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IRDG

R&D Tax Credits



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- Recap of R&D rules
- Finance Act 2012 changes
- What companies should be doing during year in terms of documenting R&D activities
- Dealing with initial Revenue queries
- Dealing with a full Revenue Audit

# Rules for R&D Tax Credit

- R&D tax credit – 25% of incremental qualifying R&D expenditure over base year
- FY03 base year
- Accounting & booking credit above PBT line
- Self-assessment basis
- Pre-approval from Revenue not required but can be obtained – project must have commenced in last 12 months
- Successful regime in encouraging R&D activities in Ireland

# Rules for R&D Tax Credit

## Utilisation of tax credit

- Firstly, use against current year CT
- Then, carry back tax credit to prior period CT
- If no CT liability in current or prior period, then may be scope to claim tax credit as a cash refund
- Note can also use carried forward credits against future CT

# Rules for R&D Tax Credit Cash Refunds

- Refund capped at 10 years CT / current and preceding year payroll tax liabilities
- USC not included in payroll taxes
- Refund over three years
- 33% in Year 1
- 50% of unused R&D tax credit in Year 2
- Balance in Year 3

# Rules for R&D Tax Credit Outsourcing

- Limits on subcontracting costs
  - 5% on university subcontracted costs
  - 10% on unconnected party subcontracted costs
- Finance Act 2012 changes (see later slides)

# Rules for R&D Tax Credit Buildings

- Buildings also qualify for relief
- Note no need to look at 2003 spend – all current year building spend qualifies, in year one
- 35% of Building must be used for R&D purposes, over a 4 year period
- May need to apportion spend to work out credit
- Note clawback provisions

# Rules for R&D Tax Credit

## Miscellaneous points

- R&D tax credit is net of grants received
- Some alignment between RDI grants and definition of R&D in tax legislation
- Group relief – 51% test, Form CT1 disclosures
- Change in year ends



# Rules for R&D Tax Credit Tests

## 1. Science test

Qualifying R&D activities must be:

- systematic, investigative or experimental activities
- in a field of science or technology
- being one or more of the following categories:
  - basic research
  - applied research
  - experimental development

# Rules for R&D Tax Credit Tests

## 1. Science test ctd.

In addition, R&D activities must:

- seek to achieve scientific or technological advancement

**and**

- involve the resolution of scientific or technological uncertainty

# Rules for R&D Tax Credit Tests

## 2. Accounting test

- Staff costs and overheads relating to R&D activities
- Plant and machinery
- Third party royalties
- Direct / indirect costs
- Apportionment methods

# Rules for R&D Tax Credit

## What does not qualify?

- Market research
- Sales promotion
- Quality control testing
- Social sciences research (eg economics)
- cosmetic/stylistic alterations
- Operational research

# 2012 Finance Act Changes

## Incremental Rules Regarding Base Year

- Volume based regime changed
- First €100k of qualifying R&D spend results in R&D tax credit (i.e. no reference to base year)
- Thereafter, only the excess of R&D spend over that incurred in base year (2003) will qualify for R&D tax credit

# 2012 Finance Act Changes

## Subcontracting Rules

- R&D tax credit for outsourced spend based on:
  - greater of 10% of in-house spend or €100k where R&D is outsourced to unconnected 3<sup>rd</sup> parties
  - greater of 5% of in-house spend of €100k where R&D is outsourced to third level institutions
- Re-grossing options

# 2012 Finance Act Changes

## Subcontracting Rules

- Requirement to notify the third party provider in writing that it cannot also claim the R&D tax credit
- Benefit of increase in outsourced cap to SMEs
- Costs relating to management or control of R&D will not qualify for R&D tax credit unless the R&D activities are carried on by the company itself

# 2012 Finance Act Changes

## EU Grants

## Trade Transfers

- Expenditure covered by grants or other EU / EEA assistance will not qualify for R&D tax credit
- Transfer of trade intra-group – R&D tax credits can now be carried forward in certain cases
- Transfer of buildings qualifying for R&D tax credit



# 2012 Finance Act Changes Remunerating employees

- Company can elect to surrender tax credit to certain employees
- Employees can use the credit to reduce their own tax bill, cannot bring their effective rate down below 23%
- Employees must be actively involved in R&D (75% of activities)
- Does not apply to directors or shareholders

# What companies should be doing?

## Process and documentation of R&D activities

- Identify all qualifying R&D activities
- Quantify qualifying R&D spend – involvement of technical dept.
- Substantiate - write up on a project by project basis

# What companies should be doing?

## Documentation of R&D activities

- No standard template
- Ensure documentation covers Revenue and legislative requirements – address advancement and uncertainty
- Reports only submitted to Revenue when and if requested

# What companies should be doing?

## Documentation of R&D activities

### Record keeping

- Entries on timely and consistent basis
- Records should be kept on a continuous basis
- All linking papers to accounting should be retained
- Integrity of electronic data is important
- Critical to maintain record of R&D expenditure to be a "qualified company"

# What companies should be doing?

## Documentation of R&D activities

- Majority of reports should be written by scientist / technologist rather than accountant
- Use of external experts by Revenue
- Expressly deal with technological / scientific "stumbling blocks"
- Importance of documentation in context of people leaving the organisation

# Dealing with initial Revenue queries

- Increased requests for technical supporting documentation
- Self audit style reviews and/or R&D audits
- 23 point questionnaires
- Can split questions between those for finance department and those for R&D department

# Dealing with full Revenue audits

- Revenue audit code of practice
- 21 days notice
- Possible to postpone in certain cases
- 14 days to give notice that qualifying disclosure will be made
- Benefits of qualifying disclosures

# Dealing with full Revenue audits

- Use of expert by Revenue
- Non-disclosure agreement signed
- Review by Inspector and expert
- Expert expresses opinion to Inspector
- Revenue then issue opinion to company being audited
- Right of appeal



# Dealing with full Revenue audits

- Focus on source documentation
  - details of objectives of R&D
  - feasibility plans / methodology adopted
  - progress reports
  - notes of problems encountered
- 23 point questionnaire
- Importance of when R&D activities actually end

# Conclusion

- Any questions?



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