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Research and Development Tax Credits

It is no co-incidence that while many firms are re-locating their manufacturing operations to other countries, Ireland remains a strong location for research and development (R&D) facilities.

Multi-national firms such as EMC, Arris and Synopsys have all recently announced expansion plans for their R&D operations in Ireland.

A skilled work-force and various Government support packages encourage firms to locate their research and development centres. The R&D tax credit is also an important incentive for both Irish and multi-national companies.

What is the R&D tax credit?

The R&D tax credit was introduced in the Finance Act 2004. It operates to give a company a tax credit of 20% for expenditure incurred (25% for expenditure incurred from 1st January 2009 onwards) of the incremental qualifying expenditure incurred on R&D activities in a particular tax year over expenditure incurred in a "base year".

The credit can be claimed through a company's annual corporation tax return. Alternatively, a retrospective claim can be made subject to the new time limits introduced by the Finance (No.2) Act 2008.

Claims made on/ after 1st January 2009, must be within 12 months from the end of the accounting period in which the qualifying R&D expenditure giving rise to the claim, is incurred.

The R&D tax credit can be set directly against a company's corporation tax liability and is in addition to any allowable deductions for R&D expenditure included in the company's accounts.

If a company does not have a sufficient corporation tax liability to utilise the credit fully in a particular year, the credit can be carried forward indefinitely or allocated to other companies in the same group.

Finance (No. 2) Act 2008 has introduced further relieving provisions for expenditure incurred in accounting periods beginning on/after 1st January 2009. A company is now entitled to carry back excess R&D tax credits to set against the preceding year's corporation tax liabilities or, apply to the Revenue Commissioners for a repayment of any unused R&D tax credits over a three year period, subject to certain conditions and limitations.

What expenditure can be included to calculate the R&D tax credit?

Qualifying expenditure is defined in the legislation. It must be incurred wholly & exclusively for research and development purposes.

Qualifying expenditure includes expenditure such as salaries, overheads, plant and machinery, administration, training costs etc.

Any expenditure that is met with grant aid is not qualifying expenditure.

How do I calculate the R&D tax credit?

For the years 2004 – 2013, the "base year" for the purposes of calculating the incremental spend on R&D is 2003. For the year 2014 and onwards, the incremental spend will be calculated using a rolling base, beginning with "base year" 2004.

For example, a company with qualifying R&D spend of €10,000 in 2003 and €40,000 in 2004 will have a tax credit in 2004 of €6,000:

40,000	(2004 spend)
<u>- 10,000</u>	(base year spend)
30,000	@ 20% = €6,000

Companies that had no qualifying expenditure on R&D in 2003 receive a tax credit of 20% of their entire qualifying R&D spend in each year from 2004 – 2008 and 25% of their qualifying spend in each year from 2009 – 2013.

What constitutes R&D activities?

In addition to its expenditure having to qualify, a company's R&D activities must also satisfy certain criteria if the company is to qualify for the tax credit.

The R&D activities must be:

- Systematic, investigative or experimental activities
- In a field of science or technology
- Basic or applied research or experimental development, or a combination thereof, and
- Seeking to achieve scientific or technological advancement and involve the resolution of scientific or technological uncertainty

As these terms are quite broad, the Revenue Commissioners have provided further

clarification on what constitutes qualifying R&D activities in regulations and also in guidance notes available at www.revenue.ie.

What about expenditure on buildings used for R&D activities?

There is a separate tax credit for expenditure on buildings or structures used for R&D activities.

The tax credit is 20% of the qualifying expenditure on the building and it is claimed over 4 years.

Finance Act (No. 2) Act 2008 contains proposed changes to the way this tax credit will work for 2009 onwards. However, these changes are subject to clearance from the EU Commission.

As with the tax credit for R&D expenditure, the tax credit for expenditure on buildings can be set directly against a company's corporation tax liability.

It is also subject to the new one-year time limit for claims as contained in the Finance (No.2) Act 2008.

If a company does not have a sufficient corporation tax liability to utilise the credit fully in a particular year, the credit can be carried forward indefinitely, or, in the light of the amendments contained in the Finance (No. 2) Act 2008, set back to the preceding year or reclaimed from the Revenue Commissioners.

To qualify, the company must be entitled to claim industrial buildings capital allowances on the building.

An important point to note is that any tax credit claimed will be clawed back if, within 10 years of the year for which a credit is claimed, the building is sold or ceases to be used for R&D activities.

What if a company sub-contracts the R&D work to a third party?

There are two situations where a company can claim the R&D tax credit if it sub-contracts a third party to carry out R&D activities:

1. If it incurs expenditure on R&D and pays a university or institute to carry out R&D activities in a member state of the European Economic Area.

However, the relief is restricted to 5% of the expenditure incurred by the company itself on R&D activities.

2. If it incurs expenditure on R&D and pays an unconnected third party (not a university or institute) to carry out R&D activities.

Relief in this instance is restricted to 10% of the expenditure incurred by the company itself on R&D activities.

Relief in this second instance is only available in respect of expenditure incurred on/ after 1st January 2009.

In these times when every penny counts, it is evident that the R&D tax credit can be extremely valuable to companies. Moreover, many companies do not even realise that they are actually undertaking R&D in their business. It is therefore well worthwhile for companies to review their operations to see if their business could qualify for an R&D tax credit. This should be done as soon as possible in light of the restricted time-frame for claims as set out in the Finance (No.2) Act 2008.

If you require any further information or assistance on how this issue might affect you please contact:

Siobhan O'Neill

Tel: 01 6790800

soneill@crowleysdfk.ie

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www.crowleysdfk.ie



16/17 College Green
Dublin 2

Tel: **01 6790800**

Fax: **01 6790805**

5 Lapp's Quay
Cork

Tel: **021 4272900**

Fax: **021 4277621**