An Roinn Airgeadais
Department of Finance

Review of R&D Tax Credit

Invitation for Submissions

February 2013

Economic and Fiscal Divisions
Department of Finance
Government Buildings, Upper Merrion Street, Dublin 2
Ireland

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1. Background and Introduction

1.1 This paper sets out some background information on the R&D tax credit as well as the terms of reference for a review of the credit that the Department of Finance is undertaking this year.

1.2 Interested parties are invited to send in written submissions that relate to the terms of reference of the review. The deadline for submissions is the close of business on **Friday 29 March 2013**. Submissions may be emailed to RDconsultation2013@finance.gov.ie or addressed to:

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

1.3 Parties should be aware that all submissions will be published on the Department of Finance's tax policy website www.taxpolicy.gov.ie. If submissions contain confidential material, it should be clearly marked as confidential, and a version of the submission should be provided which can be used for publication.

1.4 Respondents should be also aware that the Department is subject to the provisions of the Freedom of Information legislation.

The R&D Tax Credit

1.5 Ireland has a tax credit scheme for Research and Development (R&D) which was introduced in Finance Act 2004. The Key features of the scheme include:

- A tax credit of 25% on incremental R&D expenditure – in addition to the normal 12.5% trading deduction
- The scheme is based on incremental spend and provides for expenditure on R&D that is in excess of that company's R&D expenditure in the base year of 2003 to qualify for the credit
- The base year has been permanently set at 2003, making it effectively volume based for new entrants
- In line with the Programme for Government commitment, Finance Act 2012 provided that the first €100,000 spend on R&D can qualify for the credit on a full volume basis: any spend above €100,000 must be more than the 2003 base year spend
- It was announced in Budget 2013 that this exemption from the base year restriction would be increased to the first €200,000 of R&D expenditure
- There is no ceiling to the level of eligible expenditure over the 2003 base year level
- Unused tax credits can be carried back for set-off against a company's prior year corporation tax liabilities thus generating a tax refund
- Where there is insufficient current or prior year CT liabilities, the company can claim unused tax credits in cash over three years (in three instalments over 33 months from the end of the accounting period in which the expenditure is incurred)
- Expenditure includes direct and indirect costs in addition to capital expenditure on related plant and machinery
- A company's credit may be assigned to key employees

- A scheme also exists in respect of capital expenditure for R&D purposes and operates on a fully volume-based approach (i.e. expenditure does not need to exceed a level of expenditure in a base year).
- The capital expenditure regime also allows for a proportion of capital expenditure on buildings used in part for R&D purposes now qualifies for a tax credit of 25% (previously expenditure on new or refurbished buildings would only qualify for the tax credit if used "wholly and exclusively" for R&D)

1.6 Tax credits available as cash refunds are particularly attractive to start-up companies or SMEs which are not making profits as the credit can effectively part-fund the R&D activity and acts as a valuable source of cash-flow.

1.7 There have been a number of amendments to the credit since its introduction in 2004. These are summarised in the Table below.

Changes to R&D Tax Credit Scheme

Year	**Changes to the tax credit scheme**
2004	The scheme was introduced based on a 205 credit on R&D expenditure in excess of R&D expenditure incurred in 2003
2005	No change
2006	An apportionment of the R&D related share of plant and machinery costs is eligible for the tax credit
2007	The base year is fixed at 2003 until 2009 (from a previously proposed 'rolling base year' approach) Expenditure by companies on sub-contracting R&D to unconnected parties eligible for the credit subject to a ceiling of 10% of R&D expenditure in one year
2008	Fixing of base year at 2003 until 2013. For accounting periods after 2013, provision made for a ten year look-back between the year the credit is claimed and the base year expenditure
2009	Increase in the rate of relief on eligible R&D expenditure from 20% to 25% Full discharge of R&D tax credit over a three year period as an offset against corporation tax or as cash payments in the event of insufficient or no corporation tax. Proportion of expenditure on mixed used buildings and structures allowable for R&D tax credit purposes subject to a minimum (35%) use of buildings and structures for R&D activities taking place over a period Fixing 2003 as the base year indefinitely
2010	Changes to deal with base year expenditure issues under the tax credit scheme in a situation where R&D is undertaken by a company in two separate locations in the State and one of those locations is subsequently closed down

2011	Excluded expenditure on specified intangible assets from the credit where this expenditure is already covered under a separate tax relief regime
2012	First €100,000 of R&D expenditure eligible for credit regardless of level of expenditure in base year Changes to allow new tax relief for key employees engaged in R&D activities
2013	Amount of expenditure eligible for the R&D Tax Credit on a full volume basis (without reference to the 2003 base year) was increased to €200,000

1.8 As illustrated in the Table above, Budget 2009 introduced a number of significant changes to the scheme. These include the increase in the rate of the tax credit from 20% to 25 %, as well as:

- Giving companies the option to set off unused credits against their previous year's corporation tax liability, thus creating a tax refund, and where there is insufficient or no tax liability in the previous year, allowing the credit to be claimed as a payable amount over a 3 year period;

- Allowing a tax credit on a portion of the expenditure on new or refurbished buildings used in part for R&D purposes, recognising that R&D activity also takes place in manufacturing and production environments and not only in dedicated R&D facilities; and,

- Setting 2003 as the permanent base year under the scheme meaning that over time the scheme will effectively become volume-based.

1.9 The cost of the scheme including value of tax credit claimed, administration costs and compliance costs is estimated to have risen from €82m in 2004 to approximately €224m in 2010. The cost for 2010 includes the amount of credit allowed against 2010 tax together with the amount offset against tax of previous accounting periods and as payable credit. This information was not available for earlier years.

1.10 Over the same period the number of companies benefiting from the credit has increased from less than 50 to more than 1,200.

1.11 Given the level of costs associated with the scheme and that it is now four years since the last major change in 2009 which allowed for a system of payable tax credits it is proposed that that there will be a review of the R&D Tax Credit carried out by the Department of Finance in 2013. The last review of the scheme by the central expenditure evaluation unit of the Department of Public Expenditure and Reform predated the introduction of payable tax credits. The review will be conducted by the Department's Economics and Fiscal divisions.

2. Terms of Reference

2.1 The terms of reference for the review are set out below

Draft terms of reference

1. **Establish the economic rationale for incentivising investment in R&D, including:**
   - The contribution of R&D to productivity and growth;
   - The existence of market failures in R&D activity and expenditure;
   - The rationale for State intervention to incentivise R&D; and,
   - The role of direct expenditure and tax expenditures to correct for market failures

2. **To identify the exchequer cost and level of take up of the R&D tax credit.**
   - The level of take up should include a description of the types of business sectors and firms that benefited from the scheme as well as the characteristics of those firms

3. **To assess the impacts of the R&D tax credit on the following:**
   - The amount of business expenditure on R&D;
   - Indigenous and FDI investments in Ireland (both new and existing);
   - Large company and SME activity;
   - Mobile R&D investments (both new and existing)
   - Levels of deadweight and additionality

4. **To consider whether the design and structure of R&D credit is optimum by analysing:**
   - The 'incremental' approach to eligible expenditure (i.e., the use of 2003 as a base year for the assessment of incremental expenditure)
   - Possible overlaps with other tax provisions
   - The level of allowable expenditure that can be outsourced
   - Aspects of the eligibility criteria (is the regime too wide or too narrow in scope in respect of allowable activities)
   - The interaction and alignment of the tax credit with R&D grants
   - The administrative burden of the regime

5. **International competitiveness of R&D offering**
   - A comparison of Ireland's offering to that of competitor jurisdictions for mobile (R&D-based) FDI

Annex: International Incentives

The Table below provides a list of incentives available in OECD and emerging economies. The Table was provided by JPW Innovation Associates Inc. The input of Information Technology and Innovation Foundation, Washington D.C. and DG Research of the European Commission are also acknowledged. The Department of Finance is not responsible for any errors or omissions in the Table.

As the Department will be conducting its own review of a review of international incentives as part of the review of the R&D tax credit, parties are invited to comment on the information in the Table below.

Country	Corporate income tax rate large/small firm %	Rate on level %	Rate on increment %	Base for increment [1]	Expense base	Deducted from
			OECD			
Australia – R&D tax offset	30	40 large (45 small refundable)			Current expenses machinery	Tax
Austria – tax credit	25	10			Current expenses machinery, buildings	Tax
Belgium – investment deduction – withholding tax credit	33.99	14.5 75			Machinery, buildings Research wages	Income Income
Canada – tax credit – Small company – Large company	26.1/15.5	35 20			Current expenses machinery	Tax
Czech Republic – R&D allowance	19	200			Current expenses	Income
Chile	20	35			All project expenses	Tax
Denmark – R&D allowance	25	200			Current expenses	Income
Finland	26	No R&D tax incentives				

Country	Corporate income tax rate large/small firm %	Rate on level %	Rate on increment %	Base for increment [1]	Expense base	Deducted from
France[2]	33.33					
– R&D 100 M euro		30			Current expenses	Tax
– over 100 M euro		5			and depreciation	
Germany	29.37	No R&D tax incentives				
Greece – R&D allowance	20		50	2 yrs	Current expenses	Income
Hungary – R&D allowance	19	200			Current expenses, machinery	Income
Iceland	20	No R&D tax incentives				
Ireland	12.5					
– tax credit			25	2003 R&D spend	Current expenses and machinery	Tax
– tax credit - buildings		25			Buildings	Tax
Israel	24	No R&D tax incentives				
Italy – tax credit	31.4	10			Current expenses and machinery	Tax
Japan	38.01/30					
– tax credit large firm		8 -10			Current expenses and machinery depreciation	Tax
– tax credit small firm		12				
Korea	24.2/11					
– tax credit large firm		3-6	or 40%	4 yrs	Current expenses	Tax
– tax credit small firm		25	or 50%	4 yrs		
– facilities tax credit		10			Machinery	Tax
Luxembourg	28.8	No R&D tax incentives				
Mexico	30	No R&D tax incentives				
Netherlands	25.5/20					
- wage cost deduction		18 (50 small)			Research wages	Income
- RDA allowance		140			All expenses less research wages	Income
New Zealand	28	No R&D tax incentives				
Norway (refundable)	28	18 (20 small)			Current expenses, machinery	Tax
Poland	19	No R&D tax incentives				
Portugal	26.5					
–tax credit		32.5	(+)[3] 50	2 yrs	Current expenses, machinery	Tax
Slovak Republic	19	No R&D tax incentives				

Country	Corporate income tax rate large/small firm %	Rate on level %	Rate on increment %	Base for increment [1]	Expense base	Deducted from
Slovenia	20					
– R&D allowance		120			Current expenses	Income
Spain	30					
– tax credit		25	(+) 42	2 yrs	Current expenses	Tax
–credit for capital R&D		8			Machinery	
Sweden	26.3	No R&D tax incentives				
Switzerland (Zurich)	21.17	No R&D tax incentives				
Turkey	20					
- R&D allowance		200			Current expenses	Income
United Kingdom – R&D allowance	26/20					
– Small firm		225			Current expenses	Income
– Large firm		130			Current expenses	Income
United States[4]	35					
Regular tax credit			20		Maximum 50% of current expenses	Tax
Alternative simplified credit			14	50% of 3-yr base	Current expenses	Tax
Emerging Economies						
Brazil	34					
- R&D allowance		160			Current expenses	Income
China[5]	25					
- R&D allowance		150			Current expenses	Income
India						
- R&D allowance	33.22					
		200			Current expenses machinery	Income
Indonesia	25	No R&D tax incentives				
Malaysia	25					
- R&D allowance		200				
Russia						
- R&D allowance	20					
		150			Current expenses	Income
Singapore						
- R&D allowance	17					
		150			Current expenses	Income
South Africa	34.55					
- R&D allowance		150			Current expenses	Income
Taiwan						
- R&D tax credit	17					
		15			Current expenses	Tax