IRDG Submission on R&D Tax Credits to the Department of Finance

Denis Hayes

Managing Director

April 12th 2013

1 Table of Contents

2 Overview of IRDG

The IRDG is an industry-led representative group for manufacturing and services companies involved in Research, Development and Innovation (RD&I). Established by industry in 1992, the Group is an independent, non-profit body, serving the needs of members on all matters relating to RD&I.

All member companies involved in the IRDG carry out significant and varied R&D projects across their businesses as part of the cycle of new product, process and service development. IRDG membership is relatively evenly divided between Irish-owned and overseas-owned companies who range in size from start-ups to the largest companies in Ireland. The Group is largely funded by members' annual subscriptions, with additional support from Enterprise Ireland for the Enterprise Innovation Network.

Over the years, the IRDG has developed a wide-ranging network of partner organisations and has had the opportunity to support members through significant commercial projects. Today, the IRDG represents all sectors of industry including electronics, telecommunications, financial services, food, software, engineering, healthcare and plastics.

IRDG activity is organized around the 5 pillars of:

- Representation
- Funding & Support
- Innovation Networking
- Collaboration
- Learning

3 Background to the Submission

Since the initiation of the Consultation Process on the R&D Tax Credit Scheme in February last, the IRDG has engaged with members to seek the industry perspective on the scheme and to make suggestions for improvement.

In addition, IRDG worked together with IBEC, Irish Tax Institute, AmCham and other professional and accounting organisations to provide a single online survey to companies across the country to input to this review. IRDG members contributed also to that survey.

This submission paper therefore is based on the qualitative consultation process with members, and the quantitative results from the online survey in which members participated. The submission contains a large variety of direct input from members, as shown in quotes, included to highlight the true perspectives of R&D performing companies. It is intended as a constructive input to the operation of the R&D Tax Credit Scheme.

4 Executive Summary

The R&D Tax Credit is a vital incentive for both Irish Indigenous and Foreign Direct Investment companies when considering the extent and location of key R&D type projects. In fact, almost one quarter of all respondents to the online survey indicated that it was the single biggest factor in their decision-making.

IRDG members see the R&D Tax Credit scheme as a key mechanism which supports their R&D activities and believe the impact is apparent in a number of value added ways:

- A shift of research towards Ireland due to tax credits. R&D tax credits allow de-risking of research in Ireland and increases the number of research projects that are brought to Ireland.
- Creation of research jobs as a result, and the improvement in the nature of employment to include higher value added roles.
- Ensures Ireland is competitive and competes successfully against other worldwide locations for R&D work.
- It is a key factor which attracts Venture Capital investors.
- Facilitates the growth in profile of Ireland as a centre of R&D excellence.
- Supports a greater number of collaborations with academic institutions to carry out research.
- Provides opportunities to employees and researchers to up-skill and enhance their experience and knowledge through research projects. This augments the capability of the Irish workforce.
- Creates a stronger capability within Irish operations, resulting in expansion of volumes, projects and headcount, and improving the sustainability of the operation.
- Has provided structure and diligence for companies in their execution of R&D.

Throughout this submission, there is a significant sharing of direct user experience, in order to demonstrate both the value of the R&D Tax Credit scheme, but also highlight some suggestions for improvement. In this context, the key areas of improvement which IRDG proposes are:

- Introduce a specific set of increased R&D Tax Credit incentive measures for SME Companies including start-ups.
- Much better guidance should be given on how to apply, evaluate projects, and the criteria to be used for qualification. There should be specific guidelines for different sectors, depending on size and market. Include provision of guidelines on record keeping in software and services companies which take into account the modus operandi of such organisations.
- Greater clarity on what can be included is required so that companies can have certainty with respect to the integrity of financial statements and avoid future claw backs, penalties and interest.
- The addition of a Revenue funded advice facility to help companies assess the criteria.
- Develop the transfer of tax credits to key employees to include allowing the company decide who is a key employee and allow Directors under restricted conditions.
- Issue clear definitions and guidance on the use of Sub Contractors.
- Remove or raise the 10% restriction on Sub Contractor and the 5% restriction on Sub Contracting to Third Level institute.
- Phase out the 2003 base year and immediately remove the base year for all future first time R&D Tax Credit claimants.

5 The Impact and Value of the R&D Tax Credit

There is a unanimous view amongst IRDG members that without the tax credit programme, companies would lose some of the research they are currently attracting to and retaining in Ireland. These R&D projects, lead to significant employment and related tax revenues for the Government and help companies to strengthen their R&D profile and base in this country. For all companies, costs and return on investment are an imperative, and the company insights that follow demonstrate the importance of this scheme as businesses make key strategic decisions both with regards to location of operations but also location of R&D activities. We can see that the availability of R&D tax credits not only leads to new companies coming to Ireland but helps secure the futures of those already here.

With the support of the R&D Tax Credits, companies have been in a position to engage in a greater number of collaborations with third level institutions to carry out research. This increases the technology transfer between Irish Universities and Industry, and generally supports the research economy as a whole. These projects provide a learning opportunity and skill building for researchers and/or employees involved, resulting in an overall improvement in the skills, knowledge and employability of the workforce.

As Government Policy is directed at growing our R&D capability as a Nation, all activities taking place in this area, whether in industry, academia or national bodies, fuels this growth and strengthens our economy for the longer term. Successful R&D projects, resulting in products or services that have worldwide value and appeal, also continue to build the profile of Ireland as a 'Centre of Excellence' for R&D, which further promotes the country as a destination for companies interested in R&D.

Key figures from the online survey research demonstrates that between 62% and 68% of respondent companies said that the R&D Tax Credit was either 'Very Important' or 'Important' to their decision-making under each of the headings around the Creation of Jobs, Investment in R&D in Ireland, Overall Investment in Ireland and Retention of Jobs. Since the introduction of the Scheme in 2003, to today, 2013, the growth of Tax Credit related activities has been demonstrated by the survey respondents as follows:

- Total number of R&D tax credit supported projects: 48 to 425
- Total R&D tax credit related spend: €10,923,390 to €203,894,798
- Total R&D tax credit related jobs: 236 to 2,125

All of these figures serve to show the impact and value of the R&D Tax Credit to R&D-performing companies, and the way in which the Scheme has contributed to the growth of R&D in Ireland within that respondent base.

Finally, the following direct quotations from a broad selection of IRDG members of all sectors and sizes, shares their perspectives of the R&D Tax Credit Scheme which is a vital part of their R&D strategy.

"The scheme works on many fronts for an SME like ours. It was an important part of the financial contribution of starting our R&D team in recent years; a team which is now 7 people. By 2014, our increased R&D activity will have contributed to:

- *10 new R&D jobs in total*
- *Two new sales offices in USA and China*
- *8 new Sales staff across all regions*

- *20 positions for College placements*
- *30% growth in headcount to support the company strategy".*

Indigenous Company – Chemicals

"Our Irish plant employs about 170 people directly and notably in the past 5 years, has built up a team of about thirty 3rd level qualified FTE's in our product development unit who are working on the future products of the Group as part of an international team.

The R&D tax credit scheme is a significant support to capturing this R&D work here in Ireland since it incentivises the expenditure of significant amounts of money which would otherwise be spent in contract development organizations in other countries. The amount of corporation tax paid per annum by the company fax exceeds by a factor of 10 any credits achieved and a significant proportion of this cost is expensed in the local economy so filters back to government in any event. The tax credit scheme makes sense and must be retained as part of the package of incentives which encourage R&D investment here remembering that other locations with higher CT rates also provide credit schemes."

FDI Company - Pharmaceuticals

"The level of R&D activity being performed in Ireland has enhanced Ireland's reputation for innovation and has led to a "snowball" effect with more companies wanting to carry out R&D work here. Ireland is currently quite competitive internationally with its R&D offering but many other countries have similar schemes and Ireland needs to be conscious of competition among jurisdictions for R&D activity. The cash refund element is a positive element of the scheme and one which means there is a greater opportunity to continue investing in R&D activities".

FDI Company – Financial Services

"The ability to account for the credit 'above the line' has been a very significant and positive development. We feel that this makes the credit more visible within our wider organization as it directly impacts our gross margin. As manufacturing activity continues to move to lower cost locations, we feel it is essential to our survival and growth that we take maximum advantage of the highly skilled labour resources and technical knowledge which we have available locally. Attracting R&D activity is assisted by the existence of these resources but cost remains a critical factor and it is here that the benefits of the R&D credit tax should not be underestimated".

FDI Company – Engineering

"Over the past few years we have been able to use the R&D Tax credit to highlight the actual cost benefit of research and development in the Irish office. Working in a large international organisation competition can come from within where low cost development centres are always an option. The process introduced within the company to track R&D Tax Credit supplementary information has provided focus on certain areas of the development process. This focus provokes further discussion, and in some cases introduces improvement to the development process and product".

FDI Company – Software

"We are a VC funded technology start-up and the R&D tax credit has helped us build an engineering team in Ireland that is extremely cost competitive with other locations. Our investors are US/UK based, have invested $36M in

Company, and constantly benchmark spend against other locations. The R&D tax credit is critical in our efforts to sell Ireland as being both affordable and having the engineering expertise needed to protect their investment.

We have offices in Asia, USA and Ireland but R&D tax credit makes it a much easier decision for our investors when deciding where the Company should design our next product. Ireland is the preferred location. I have had enquiries from all our investors in relation to R&D tax credit specifically as they consider investment in other Irish companies. They want to know how scheme works as the R&D tax credit is key in their decision making process".

Indigenous Company – Technology

"This is a vital component for the continuation of our activities in Ireland. Currently there are 7 people employed and these are exclusively devoted to carrying out or supporting internal group R&D activities. The annual gross expenditure budget is approx. €1m and the tax credit scheme reduces this gross amount by approximately €200k annually. Recently, a strategic review was carried out with the Group to determine where future R&D activities should be carried out and/or expanded where necessary. Strong competition to our facility was experienced from a sister company in Europe and after much deliberation, our facility was chosen. The 2 deciding factors which swung the decision were

- *Ability to expand in the future if required*
- *Direct impact of R&D tax credit scheme to reduce operating costs in Ireland".*

FDI Company – Life Sciences

"The ability to make a claim for R&D tax credits has allowed us to hire an additional two junior engineers in our R&D department, the salary cost of which is offset by the tax credits received".

Indigenous Company – Engineering

"It is very important that Ireland's R&D Tax credit is competitive when compared with other worldwide tax jurisdictions. Comparisons are always done when the business is deciding where to locate R&D activity. As an example our site was recently internally assessed by Group as a potential location for further global Group R&D development and a significant part of the assessment was a comparison of the tax incentives within Ireland versus other European locations".

FDI Company – Food & Drinks

"System has helped to attract new R&D business to the Irish facility over the last 10 years. It is recognized by corporate as a positive scheme and employees working in the area have received significant opportunities to up skill and enhance their knowledge and experience through funding for new projects brought to the site. Employment in the dedicated R&D groups at the site has increased over the years".

FDI Company – Pharmaceuticals

"Our Company has in the past only ever developed new platform technology at their San Francisco Headquarters. However, due to the opportunity to avail of the tax credit regime, we have plans to locate up to 10 high value roles in Ireland. The scheme is accessible and administratively easy to operate, and is within the bounds and control of the company to avail of".

FDI Company – Financial Services

"As a Company we have yet to avail of R&D tax credits. However, the positive impacts the scheme would have for our company would be fourfold. It would enable us to set aside staff to carry out the research and development, maintain employment in the state of individuals who would otherwise be lost to immigration and would enable us to bring a new product and new service to the market".

Indigenous Company – Technology

"Our company has claimed R&D Tax Credits every year since 2008. It is viewed very positively by the Senior Leadership Team and the benefits have been communicated at various levels within corporate, including to the Head of Pharma Technical Operations and to the Head of Development. It is referenced in a number of capital requests made since 2008 for funding for new product introductions and new installations. The availability of R&D Tax Credits has not been the deciding reason for any of these investment but it does help in making our case and because it improves the potential cash inflow it can make approval easier. It also demonstrates very clearly the Irish Governments favourable approach to attracting new business to Ireland and particularly promotes the case for process development in Ireland. While it is probably not going to influence the Corporation to establish a full scale development facility in Ireland it can create the atmosphere where our site could attract some particular development projects to Ireland working in conjunction with the University sector e.g. Synthesis and Solid State Pharmaceutical Cluster".

FDI Company – Pharmaceutical

"The scheme is an important factor to maintain and build the current R&D team in Ireland. We currently have 13 engineers/technicians full time engaged in R&D with part time support from a further 6 process engineers. The site is seen by Group Management in Europe as a key centre for growth. Our competence and experience combined with a relatively low cost/hour (in Europe), supported by the R&D Tax Credits and Grants, have put us in this position. Investment in R&D facilities and equipment is facilitated and financed indirectly by the scheme, which in 2012 represented in excess of €250,000 in equipment alone".

FDI Company – Engineering

"We understand that R&D activities are eligible for the tax credit regime in cases where the Irish entity provides R&D services to foreign affiliates. We'd welcome that this practice continues. In addition, we compete with the following countries that perform research into chemistry related adhesives topics: US, Japan, Germany, and China. We have 120 high quality R&D jobs in Ireland with an annual spend of c. €20M on R&D & related activity, and the tax credits have played a role in achieving this. We collaborate with colleges on R&D and it would be important that this work is recognized in the scheme. The scheme works well for us as we have a clear segregation of R&D v's manufacturing activities.

FDI Company – Chemicals

"Our Company has increased its employment in Ireland by about 150 over the last 3 years. Approximately half of these additional employees are qualified at degree or technician level. Considerable capital investment was required for the new projects that generated this employment. The availability of R&D tax credits in Ireland was a very important factor influencing Group's decision to approve and fund these investments. The continued availability of R&D tax credits would favourably influence future decisions to invest scarce funds in Ireland".

FDI Company – Life Sciences

"The R&D Tax Credits has had a very significant impact on our Ireland operation both in terms of the level of R&D and Manufacturing carried out on our site. Without the R&D Tax Credits, less development of new products would happen in Ireland and it would be less likely that the new products are manufactured in Ireland.

The reality is that the cost of R&D Scientists and Engineers is similar in most parts of the world and we need to offer a benefit to have the R&D happen in Ireland rather at a head office local. The R&D Credits were part of our defense when Boston Consulting were advising Group to centralize more activities elsewhere. While the scheme may appear to be generous, due to the lower corporate tax rate in Ireland, the net after tax benefit compared to doing R&D in higher corporate tax locations is limited. A key benefit is that the credit is treated as above the line, with the gain seen by the R&D function rather than being lost in the tax line. As a private company, EBITDA is a key driver and the R&D Tax Credits help this number if the R&D occurs in Ireland".

FDI Company – Life Sciences

6 User Experiences & Suggestions for Improvement

Companies were surveyed on their experience of using R&D Tax Credits and IRDG has developed suggestions for improving the scheme based on user feedback.

6.1 Start-up Companies and SME's

National policy is to prioritise the development of indigenous SMEs performing world-class R&D, on the grounds that the resulting innovation will drive future economic growth, exports & ultimately tax revenues. IP-focused start-ups that are the most R&D driven – in areas such as drug discovery, industrial biotech, medical device design, semiconductor design etc. – get disproportionately little benefit from the R&D credit.

This sector also faces a major challenge in raising investment finance to finance long product development cycles (3-7 years), before substantial sales & break-even can be achieved. For start-ups in particular, one major shortcoming is the tranche payment of the credit over 3 years and the difficulty in obtaining bridge finance. There is therefore a mismatch between national economic development policy, and the Revenue policy for R&D tax credits.

The number of companies involved is relatively small, so the short-term cost of incentivising them would be small. If you accept the thesis that today's indigenous R&D-performing SMEs are the Kerry's, Elan's and Glanbia's of tomorrow, this cost will be greatly outweighed by the long-term benefits to other tax receipts.

Just as Ireland's corporation tax policy successfully brings in FDI by multinationals, so a smart R&D tax policy would encourage more highly mobile IP-generating SME management teams to locate and develop their businesses here (again this is EI policy). There is an opportunity to use R&D tax policy not just to level the playing field, but to differentiate Ireland as an attractive place for new SME start-ups.

"We spent almost €1m on R&D activities in 2012. This generated around €300,000 for Revenue in payroll taxes & levies. We will receive a credit in March 2013 of c. €60,000. The €100,000 balance on the R&D credit is pre-approved

but cannot be accessed until 2014 and 2015! For businesses like ours, with a cost of capital in the region of 40-60%, cash today is worth far more than a promise of cash in the future – indeed it can be the difference between life & death".

Indigenous HPSU – Life Sciences

"R&D tax credits have been extremely important. I set up and ran an R&D department in a multinational for many years and this would not have existed were it not for the scheme. It is extremely difficult for the Irish based arms of large multinationals to expand beyond pure manufacturing without support from the state. These supports are key to the future of the medical device sector in Ireland as more and more the manufacturing base for these companies is moving towards lower cost economies. R&D is one area where we can compete with the lower cost economies because of the tax credits and this has to continue.

The scheme has driven increased generation of intellectual property in Ireland rather than purely importing the know-how and developing it for manufacturing. More and more the medical device sector is now looking for the next generation of products to start-up companies with strategic IP. These start-ups are key targets because internal R&D is increasingly more and more expensive. This is the sector that I am now involved in – building and developing start-up companies around key pieces of IP developed in Ireland and Europe. Regenerative medicine is the key area of R&D that will generate the next multinational sized companies in this sector – it is vital then that Ireland continues to play a large role in this."

FDI R&D Executive turned Start-up Director

For some small Irish companies, the R&D tax credit scheme proves challenging. The nature of their operation is such that their resources are limited, and their capability to do R&D is restricted. Yet, through their ambition and commitment they are proactively pursuing product development and improvements, creating jobs and generating exports.

Such companies feel that a large portion of the refunds are credited to the large multinationals rather than to the SMEs. It is their belief that specific measures should be in place to encourage and facilitate SMEs to engage in R&D.

In addition some small companies struggle with the rigidity of the definitions of R&D. Projects that they pursue as R&D, developing new products or services, or making improvements to existing ones, are rejected on application for tax credits as not being novel enough. Yet these products or services are a catalyst for growth in these businesses, helping them to get into a positive business cycle of being able to recruit more staff, increase exports, and generate additional revenues. The financial support provided by the R&D Tax Credit scheme is vital to support them to get into this cycle.

6.1.1 IRDG Suggestions

- **Introduce a specific set of increased R&D Tax Credit incentive measures for SME Companies including start-ups.**
- **Support SME's by shortening the cash payment tranche cycle to 1 year**
- **Build a type of scaled tax relief system depending on R&D expenditure and extra R&D employees working in the area**
- **Establish a class of companies that qualify as 'highly R&D-performing start-ups' – limiting criteria could be turnover, number of employees, R&D spend as a % of total spend, EI HPSU designation**

- **Greater than 5% allowance should be given to SME's for outsourcing R&D projects to third level institutions.**
- **Consider other tax-based incentives for this sector – the goal being to keep cash flow in the company & reduce the need for new investment capital.**
- **Keep all such incentives very simple – start-ups do not have dedicated financial expertise to manage complex arrangements.**
- **Align the administrative requirements for the R&D tax credit and the Enterprise Ireland R&D grant funding for SME's.**

6.2 Software / Services Companies

There are particular challenges faced by companies operating in this space. In their experience, the criteria set out in the documentation are not well suited to software or services development by developing technology solutions through programmes and applications.

Companies generally feel there is very little in the way of guidance for the software development and services industries. For example, there is no formal legal requirement to produce software in a particular way or to provide data captured during the development process to ensure standards are met. More and more software companies are taking on an 'agile' development process which compared to the more traditional 'waterfall' approach there is a lot less documentation required before actual software development commences. This directly reduces the amount of collateral available in retrospect, and has proven problematic for those companies that have experienced an Audit.

"We are an indigenous application software company, engaged in R&D on our own application. Our stock-in-trade is R&D. This is fundamentally different to a bank or a retailer. All five tests are by definition covered for the activity of the software development department of such a software company. Novelty, uncertainty, advancement, technical risk, wow factor - can all be said to be always at play in such a company where it has reached market. Not software consultancies, just companies producing products. Furthermore the spirit and purpose of the R&D tax credit is fulfilled in all cases of such companies, you have people being paid a high salary for the advancement of technology and production of IP for sale out of fresh air". **Indigenous - software company owner and entrepreneur**

6.2.1 IRDG Suggestions

- **Provision of guidelines on record keeping in software and services companies which take into account the modus operandi of such organisations.**

6.3 Clarity of Definitions, Administration & Audit

R&D Tax Credits are designed to be an incentive for companies to undertake R&D. In order for companies to have confidence in applying for the Tax Credit it is critical that an adequate level of certainty exists in relation to what constitutes qualifying R&D and expenditure. Feedback from companies indicates a lack of certainty in some situations. This mainly revolves around definitions, guidelines and audit procedures. This can impact on smaller companies and larger multinationals particularly where "above the line" accounting practices have been used.

Companies vary in their perspectives on the process of applying for R&D Tax Credits. Certainly those companies, who have been through the application and audit processes, have a greater degree of familiarity with what is required. Many of them however have had to secure the help of external consultants to get them to that point.

"Applying is difficult. I don't believe we would have been successful without a consultant. I feel the whole application process could be made simpler and clearer". **FDI – Life Sciences**

Not all companies, particular smaller companies, have the wherewithal to engage consultants to provide support, and this makes the scheme appear restrictive. Companies generally find that the definitions of what is or is not R&D to be unclear, too broad and repetitive, and consequently left open to interpretation. This leaves companies feeling uncertain and vulnerable in the event of a disagreement on terms during an audit.

"It makes little sense to allow companies second guess the situation for lengthy period or even years, before finally getting a "surprise" audit". **FDI – Financial Services**

Companies operating in the software and services area find the definitions and lack of guidance to be a particular source of difficulty to them.

"The definition of R&D is antiquated and not aligned with a lot of where we are going. We need user experiences R&D included. This is a key enabler to the future of research and innovation in Ireland. We need research with commercial potential that is bringing new experiences to users, not just definitions from the 80's when this dimension didn't exist".

FDI - Technology

The objective of the R&D performing business community is to apply and obtain Tax Credits for the R&D activities underway, in line with regulations. The challenge faced however is that many companies find it difficult to apply those regulations to their own business, and anxiously await the announcement of an audit, only to find that what they thought was adequate and in compliance was potentially not so.

"We have not yet had an onsite Revenue audit and we would be concerned that although we have only applied for the R&D Tax Credits within the rules as we understand them, the Revenue or Technical Assessor may not agree with us".

FDI – Life Sciences

"Business-wise the uncertainty is the main difficulty. The 'ah come on test' sounds ridiculously arbitrary".

Indigenous - Software

In addition, given the retrospective nature of the audit, and the lengthy period it can take to complete, organizational changes within companies can make it very difficult for them to comprehensively address the audit needs and potential gaps which may have been inadvertently made at the time of application.

"The R&D Audit process needs improvement – the current process is long-drawn-out, historical by nature – 2 to 3 years old and slow". **FDI – Life Sciences**

Companies' experience of other audit-type processes would suggest that, by comparison, Revenue audits are slow and cumbersome.

Ultimately, the scheme should be as transparent and as easy to follow as possible, such that all parties, finance and non-finance, are confident and clear about what is in scope, what is required to support the application, and so that an audit could be conducted in the most efficient manner possible.

6.3.1 IRDG Suggestions

To provide the improved clarity for the business users, to ensure that applications for R&D Tax Credits comply with requirements and would serve the needs of an audit, and to make a more efficient process for the benefit of all parties, the following recommendations are proposed:

6.3.1.1 Clarity of Definitions

- **The R&D Tax Credit Scheme should reflect and be aligned to the Frascatti Manual, and definitions and examples given therein become accepted standard (in particular the classification of Phase 1 to Phase 3 Clinical trials as being eligible R&D).**
- **If a company has obtained a patent or has gone through the process of registering a patent and it has been found to meet the requirements of same, this should be sufficient from a technical write-up point of view and need no further detailed explanation.**

6.3.1.2 Administration & Audit

- **Much better guidance should be given on how to apply, evaluate projects, and the criteria to be used for qualification. There should be specific guidelines for different sectors, depending on size and market. It would be helpful if the R&D guide notes gave typical examples that reflect specific Industry types (in particular those that are very important to the Irish economy), e.g. Pharmaceutical Sector, Food Sector, IT/Software Sector, Agri-Forestry-Fish, Renewable Energy**
- **Clarity in the form of templates should also be provided. The technical merits of a claim still have to stand-up to scrutiny.**
- **Examples through case studies and sample submission documents in the various industries involved in the scheme would provide another level of detail on what may or may not qualify and help companies to become more confident and efficient about what they focus on.**
- **Clearly indicate what documentation will be required during an audit, including the format and level of detail required within.**
- **Define what is 'Fair & reasonable'. It is used extensively by Revenue – however it is all down to interpretation of the individuals as to what that actually means.**
- **The addition of a Revenue funded advice facility to help companies assess the criteria they apply, which might also provide a sample manifest of artifacts that the Revenue Commissioners would like to see to support a claim, could be a valuable contact point between Industry and Revenue.**

- **Provide an Audit timeframe at the outset: turnaround time from initial contact to completion of the audit process.**
- **Given that Revenue has shortened the period that companies can go back to claim, the Revenue should also have a similar challenge period.**

6.4 Base Year

The reduction in the base amount by €200,000 as introduced by the Finance Bill 2013 is welcomed by IRDG as it does create an improved position for some member companies. However, there is still scope for further improvement.

In general terms, the utilisation of 2003 as a base year creates an uneven playing field with respect to those companies that were carrying out significant R&D projects during 2003 and those companies that had a low R&D spend in that year, or commenced R&D activities in subsequent years.

"The main shortcoming for us is the incremental based approach – the fact that we can only claim on R&D expenditure in excess of our 2003 base year R&D expenditure (the €100,000 volume based concession does not benefit us) places a significant limit on the value of the credit to our business. As competition for winning R&D projects exists internationally within our group, the greater the amount of expenditure which we can claim against, the more cost competitive we can be". **FDI -Engineering**

The 2003 base year is also increasingly difficult for companies to deal with. 2003 can still be audited in 2013, 10 years after the expenditure has incurred. Normally Revenue audits only go back 4 years. It is very difficult to ensure that records for 2003 are available. Equally it is very possible that the relevant personnel may have left the company and it's becoming very difficult for the taxpayer to have to defend their position of 10 years ago.

Companies also find that they invariably have to defend that they didn't carry out more R&D than claimed in 2003, and this is particularly concerning.

"When the Revenue is auditing a R&D tax credit claim, they are obviously reviewing the 2003 figures to be understated and would be questioning if the company left out qualifying R&D activity or spend. Only personnel involved in R&D in 2003 can explain any discrepancies the Revenue may have on this. Equally a company can't be expected to hold records for something that didn't happen!" **Indigenous - Food**

6.4.1 IRDG Suggestions

Taking into account the current national financial constraints, and in order to encourage companies to continue and increase their commitment to R&D, the impact of the base year should be reduced over a period of time. This would standardize the calculation of the qualifying spend.

The ultimate objective would be to remove the 2003 base year altogether, and proceed totally on a volume basis for all companies. However, the following recommendations would serve as improvements on the current position:

- **For all future first time R&D Tax Credit claimants, a nil base year figure be used.**

- **In the event of a first time audit, the previously submitted figure for 2003 is accepted without audit.**
- **In the event that a company was already subject to audit, the R&D spend for 2003 that was agreed during that audit would no longer be questioned / audited.**

6.5 KEY EMPLOYEES

IRDG broadly welcomes the changes in the Finance Bill 2013 in relation to the Key Employee.

In a recent survey of members, only a minority stated that they were introducing, or would introduce, the scheme as it stands currently. Many companies have stated that they will not implement the current scheme because they see it as potentially divisive between individuals and departments. It may also reduce flexibility in the workforce as an employee could qualify one year and not the next. Typically, R&D projects are developed and brought to market using a team approach with employees from many different departments. Companies feel the reward mechanism should be capable of being applied to all relevant staff and that the definition of key employees is too narrow. Companies have expressed the view that the objective of this mechanism should be to incentivise companies to undertake and invest in R&D. The addition in Finance Act 2012 of the use of the R&D Tax credits to reward employees may not be practical in MNC's as it favours one employee working in R&D over another employee and creates inconsistencies in employee's net salaries.

Despite the welcome change in the threshold from 75% to 50% there are a number of outstanding concerns which will impact on the ability and willingness of companies to implement the initiative.

The key decision makers and facilitators in relation to R&D investment are the senior strategic management and not necessarily the technical R&D team. The Key Employee provision still does not recognise that in companies, it is mostly the senior executives that decide the R&D budget and spend, not R&D personnel. By allowing those who decide what the R&D budget and spend to personally avail of the R&D Tax Credit, this should incentive them to allocate more to R&D spend.

"Excluding directors is unnecessary and unfair, and further tilts the balance away from the risk-taking in the economy that the tax credit is supposed to promote. Who is in a riskier position than the promoter of the company embarking on the R&D? There is an increasing flight of brains from the country (we have lost two of our top young guys) and I believe soon the export sector and our entrepreneurs will start to decamp. It's happened before - Dermot and Denis will never be back in the tax net". **Indigenous - Software**

The current scheme favours highly paid R&D employees over lower paid employees. The solution put forward previously by IRDG in respect of linking the amount of credits receivable to the amount of tax paid by the employee would appear to be a more fair and equitable solution. Where an employee works full time in R&D, this, in itself, should entitle him/her to obtain a portion of credits irrespective of the number of hours spent on qualifying projects and allow an employer to treat all R&D employees equally.

Finally, there is concern as to how this will actually work in practice particularly in relation to a possible claw back following an R&D Tax Credit Claim Audit at which time the employees may no longer work with the company on even reside in the state. The work involved to make sure that the person receives the tax credit and that their effective tax rate does not fall below 23%, places a significant burden on the employer to track and manage this. This current process also places a burden on the employee to submit and file a return to Revenue to claim this credit.

6.5.1 IRDG Suggestions

- **Revenue to issue a practice statement on the paying out of credits to employees as companies are still not clear on how it will work in practice.**
- **Allow the company to decide who is a key employee; extending beyond just R&D staff.**
- **Allow Directors under restricted conditions.**
- **Ability to claim for R&D employees who spend time outside the EU up-skilling at corporate headquarters. Currently any expenditure outside the EU is out of scope per the current allowances. There may be possible opportunities here to up skill the current workforce.**
- **On recruitment of dedicated R&D employees allow a claim of 2xsalary for the first number of years to encourage companies to take on dedicated employees.**

6.6 SUB-CONTRACTORS

The restriction on claiming subcontracted R&D costs being the greater of 10% of in-house expenditure or €100,000 is set quite low and we would welcome an upward revision of this threshold. Research and development projects are, by their very nature, complex and it is often necessary for a company to use the services of consultants to provide expertise not available in-house or to assist with key stages of a large project.

Many companies fund significant external R&D activities, which they cannot include in their R&D Tax Credits application. This portrays an expenditure figure which in effect is not fully reflective of reality.

"Our Company has a clear understanding of the philosophy of the R&D Tax Credit which is to demonstrate an R&D culture within the company. However in our experience with tax credit claims relating to a very wide range of projects, often specialist skills are not available in-house and a body of work may require outsourcing to a specialist firm or university. Given that the cap is 10% on contracted R&D, this greatly limits the extent of our real claim and does not reflect the reality of external money spent on R&D which in turn is benefiting the economy and maintaining jobs in Ireland". **Indigenous – Energy and Clean-Tech**

Other companies are restricted in their engagement with external researchers, particularly the Third Level Sector, as a result of this cap.

"The limit on external R&D actually limits our spending with Irish Universities and Third Level Institutions as the R&D Credits are effectively not available to us for such incremental spend". **FDI – Life Sciences**

Companies operating in the software environment in particular also feel that the cap should be removed; at least until such time as there is sufficient number of Software Graduates in the marketplace to fill the vacant positions. These companies are having to hire external consultants to support their activities, but yet cannot claim for that resource.

We have also encountered a lack of clarity regarding what is allowable for outsourcing R&D services and materials, and the consistent application of this. Companies have requested guidance on the definition of a sub-contractor.

6.6.1 IRDG Suggestions

- **Issue clear definitions and guidance on the use of Sub Contractors**
- **Do not classify sub-contractors and agency workers who effectively undertake genuine in-house R&D as being subject to the 10% limit.**
- **Remove or raise the 10% restriction on Sub Contractor**
- **Remove or raise the 5% restriction on Sub Contracting to University or Third Level institute.**

7 CONCLUSION

From all the research undertaken in the course of preparing this submission, there is overwhelming support for the R&D Tax Credit scheme, and the benefits it brings to the R&D performing community and wider economy has been cleared demonstrated. Overall, IRDG is of the view that a cocktail of incentives is required to increase the profile of Ireland as a location for undertaking R&D activities and to make it the jurisdiction of choice for the location, creation and trading of intellectual property. The R&D Tax Credit scheme is one such key incentive.

There is however scope for improvement, and members, through IRDG, are keen to work together with the Department of Finance and Revenue to devise and implement value added improvements for the benefit of all parties. Apart from the IRDG R&D Tax Credit audit events in the last 12 months, companies feel that there is little in the way of collaboration between Revenue Commissioners and Industry to outline what companies can expect when engaging in the scheme.

Finally, there is a clear recognition of the challenges facing the Irish economy at present, and the implications for the Budget of the country as a result. The proposals made within this submission are presented in the spirit of continuous improvement, and come from a group of people who have R&D and Innovation at the heart of their day to day operations. Their common purpose therefore is to see R&D grow and strengthen in Ireland, for the benefit of industry, academia, the employee population, and the economy as a whole.