



Knowledge Development Box Regime

Mike Sheehan & Brian Cronin

In Association with IRDG

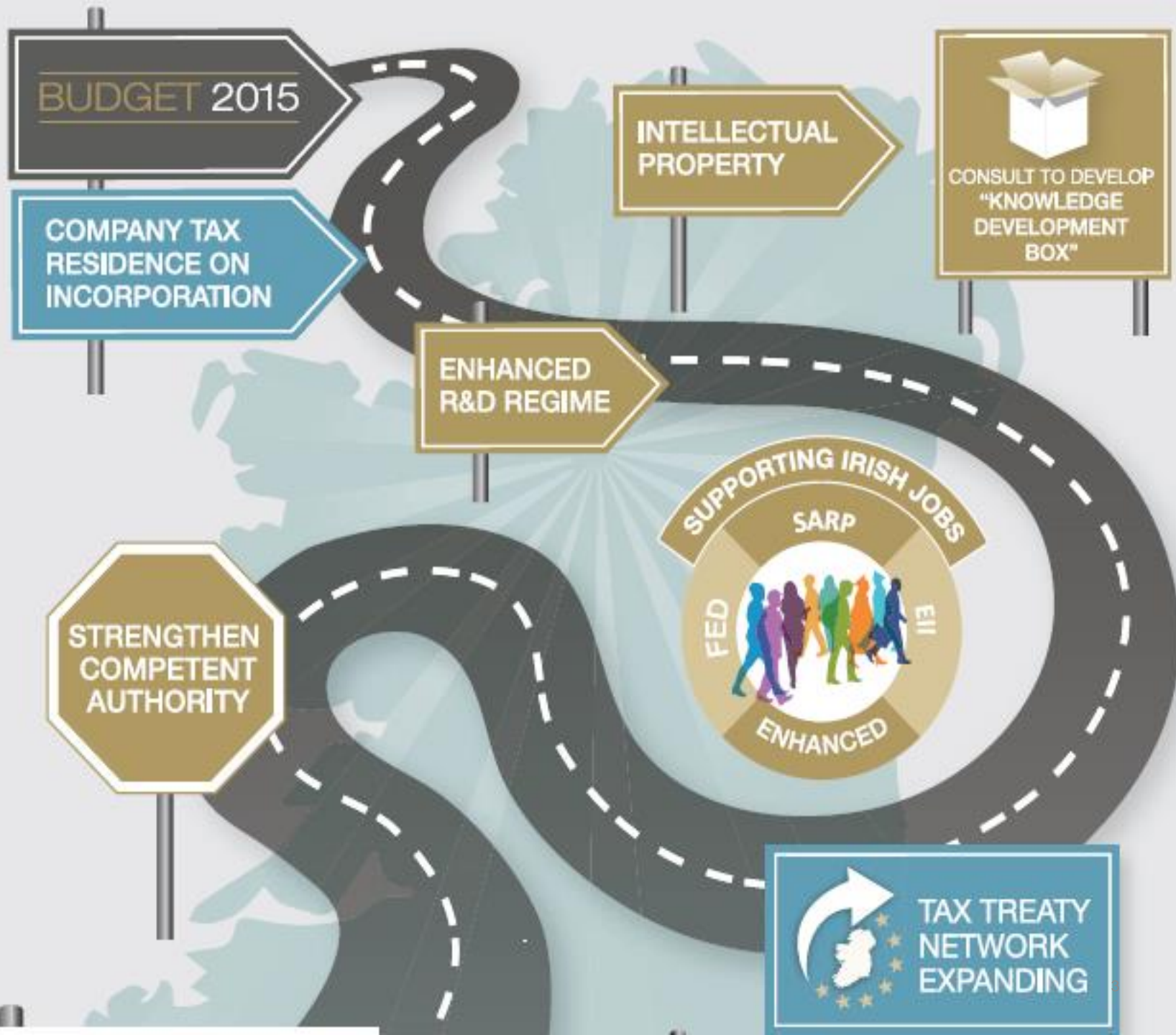
Kingsley Hotel

21st April 2016

Agenda

- What exactly is the “Knowledge Development Box”?
- Is it relevant to my company?
- How much tax might we save?
- What are the administrative requirements?

Road Map for Ireland's Tax Competitiveness



**RATE
REGIME
REPUTATION**

Overview of KDB

- Profits
 - Arising from certain IP assets
 - Resulting from R&D Activities
 - Carried out by that same company.
 - Are taxable at an effective rate of 6.25%
 - By giving a deduction equal to 50% of qualifying profits.

Relationship between R&D and KDB

- R&D work is a prerequisite to claiming KDB relief.
- Modest amounts of R&D might generate valuable IP, and large KDB claims.
- Large amounts of R&D might generate modest IP, and little / no KDB claims.

But one cannot have a KDB claim without first carrying on R&D.

R&D Credit

What's meant by "R&D" for R&D tax credit tax purposes

- For an activity to be eligible as R&D for tax purposes, two key criteria must be met:



- Success is **not** a requirement

- The R&D project starts when work to resolve the technological uncertainty commences and ends when the uncertainty is resolved, or efforts to resolve it cease

Science or Technology

What's In

- Activities within the fields of
- Natural Sciences (including Computer Science and Maths)
- Engineering or Technology
- Medical Sciences
- Agricultural Sciences

Full List provided in Appendix 1 of Revenue Guidelines for R&D Tax Credits

R&D tax relief

OVERVIEW

1. Identify Eligible Projects

2. Quantify the total eligible expenditure (Opex & Capex)

Credit is 25% of the above

Focus is on TOTAL Spend – which is compiled by project

Knowledge Development Box ("KDB")

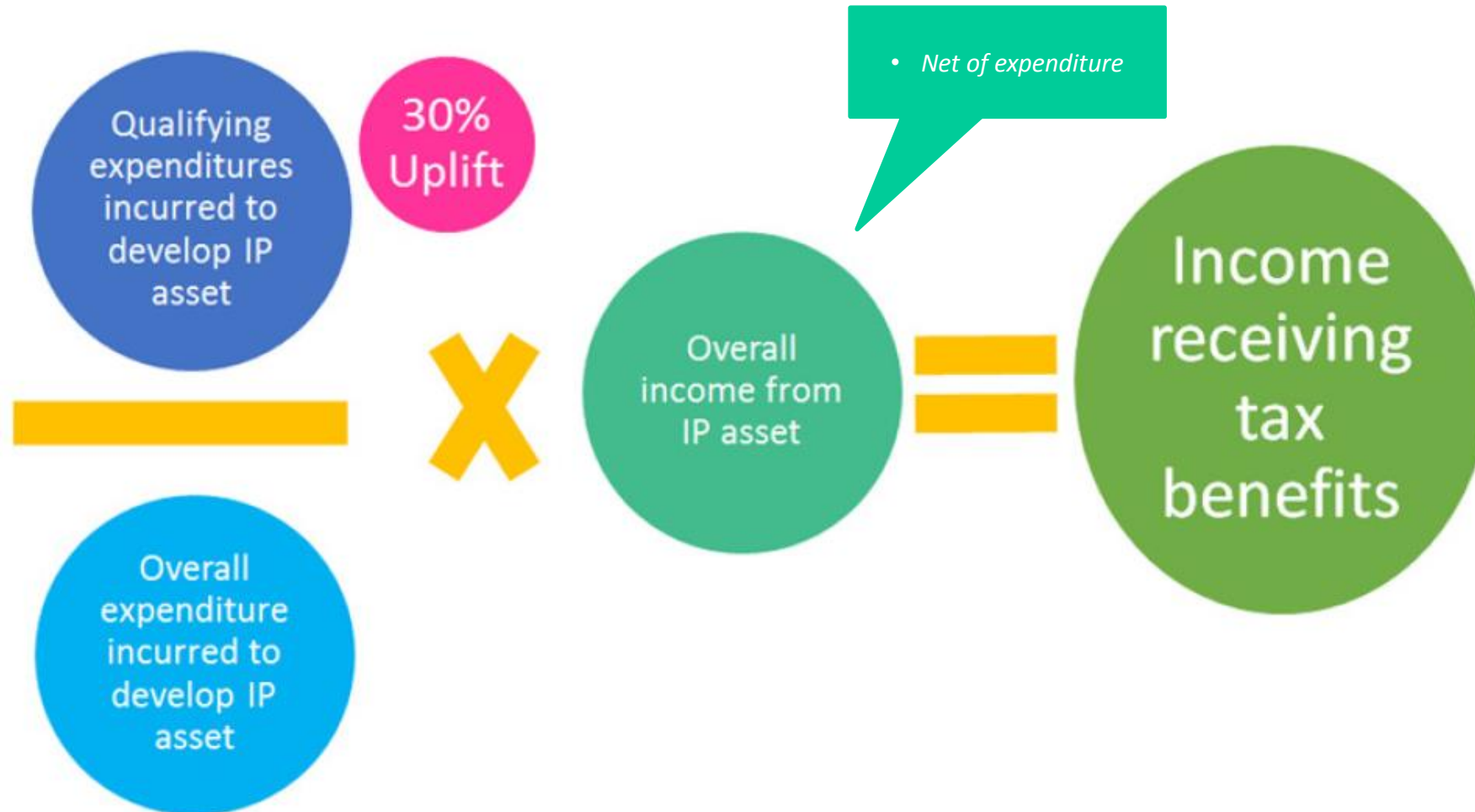
KDB Relief

MODIFIED NEXUS APPROACH

- Amount of relief under KDB
- Is linked to the % of total costs incurred on developing an IP asset
- Which was incurred by the Irish company
- Amount of relief will vary substantially between assets depending on the application of the modified nexus formula

Focus links quantum of relief to proportion of work by Irish company

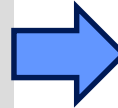
Knowledge Development Box Nexus Approach



Knowledge Development Box Definitions – Qualifying Asset

Qualifying Asset

- An asset which is "intellectual property"
- Other than “marketing-related intellectual property”
- And which is the result of R&D activities



Intellectual Property

- Computer program
 - Copyright and Related Rights Act 2000
- Invention protected by:
 - A qualifying patent
 - Any supplementary protection certificate concerning protection for medicinal products or plant protection products
 - Any plant breeders' rights



Marketing-related Intellectual Property

- Not within the meaning of qualifying asset.
- Includes:
 - Trademarks
 - Brands
 - Image rights
 - Other IP used to market goods & services



Qualifying Patent

- Patent granted following substantive examination for **novelty** and **inventive step**, or
- A patent, excluding short term patents, where
 - where the Patents Office has caused a search to be undertaken, and
 - the patent was granted prior to 1 Jan 2016, or if prior to 1 Jan 2017, patent agent cert required.
- Provision for families of assets

Knowledge Development Box

Intellectual Property for Small Companies – S769R

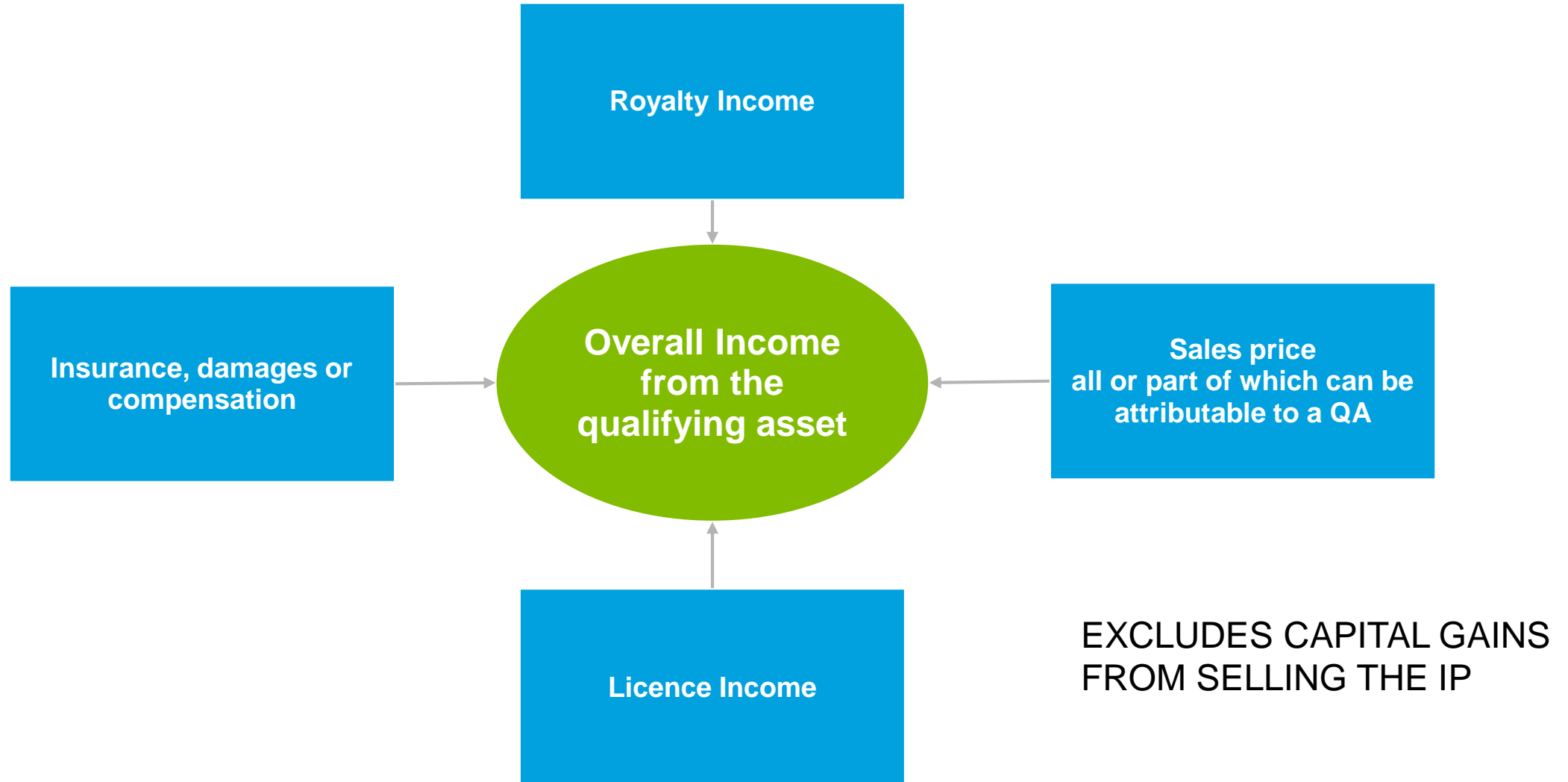
- Average overall income from IP < €7.5m
 - Global Turnover < €50m

 - Definition of IP extended to include inventions that are:
 - Novel,
 - Non-obvious and
 - Useful
- * Subject to Ministerial Order



Knowledge Development Box

Definition – Overall Income from the Qualifying Asset



Income of the Specified Trade

- The income relating to each qualifying asset or family of assets must be separately identified.
- Embedded royalties in products and services – need to identify the qualifying element.
- Disallow
 - Marketing IP
 - Know How
 - Return on manufacturing activities

Profit from exploitation of IP.

- Relief applied only to the profits of the specified trade
 - The managing, developing, maintaining, protecting, enhancing or exploiting of intellectual property.
 - The researching, planning, processing, experimenting, testing, devising, developing or other similar activity leading to an invention or creation of intellectual property, or
 - The sale of goods or the supply of services that derive part of their value from activities described in the above where those activities were carried on by the Company.

Allocating expenses

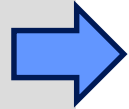
- Allocation on a just and reasonable basis.
- Equivalent to what a third party contractor would charge.
- Allocation of expenses between qualifying and non qualifying income / between income of qualifying assets.

Knowledge Development Box

Definitions - Expenditure

Overall Expenditure

- Qualifying Expenditure incurred in relation to that qualifying asset +
- Acquisition Costs +
- Group Outsourcing Costs



Qualifying Expenditure

- Wholly and exclusively in the carrying on by it of R&D activities in a Member State
- Where such activities lead to the *development, improvement or creation* of the qualifying asset
- Allowable as a trading deduction/capital allowance and
- Costs of outsourcing R&D activities to 3rd parties



Qualifying Expenditure

- Shall not include:
 - Acquisition costs
 - Interest paid/payable
 - Intra group outsourcing of R&D costs
 - Non-arm's length expenditure under a CSA
 - Costs which are relievable in another country
- Up to 30% uplift for acquisition costs / group outsourcing



Transitional Regime

- For accounting periods between 1 Jan 16 – 31 Dec 2019:
 - Qualifying expenditure includes that incurred in 4 year period ending on last day of accounting period.
 - E.g. for y/e 31 December 2016, qualifying expenditure incurred since 1 Jan 2013
- No time limit on total expenditure
- For accounting periods beginning after 1 Jan 2020:
 - Qualifying expenditure shall not include expenditure incurred pre 1 January 2016.
- Exception where adequate documentation to support qualifying expenditure

Knowledge Development Box

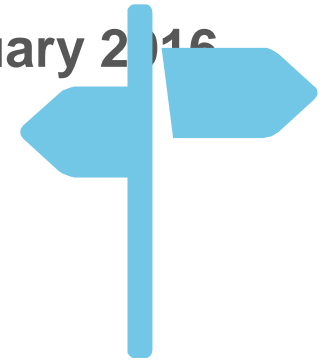
Documentation

- **Tracking Requirement**

- Need to be able to show how income and expenditures are linked to the qualifying asset.
- Detailed financial records
- Detailed R&D records regarding the creation, improvement and further development of IP

- **Family of assets** – Documentation to support the reasonableness of grouping of assets

- This level of documentation not required for expenditures incurred **prior to 1 January 2016**



Knowledge Development Box

Example 1

	Specified Trade
Royalty Income	750,000
COGS & Operating Expenses	(100,000)
R&D Exp incurred in developing IP	(200,000)
Profits	450,000

$$\frac{QE + UE}{OE} * QA = \text{Qualifying Profits}$$

$$\frac{200,000 + (0 * 30\%)}{200,000} * 450,000 = 450,000$$

CT Computation

PBT	450,000
S769l(5) Allowance	<u>(225,000)</u>
Taxable Profits	<u>225,000</u>
@12.5%	28,125 (ETR 6.25%)

***ignoring R&D tax credits & S291A allowances**

Knowledge Development Box

Example 2 – Including Acquisition costs + Group Outsourcing Costs

Acquisition of Qualifying IP	100,000
	Specified Trade
Royalty Income	750,000
COGS & Operating Expenses	(100,000)
R&D Exp incurred in developing IP	(200,000)
R&D Exp incurred by sister co	(30,000)
Profits	420,000

$$\frac{QE + UE}{OE} * QA = \text{Qualifying Profits}$$

$$\frac{200,000 + (30\% * 200k)}{330,000} * 420,000 = 330,909$$

CT Computation

PBT	420,000
S769I(5) Allowance	<u>(165,455)</u>
Taxable Profits	<u>254,545</u>
@12.5%	31,818 (ETR 7.58%)

***ignoring R&D tax credits & S291A allowances**

Knowledge Development Box

Other Provisions

Trading Losses

- Should there be a trading loss in respect of a qualifying asset in an accounting period, 50% of the loss will be available for offset in the normal manner.

Administration

- Make a claim on CT1.
- Claim to be made within 24 months of end of accounting period.

Transfer Pricing

- If a company is subject to TP rules, the apportionment and application of all qualifying income and qualifying expenditure must be in line with transfer pricing rules.
- For smaller companies, income and expenses should be apportioned on a just and reasonable basis.

R&D Tax Credit Refund

- The KDB may impact on cash refund claims made under the R&D tax credit regime. Broadly, the R&D tax credit is calculated as if the KDB regime was not in place.
- This should only present a cashflow timing issue.