American Chamber of Commerce Ireland

Submission on the Review of the R&D Tax Credit

To the Fiscal Division of the

Department of Finance

12 April 2013

Strengthening Investment and Employment Competitiveness

1. Introduction

The American Chamber of Commerce Ireland shares the Government's objective to ensure that the R&D Tax Credit remains 'best in class' internationally, represents value for money for taxpayers and supports the retention and attraction of investment and jobs.

Investment by US firms in Ireland remains; instrumental in helping to create and develop a world class labour force; critical in dispersing technology and innovative capabilities across the economy; and key in expanding the global reach of indigenous firms. Ireland remains a unique gateway for US investment into Europe. Since 2010, Ireland has seen the greatest surge of investment come into the country in over a decade. In 2011, for example, US companies invested over $30billion in Ireland and in 2012 over 146 new projects and 13,000 jobs were announced and three quarters of those came from the United States. It is the third largest European recipient of US FDI and investment flows from the US to Ireland since 2000 have been 6 times larger than those to China.

Today, over 115,000 people are directly employed in over 700 US firms in Ireland accounting for over 70% of all IDA supported employment. Collectively US companies have US$188b in foreign direct investment (FDI) in Ireland. This represents 8% of all US investment in the EU & 4.5% worldwide. This equates to more than the total invested in the much hyped BRIC economies (Brazil, Russia, India, China). US firms in Ireland form a critical part of Ireland's cutting edge, internationally traded goods and services economy in industries such as information & communications technology, biotechnology, pharmaceuticals, medical technologies and financial services, but we cannot afford to take this for granted.

Ireland's FDI sector has proven to be robust and resilient, providing a source of stability for the entire Irish economy. Multinational companies accounted for over €1.3 billion of a total of €1.9 billion R&D expenditure in Ireland in 2011, and since the introduction of this credit over 380 new R&D projects have been announced by multinationals. These new investments have enhanced the strategic importance of Irish operations of multinationals and helped to modernise this base of industry since the introduction of the credit in 2004. **This has bestowed macro-economic benefits not only on the country in general but also to the building of our research, development and increasingly, our innovation and commercialisation capacity. The R&D Credit is now an integral part of Ireland's corporate taxation proposition to attract this investment.**

Tax incentives have become an increasingly popular policy instrument to boost research and experimental development (R&D) activities of businesses internationally. According to an OECD study (Warda, 2006); the practice of providing R&D tax credits is expanding among OECD countries, from 12 countries in 1996 to over 20 countries presently. The many empirical studies that have been conducted throughout OECD countries over the past number of decades show that research and development significantly improves firms' performances, however measured. The economic performance of a country thus depends on its capacity to provide the right incentives to R&D.

A paper by Bloom et al (Centre for Economic Policy Research, CEPR) suggested that tax incentives are effective in increasing R&D intensity. This is true, they argue, even after taking into effect permanent country specific characteristics, world macro shocks and other policy influences. They estimate that a 10% fall in the cost of R&D stimulates a 1% rise in the level of overall R&D in the short run; R&D increases by nearly 10% in the long run. In addition, the knock on effects to the rest of the operation would only add to this impact on employment numbers as outputs are developed and commercialised successfully.

By and large our members are happy with the R&D Tax Credit and it is clear that it has become an integral part of Ireland's tax and economic offering.

We recognise the **key positive aspects** of the current R&D Tax Credit Regime which include:

- **Rate of credit:** The current rate of the credit, at 25%, is generally perceived as competitive. It is clear that it has enabled many members to tender and compete for R&D projects, not only on past performance and talent but critically on cost.

- **Above the Line:** The ability to recognise the R&D credit "above the line" for accounting purposes is an important factor and recognised by our members as one of the critical improvements in the regime. It is clear that it has been an enabling factor that has driven more and more business decisions to locate R&D in Ireland.

- **Scope of activities:** Our members are reasonably content with the scope of activities eligible for the R&D tax credit, although differences do exist across certain industry sectors and can depend substantially on the nature of the activities undertaken by members.

We believe that the R&D tax credit has been, and can continue to be, a critical tool in ensuring that Ireland is competitive for research, product development and process innovation projects and our member's are of the view that there is scope to enhance its ability to attract further investment.

2. Methodology adopted in preparing our submission

Further to the Department of Finance's request for submissions on the Review of the R&D Tax Credit, the Taxation Working Group of the American Chamber of Commerce Ireland (AmCham) met to consider the issues. The Taxation Working Group comprises senior finance and taxation executives from all relevant sectors of the US Multinational community (ICT, Pharmaceuticals, Medical Technologies and Financial Services), together with representatives from the relevant professional firms.

In addition to engaging directly with a number of member companies to illicit their specific and detailed views on the credit, the American Chamber supported an **Industry Survey on the R&D Tax Credit (April 2013)** which was facilitated by IBEC. The findings from that survey were shared with us.

While the Terms of Reference of the Review of the R&D Tax Credit is broad, we have focussed specifically on the following aspects in this submission;

(a) The impact of the R&D tax credit on investment/ employment in Ireland, and

(b) Whether the current design and structure of the R&D tax credit is optimum.

3. *The impact of the R&D tax credit on investment/ employment in Ireland*

Based on our engagement with members, it is clear that the R&D tax credit plays a crucial role in the decision making process and on member companies ability to win mobile R&D investment. Moreover it is now seen as part of the package of measures required to ensure that Ireland is an attractive and competitive place for foreign direct investment. Access to the R&D credit has become a significant part, not just of Ireland's corporate taxation strategy, but to the competitiveness of performing R&D in Ireland.

It is also critical to understand the broader impact that performing R&D can have on the rest of an organisation. The Chamber's CEO Forums at six locations around the country during March 2013 met with over 100 CEO's of US multinational subsidiaries in Ireland. When considering this Review with the Chamber, they were strongly of the view that performing R&D has enabled them to engage in other activities, like manufacturing, commercialising and services, for example, that would not have been available to them had they not been engaged in part of the R&D process. It is important to point out that these related non-R&D jobs tend to be larger in number than the R&D jobs themselves but potentially only possible to create where R&D takes place within the organisation itself here in Ireland.

Of the foreign owned companies who responded to the aforementioned **Industry Survey on the R&D Tax Credit** (131 in number), 76% of respondents believed that the R&D tax credit was either a 'very important' or an 'important' factor in the company's decision around locating overall investment in Ireland. 79% of respondents believed it was either a "very important" or an "important" factor in the company's decision to locate specific investment in R&D in Ireland. In addition, 71% believed it was "very important" or "important" from the perspective of creating new jobs and 77% believed it was "very important" or "important" for the retention of jobs – both equally valid in the context of the Governments stated objective of creating 100,000 net new jobs in the economy by 2016 (Action Plan for Jobs 2013).

In addition, of the foreign owned companies who responded to the survey and provided full total R&D spend details for 3 identified reference years (2003, 2007 and 2011), there was a startling 15 fold increase in total R&D spend over the period and a 20 fold increase in R&D tax credit related spend. While this will have resulted in a significant increase in the "cost" of the R&D credit which has been disclosed in the request for submissions, it is also is also critical to understand the consequent increase in associated spend by the companies – a net €3 by each company for every €1 of credit - with much, if not all, of that being spent in the local economy.

And it is not just investment that has increased over that period, again of the foreign owned companies providing total R&D spend details for each of the reference years, there was a 9 fold increase in R&D tax credit related jobs in the 2003 to 2011 period.

Where Governments stated objective is to achieve MNC spend on R&D of €1.7bn by 2014, and the attendant benefits that creates (especially in terms of potential job creation in other areas like manufacturing etc), the benefits of incentivising R&D to occur in Ireland, cannot be underestimated.

4. Is the Design and Structure of the R&D Tax Credit Optimum?

By and large our Members are happy with the credit and it is clear that it has become an integral part of Ireland's tax and economic offering. As an overarching comment, it is important to state that it is critical that the credit remains at least as **competitive** as it is today. It is also critical that there is **consistency** in how it operates (no dramatic negative changes), and its availability remains **certain**.

In that context, in our introduction we have set out some of the key positive aspects of the Irish system that our members have noted. Below, we have commented on the international competition for R&D investment and in that context have set out the areas, which should be considered to enhance the credit's impact.

A. International Competitors

Where R&D investments are made is highly competitive and our members face huge internal competition in trying to secure R&D investments. It is therefore fundamental that the Irish R&D tax credit is truly 'best in class' to continue to make Ireland an attractive place to locate mobile R&D projects.

In our engagement with members, they pointed out a vast number of competitor locations and the pressures faced in competing for R&D investment projects. Countries sited include; Singapore, Costa Rica, Puerto Rico, UK (including Northern Ireland), USA, India, China, Poland, Israel, Hungary and Switzerland. As you can appreciate, each region provides different benefits which can make them attractive sites for the location of mobile R&D, such as low labour costs, attractive taxation regimes, availability of grant aid and subsidies, good availability of skilled labour etc.

Recognising the global nature of the competition and what will be required to remain best in class we have set out below some suggested improvements to the regime.

B. Suggested Improvements to the Regime

It is increasingly important that our members can use the credit to influence the cost of undertaking R&D in Ireland. In order to do that they must have certainty in their ability to (a) factor the R&D tax credit into investment appraisals, and (b) certainty that the benefit can be sustained and they won't be forced to restate their costs. The suggestions made in point (i) below are aimed at improving certainty around factoring the credit into investment decisions.

The suggestions made in points (ii) and (iii) are designed to ensure that the system recognises the way in which businesses operate in a fast moving environment.

I. **Certainty:** It is clear from our engagement with members that there is significant concern over the "certainty" of being able to hold onto the credit once a claim is made. This sensitivity is heightened in circumstances were the credit has been recorded "above the line" and any impact or change in the claim will have an immediate profit and loss account hit.

   There is real concern, and some dissatisfaction among members, in particular those who have been through the audit process and this is born out in the results of the aforementioned Industry

Survey on the R&D Tax Credit (April, 2013). Companies clearly recognise the need to have audits in many spheres of their operations to ensure compliance with accepted rules, but they do have difficulties with inconsistencies of approach and resolving matters where certain logjams occur in the audit process.

In order to deal with matters of uncertainty, one suggestion might be to establish a specific Consultative or Steering Group (comprising Revenue, Department of Finance, Department of Enterprise Jobs and Innovation and industry participants) which would engage to consider matters of concern and ambiguity. In addition, the group could be used to determine policy and help to push consistency of interpretation and approach. This may facilitate more consistent interpretation of certain aspects (both tax and scientific technical) of the credit.

Another suggestion which could aid the certainty issue is to shorten the audit window. This would enable Revenue to raise questions in a reasonable time period rather than the current position where if changes are required to be made to a claim, it could result in a hit to a company's profit and loss account up to 5 years after the event leading to the claim. The length of this audit window can result in companies delaying taking the benefit for accounting purposes which should be available thus not actually securing the "competitiveness" benefits they sought to achieve or indeed the benefit of the R&D credit not being factored into the decision making process at all, which in many cases can lead to lost opportunities.

In certain industries and fields of technology there is also some uncertainly around what activities can and potentially do not qualify for the credit. There have been calls for further guidance in this area. While further guidance may be of assistance to certain industries, perhaps having a nimble and responsive Consultative or Steering Group may be preferable.

II. **Contractors:** A growing trend amongst our members is the use of flexible/outsourcing models which are critical for the Irish entities to remain competitive. This often involves the use of contractors (supplied by third party agencies or companies) who work on site at the company's Irish facility for specific projects and or for specific periods of time. At present, as the payment for such contractors is made from the company to another company, the cost is caught under the cap imposed on 'outsourced R&D'. The result of this is that notwithstanding the contractors are working under the control and direction of member companies and their R&D leads, companies using contractors are significantly disadvantaged. We believe that a measure should be introduced to allow for the inclusion of the full cost of agency staff/ contract staff which are a key requirement in an age of mobile R&D investment. R&D incentives in other jurisdictions such as the UK and US have addressed this point by allowing between 65% and 100% of the expenditure paid to a staff provider (or agency) for the supply of externally provided workers. We believe that an amendment to the Irish R&D tax credit regime should be considered in this regard.

III. **Outsourcing:** While our members understand the concerns with raising the permitted outsourcing limits (and we would distinguish that from use of contractors working under the control and direction of the engaging company which is the issue at stake above), we are also conscious of the benefits that could be achieved if there was greater collaboration between our member firms and local indigenous Irish companies.

5. Base Year issue:

We have consistently communicated our view that the removal of the base year for those small number, but often large scale employers, would allow these companies to lock down their current investments and jobs and compete for the next wave of new investment opportunities.

Recognising the rationale for the adoption of an incremental based system, and indeed being cognisant of the strained financial environment in which we operate, we are very conscious of raising the base year issue at this time. That said, it is important that we draw two particular issues to your attention being faced by certain members who had a relatively high base year.

Firstly, these members tend to be long term investors in Ireland, and significant employers. In the context of maintaining employment and the State's net 100,000 new jobs creation target and recognising the multiplier effect of companies undertaking R&D in Ireland and the spin off activities that can result (manufacturing, related services etc), it is incumbent on us to find a solution that works and enables this cohort of companies to access the credit in competing for investment opportunities.

Suggestions to deal with this matter could include abandoning the base year completely in the case of "new technologies" or "new projects". Alternatively it might involve rebasing the base year or indeed for the company to adopt a lesser credit, say 20% in circumstances where the companies in question adopt a volume based approach. It is important however that any remedies designed to deal with this issue do not jeopardise the necessity for the credit to be competitive and the requirement for certainty in accessing and maintaining the credit.

Secondly, from an international competitiveness perspective, it is important to point out that many countries (including the UK) adopt a volume base system. In order to be best in class, it is important we find a way to deal with this matter.

6. Other Matters

While the consultation process is focussed on reviewing the R&D Tax Credit itself, it is also important to ensure we do not lose sight of other complimentary areas. Specifically, it is important that the cost of employing people in Ireland does not increase any further and when appropriate the opportunity is taken to reduce the income tax burden. In addition, it is important that we continue to work to ensure our IP regime is competitive for mobile IP investment.

7. Conclusion

The American Chamber of Commerce Ireland will continue to work closely with our members in bringing forward recommendations where we believe the suggestions can make a meaningful difference in terms of strengthening Ireland's investment and employment competitiveness. The R&D Tax credit is essential to this.

We believe that Ireland's modern exporting technology and service sectors are leading the process of economic recovery and have more to contribute in terms of economic growth and jobs if the Government remains steadfast in its strategic focus and pragmatic actions to support the FDI sector. Given the role played by US business in Ireland it is vital that an environment that supports the retention and growth of Foreign Direct Investment continues to be fostered.

Our members have communicated to us that this Review is a high priority for the retention and growth of their operations in Ireland. They believe that the R&D tax credit has been, and can continue to be, a critical tool in ensuring that Ireland is competitive for research, product development and process innovation projects and they are of the view that there is scope to enhance its ability to attract further investment.

We remain available to you and your Departmental officials for further consultation on this matter and look forward to continuing our dialogue.