The Consultative Committee of Accountancy Bodies-Ireland

Chartered Accountants Ireland
The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Institute of Certified Public Accountants in Ireland

47 – 49 Pearse Street, Dublin 2

"Review of the R&D Tax Credit"
Fiscal Division
Department of Finance
Upper Merrion Street
Dublin 2

12 April 2013

Dear Sir/Madam

Review of the R&D Tax Credit

We refer to the Invitation for Submissions of February last.

The Accountancy profession, in successive submissions to the Minister for Finance in relation to Budgets and Finance Bills, has made suggestions towards the improvement of the R&D Tax Credit regime. From our perspective, it was not necessary to initiate a formal review process to invite comment from the profession.

Our most recent observations were made in our Pre Budget 2013 and Pre Finance Bill 2013 submissions to the Minister. The comments made in those documents continue to reflect the views we would wish to have considered in the current Review of the R&D Tax Credit. They are reproduced in this letter for your ease of reference. Our core recommendations have been:

- Encourage more scientific development by the people who really carry out R&D work
- Move to a full volume based system to correct discrimination against companies investing in R&D since 2003

CCAB-I Pre Budget Submission 2013

Limitations of the R&D Relief for Employees

Companies are not innovators; the individuals employed by them are. Therefore, the idea of passing down the benefit of the R&D tax credits to certain employees as introduced in FA

2012 is well worthwhile[1]. However, the incentive as it is currently structured does not have the desired effect.

The minimum income tax effective rate criterion, which disregards PRSI and USC, has the effect of confining the availability of the relief to higher earners and large companies. For example, in order to fulfil the requirement that the relief cannot reduce the employee's effective rate of tax below 23%, the starting salary level is €57,000 for a single individual. The individual in practice must be earning in excess of €57,000 to ensure that claiming the relief does not reduce the effective rate to less than 23% which means that the individual should have salary in the order of €70,000 to even consider qualifying for the relief.

The latest salary scales for the R&D sector indicate that a process chemist with three years' or more experience earns €45,000 to €55,000. An employee in the R&D sector would need to hold a very senior post such as R&D director to reach a pay scale of €75,000 to €95,000.

The relief should be amended to remove this provision which discriminates against lower paid employees who make a valuable contribution to the R&D process in large and small companies. Lifting, what is essentially a high salary condition to the relief, will assist small indigenous businesses in particular in attracting and retaining talented, innovative employees for the long term growth of the business.

The most critical phase of the R&D process is in the early life cycle, at a time when the company is least in a position to generate profit while having the maximum need for key research personnel. However, the R&D relief for employees can only be offered by a company in profit and paying tax. The current structure of the relief must be amended to remove this impediment to new companies.

Many key employees, as defined, are directors of the R&D company and therefore ineligible for the relief. Again, we would contend that this restriction impacts on smaller indigenous companies.

With reference to the Government's Action Plan for Jobs for 2013, we suggest that the R&D relief option for employees needs to be extended to account for the deficiencies outlined above if we are to assist and support indigenous R&D companies.

An Innovation Income Tax Rate

It remains important to recognise the input and involvement of employees who contribute to the nation's bank of Intellectual Property, irrespective of their pay scale or position within the company. The 12.5% Corporation Tax rate is in itself a powerful brand, immediately associated with rewarding enterprise. We suggest that a special Income Tax rate of 12.5% be available on:

- income and bonuses paid to inventors, or

[1] We note in this regard that Section 5 FA 2013 amended Section 472D(1) to reduce level of duties dedicated to R&D condition from 75% to 50% subsequent to our making this submission.

- bonuses paid to employees directly involved in the innovation process, and
- dividend income paid to shareholders of a company involved in innovation.

In common with the Foreign Earnings Deduction introduced last year, the amount taxable at this special Income Tax rate could be set relative to overall remuneration. In this way, it could be ensured that the benefit of the reduced Income Tax rate is only available in respect of the contribution towards innovation.

The 12.5% tax should constitute the final liability inclusive of Universal Social Charge and PRSI. This is because the effective rate of Income Tax for many employees is less than 12.5% when the benefit of tax credits are taken into account. The incentive must be at the marginal rate, if it is to be fully effective

This is a relief that favours a particular taxpayer over others, but reliefs of this nature have a proven track record of stimulating economic activity in a target sector which generates jobs and corresponding payroll taxes. Reliefs of this nature continue to have a place in our tax system if they reward some of the most economically productive people in society. A relief such as that proposed here is essential if we are to remain competitive with our nearest neighbour, the UK. From 1 April 2013 a so-called “Patent Box” relief, targeted at the same type of activity and allowing companies what the effect will be a 10% rate of Corporation Tax will be in operation in the UK.

This approach will be attractive in the commercial environment where the remuneration for an innovator and their team can be directly linked to the commercial return being made from their underlying work. However it would not be sufficient to implement this measure on its own, as this would be to the detriment of innovation within the public, and in particular, the university sector.

Base Year Limitations

The introduction of a volume based R&D relief for the first €100,000 of qualifying expenditure in FA 2012 is a step in the right direction when it comes to ensuring the fair application of R&D relief. However, the 2003 base year concept continues to discriminate between companies established before 2003 and those who came into the market after that date when expenditure exceeds €100,000. As a result, companies with long term high levels of R&D expenditure are at a disadvantage compared with companies with substantially lower R&D expenditure established after 2003. A full volume based R&D relief system would remove this anomaly and encourage otherwise restricted companies to increase annual expenditure beyond €100,000.

CCAB-I Pre Finance Bill Submission 2013

We acknowledge the positive step towards improving the Research and Development Credit as set out in Budget 2013 which sees the increase in the volume expenditure threshold from

€100,000 to €200,000[2]. This, however, does not address the inequity faced by companies established in the Irish R&D sector before 2003.

We note that a review of the R&D Tax Credit regime was also announced in Budget 2013. As part of this review we call for the removal of what we described in our Pre-Budget 2013 Submission as a high income restriction which impedes the average employee working in the R&D sector from availing of the tax relief as introduced in Finance Act 2012. Furthermore, the relief as currently structured is only available to companies who make sufficient profits to pay tax, and thereby excludes companies in the start-up phase who are in most need of a means of incentivising R&D personnel.

The introduction of an innovation income tax rate would also represent a worthwhile advancement of the R&D Tax Credit regime. As set out in our Pre-Budget 2013 Submission we suggest the introduction of a special 12.5% income tax rate on:

- income and bonuses paid to inventors, or
- bonuses paid to employees directly involved in the innovation process, and
- dividend income paid to shareholders of a company involved in innovation.

The amount of income/return taxable at this special income tax rate could be set relative to overall remuneration to ensure that the benefit of the reduced Income Tax rate is only available in respect of the contribution towards innovation. This approach would be very attractive in the commercial environment where the remuneration for an innovator and their team can be directly linked to the commercial return being made from their underlying work.

We trust that these points will be factored into the current Review being undertaken by the Department. If you have any queries in regard to the foregoing, please contact Brian Keegan, Director of Taxation at Chartered Accountants Ireland – brian.keegan@charteredaccountants.ie.

Yours sincerely

Liam Lynch

Chairman, CCAB-I Tax Committee

[2] We note in this regard that Section 28 FA 2013 amended Section 766(1) TCA 1997 subsequent to our making this submission.