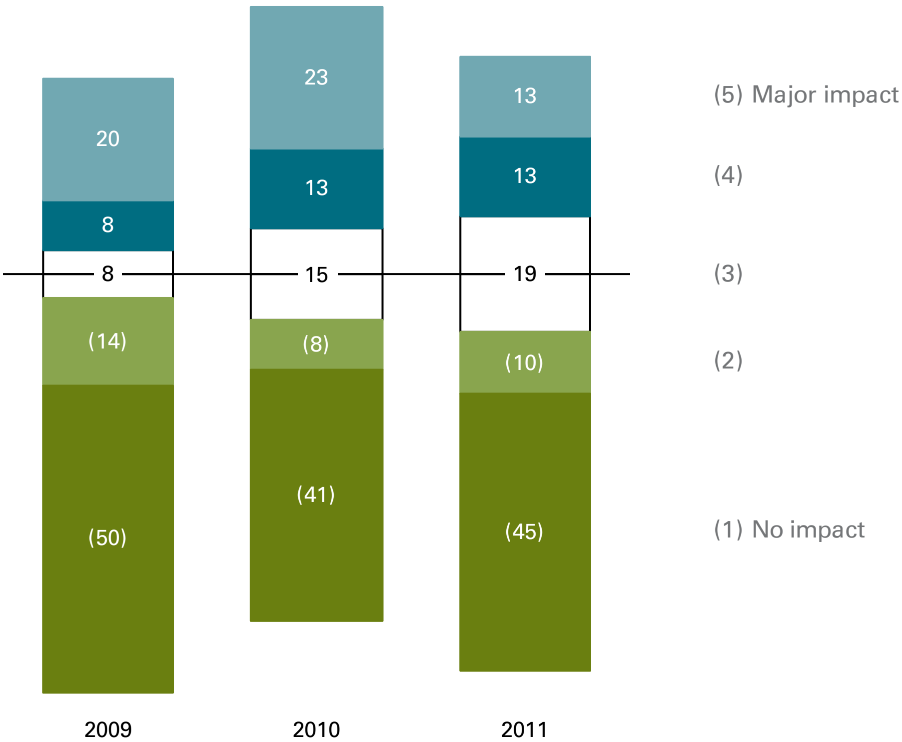
Impact of increasing the tax credit rate to 35%

The R&D tax credit now provides a benefit of 25% of incremental R&D expenditure over and above R&D expenditure incurred in the base year (i.e. 2003). Whilst one of the most attractive regimes available internationally, the Irish tax credit is significantly less attractive than schemes in a number of other jurisdictions such as Australia, which currently offers up to 45% refundable tax credit.

We asked those surveyed whether it is it likely that a further increase in the Irish R&D tax credit would lead to more investment in Ireland. Over one quarter (26%) of companies would expect a significant impact on R&D investment if the R&D tax credit were increased from 25% to 35%. When considered alongside the potential additional tax revenue that further investment could raise (e.g. payroll taxes, PAYE and corporate tax), a credit of 35% has the potential to yield net gains to the exchequer and at the very least could prove revenue neutral.

Expected impact of R&D tax credit Increase to 35% on R&D investment

(Base: All businesses – 100)



*Over **1** in **4** companies (**26%**) would now expect a significant impact on R&D investment if the R&D tax credit were increased from **25%** to **35%**.*

Employment opportunities

Changes in the Irish and world economy as a result of the economic downturn continue to pose significant challenges, particularly for employment creation. Furthermore, access to a readily available pool of skilled labour remains a key issue for those making investment decisions in any market. This survey once again suggests that the availability of R&D tax credits can be hugely relevant in this context.

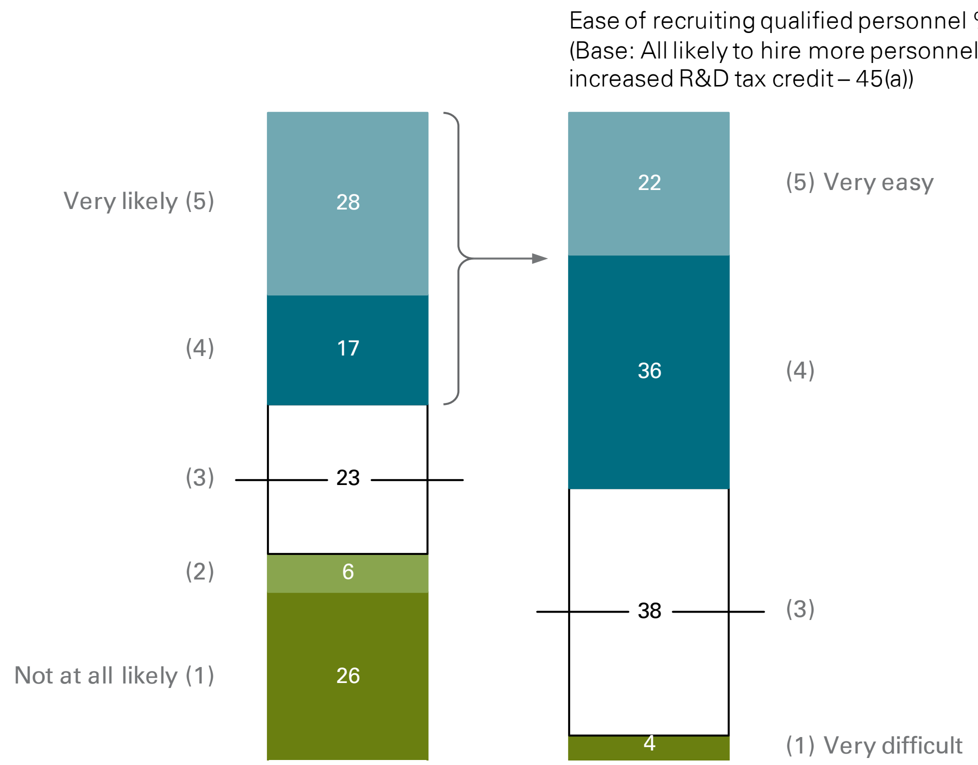
To facilitate high value job creation, companies must be continuously encouraged to invest and the R&D tax credit is an important mechanism to facilitate this. For every employee conducting R&D, the R&D tax credit can effectively 'refund' up to 25% of the cost.

This survey indicates that nearly half (45%, compared to 36% in 2010) of the companies would hire more personnel if the rate of R&D tax credit was increased to 35%. The interest in hiring more staff as a result of an enhanced credit is relatively similar amongst smaller companies (48%) as it is for medium or large sized businesses (42%). This increase in the rate of the R&D tax credit could allow SMEs to increase R&D activity and add skilled individuals to their workforce, thus providing a greater ability to compete in the Irish and world economy.

In 2011, 58% of the companies surveyed would find it 'easy' or 'very easy' to hire more qualified personnel. This has increased dramatically since 2010 when just 39% of companies felt they could easily hire qualified personnel. Only 4% of respondents thought that it would be 'very difficult' to hire qualified personnel.

Increased R&D tax credits resulting in hiring more personnel

(Base: All businesses – 100)



Note: (a) Small base size.

Necessary changes to the scheme

Removal of uncertainty

What do we mean by 'uncertainty'?

The overriding principle of the credit is that it should act to 'incentivise' the undertaking of inherently risky behaviour by providing a partial cushion for the costs associated with undertaking R&D. However, the mechanism by which it currently operates results in a significant degree of uncertainty associated with the credit claim process, which renders it less effective as a means to incentivise R&D.

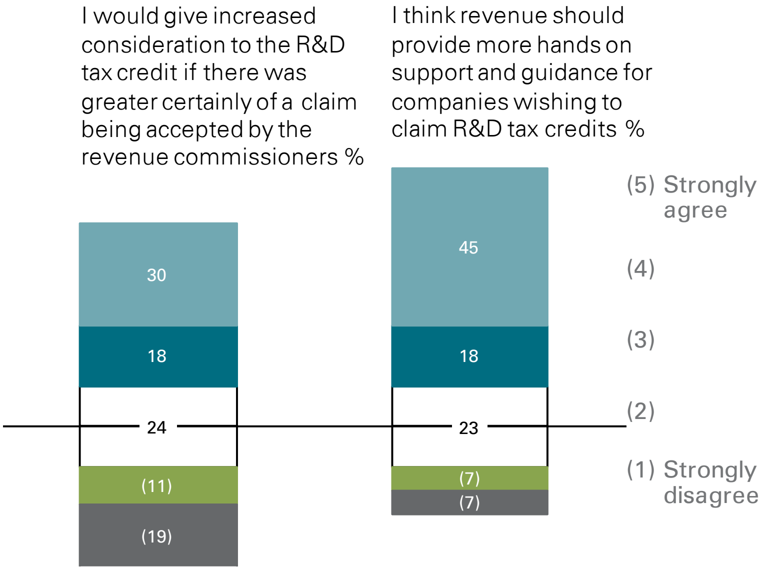
The scheme operates under the principle of self assessment. This means that a claim for a credit is made by way of a claimant's tax return, with no additional supporting documentation submitted. Claimants often mistakenly believe that their claim has been 'accepted by Revenue' because they have received a refund in respect of their claim. The receipt of a refund of corporation tax or a cash payment in respect of an R&D tax credit claim does not mean that the claim has been accepted by Revenue. Revenue reserve the right to audit the claim for four years after the return has been made and in our experience they frequently exercise this right.

Currently the scheme presents uncertainty in a number of areas including:

- Whether the activities carried out would be deemed eligible
- Whether the treatment adopted for expenditure is appropriate
- Whether there is sufficient supporting documentation to substantiate the claim
- Due to the presence of base year expenditure, what benefit will actually be derived by the company if they successfully pitch for a project to be located in Ireland?
- Due to the Revenue audit window of four years (compared to the claimant's window of one year to make a claim), when will the claimant know whether or not their claim is correct? When can they confidently spend the money?

Role of Revenue when claiming R&D tax credits

(Base: All businesses – 100)



*Almost **2** in **3** (**63%**) feel that Revenue should provide more guidance/support for companies wishing to claim the tax credit – this is particularly the case for smaller companies. Almost half (**48%**) express they would give the credit more consideration if there was greater certainty of a claim being accepted by Revenue.*

Why does it matter?

We have found that Revenue are taking an increasingly robust line with respect to issues arising from audits of claims. For example, to the extent that a claim has been overstated (as a result of including ineligible activities or incorrect inclusion of expenditure) or is unsupportable (i.e. does not have sufficient documentation to substantiate either the activities carried out or the expenditure incurred), the claimant will face repayment of part or all of the credit. In addition, Revenue are now seeking interest, and penalties, and in some cases are mentioning publication.

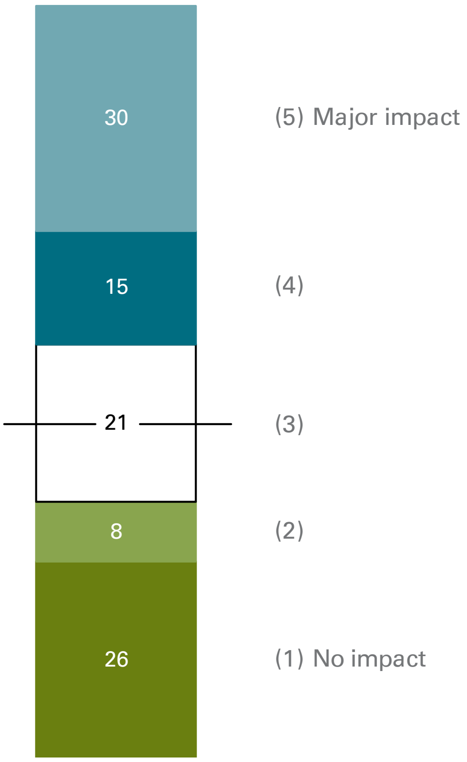
The need for certainty is reflected in the findings of the survey, which demonstrate that almost half of those surveyed would be more likely to make a claim for a credit if there was greater certainty provided by the claim process. In addition, 63% of those surveyed felt that Revenue should provide more hands-on support and guidance for companies that wish to claim the R&D tax credit.

Cash refund in first year

As noted, a cash refund of the credit is generally paid by way of three instalments over a thirty-three month period. While the cash refund mechanism is undoubtedly a very positive element of the credit scheme, an important change is needed to enable companies, particularly SMEs, to access 100% of the cash refund in the year in which the claim is made. Almost half of those surveyed felt that this change would encourage them to increase the level of R&D activity they carry out. A quicker return of the credit would allow SMEs a greater opportunity to continue investing in R&D activities at a time when they face cash flow challenges. We would strongly encourage the Government to consider implementing this change.

Possible impact of 100% R&D tax credits in cash in the first year of claim on company's R&D activities

(Base: All businesses – 100)



*Almost half (**45%**) of all companies feel that a 100% cash payment in the first year, rather than staggered payment over 33 months, would encourage more R&D activities.*

Is the base year method appropriate?

The Irish R&D tax credit regime, unlike most of our international competitors, operates on an 'incremental' basis. This means that a credit is given for R&D spend that is in excess of R&D spend in the 'base' year (i.e. 2003), rather than simply providing a credit for total R&D spend. This is an unequal and inequitable system that penalises companies who have carried out R&D in the past. It is unsuitable for today's climate where R&D budgets are under significant pressure and costs are being cut.

There is a large number of companies who invested heavily in R&D in Ireland in 2003 who are effectively being penalised for their historical R&D activity. Those that carried out R&D in 2003 are in a position whereby they are receiving less (if any) benefit from their R&D expenditure than their counterparts who either arrived in Ireland or commenced to carry out R&D activities post 2003. As a result, they will find it more challenging to compete with other non-Irish locations for the next mobile R&D project.

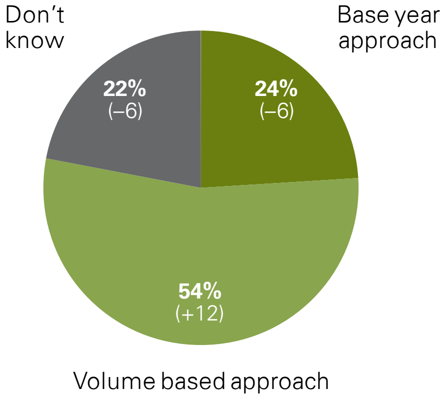
We welcome the Government's initial acknowledgement of the necessity to address the base year issue for smaller companies in the 'Programme for Government' earlier this year. However, we feel that the proposed changes (i.e. €100,000 base year holiday) do not go far enough to address this fundamental issue and would recommend that an alternative to the base year is implemented if we are to remain competitive with other international jurisdictions.

We remain of the view that a Volume Based Approach ('VBA') is more equitable, whereby every cent of eligible spend that a company incurs qualifies for the R&D tax credit. This is the approach adopted by most competing jurisdictions around the world and without it, Ireland remains almost certainly at a competitive disadvantage.

A move to a VBA to calculate R&D tax credits remains the most preferred choice among respondents with more than half of those surveyed (54% in 2011, 42% in 2010) agreeing with this approach.

Base year versus volume based approach

(Base: All businesses – 100)



The majority of companies prefer a volume based approach to the R&D tax credit. This is particularly the case among medium/large companies.

Simpler and more generous scheme for SMEs

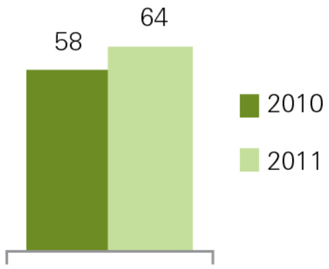
It is clear that the credit, as it is presently designed, does not benefit SMEs to the same extent as larger, Multinationals. The current 'one size fits all' approach does not take account of the differences presented by different sized entities, i.e. resources available and the nature of R&D activities carried out by them. There is a clear need for a separate, more generous and simplified R&D tax credit scheme for SMEs in order to promote and increase R&D activity within the SME sector. This fact has been recognised in the UK where they have successfully implemented separate large company and SME R&D tax credit schemes.

As mentioned previously,almost two in every three small companies surveyed (64%) in 2011 believe that a simplified and more generous SME focussed R&D tax credit would lead them to increase R&D within their organisation, as compared with 2010 (58%).

Possible impact of a simplified and more generous SME specific R&D tax credit on increased R&D investment

(Base: All businesses with less Than 50 employees - base = 50)

Yes %



*Almost **2** in **3** smaller companies believe that a simplified and more generous R&D tax credit would lead them to increase R&D within their organisation – this is an increase from 2010.*

Conclusions

- We believe that this research provides a timely, actionable and relevant assessment of how well Irelands' current R&D tax credit regime is working. It also highlights the potential benefits of changes in tax legislation in keeping with current economic circumstances
- The reaffirmation of Ireland's 12.5% Corporation Tax has proven an essential part of Ireland's business appeal. We would also like to reiterate the need to ensure that other related factors combine to build and strengthen this attractiveness - including an effective R&D regime. This remains a key aspect of investment decision making and has the potential to be a catalyst in helping create highly skilled jobs at a time of considerable economic challenges. One of the most important findings is the significant increase this year in those stating that they would hire more staff if the credits were increased. At the very least this should trigger an assessment of the extent to which some aspects of the R&D regime are fit for purpose
- It is widely accepted that economic stability and sustainability requires us to encourage innovation and entrepreneurship. Importantly, this applies not just to multinational organisations, but also to the encouragement of indigenous businesses in every sector and at every stage of their development. A small, open export oriented economy requires this balance between multinational business and domestic firms in its economic structure. Further developing a R&D friendly environment can also help strengthen linkages between these businesses and helps domestic businesses in particular move up the value chain. Despite the number of surveyed claimants remaining static, we welcome the trend noted in our 2011 survey of a significant reduction in those not claiming a credit due to lack of awareness (down from 18% in 2010 to 6% in 2011)
- We have observed a fourfold increase in Revenue audits of R&D tax credits since last year's survey. While this finding is to be expected, given the valuable, cash paying mechanism in place and the current economic climate, it is a clear illustration of the increasing need to ensure that a claim is properly made and is fully supportable before it is submitted to Revenue.

Recommendations

- So what should we consider changing? Other small European economies continue to show a consistently higher level of R&D activity. We believe that the growth of R&D in the SME sector for example could be a major factor in the growth of Ireland's knowledge-based economy – if an SME specific regime, similar in approach to other countries, is put in place
- In addition, we note that the current regime was put in place in different economic circumstances and thus we still implement a 'base year' system where spend is compared with 2003 in assessing potential eligibility. This no longer makes any sense and given the downward pressure on costs and budgets and puts us at a competitive disadvantage compared with many other markets
- The issue of where the R&D Tax Credit should be booked – 'above or below the line' also remains unsolved. It is critical that this issue is actively addressed and certainly be brought to correct treatment – Ireland is losing out on a competitive advantage that can be gained at no extra cost to the Exchequer. We also remain strongly of the view that qualifying spend is moved to a volume based approach which would have the effect of encouraging R&D by making every cent invested in R&D allowable in submitting a claim

- Whilst the R&D Tax Credit has certainly helped to increase investment in R&D in Ireland, a lot more could still be done to drive awareness and making participation more attractive
- In the context of continued economic and exchequer funding challenges, there may be a tendency to try to minimise the financial support for R&D Tax Credits. However our survey consistently shows that a more attractive regime would generate additional employment gains and a potential multiplier effect. Thus we would encourage all stakeholders to assess what else might be done in this area
- Inevitably, our economic competitors are continually re-evaluating the best approach to incentivising R& D and innovation. Whilst Ireland's attraction as a business location is undeniable, it's essential that we continually review incentives to ensure that they are 'fit for purpose'. The tax treatment of R&D needs to be an integral part of this
- We recognise the severe constraints on expenditure and the need for the exchequer to ensure value for money in any incentivisation of innovation and R&D. It is widely recognised that overall policy options are relatively narrow in the current circumstances -however there are key areas of tax policy within Ireland's control which may be altered to suit our economic needs. We believe that this survey provides a worthwhile basis upon which to continue the discussion as to how best encourage R&D in Ireland by highlighting areas of concern and noting areas for improvement
- In an increasingly competitive world Ireland has done well in terms of innovation and R&D. It is vital that we retain our focus given the potential for further business and employment gains and their contribution to our economic future.

Kenneth Hardy
Tax Partner
Europe, Middle East, Africa R&D Incentives Practice Leader

Contact us

Ken Hardy
R&D Tax Incentives Practice
T: +353 1 410 1645
E: ken.hardy@kpmg.ie

Emma Fidgeon-Kavanagh
SME R&D Tax Incentives Practice
T: +353 1 700 4086/ 021 425 4558
E: emma.fidgeonkavanagh@kpmg.ie

www.kpmg.ie/R&D

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