

Generating cash from Irish R&D activities

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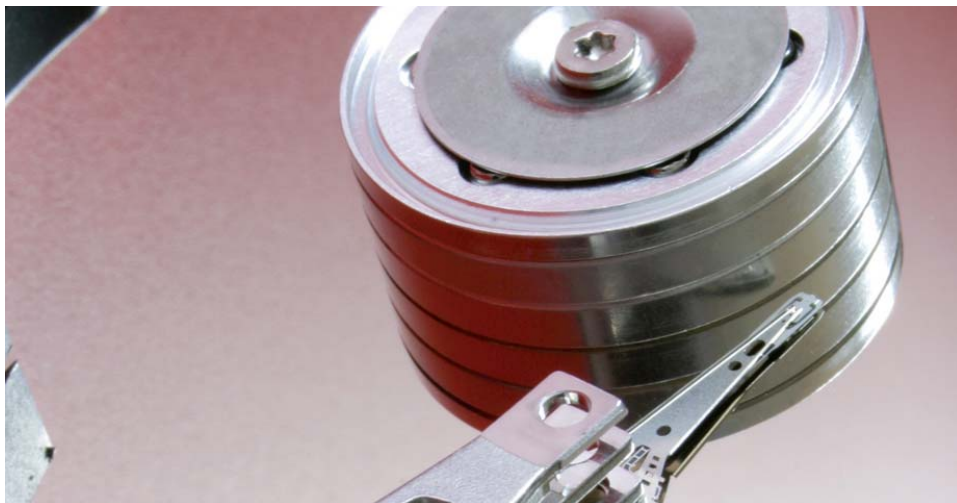
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Ireland's research and development ('R&D') tax credit regime has positioned Ireland to the forefront of locations to develop, manage and exploit intellectual property.

In 2008 40% of Ireland's foreign direct investment projects related to R&D. Allied to the new IP tax regime introduced in 2009 and Ireland's range of R&D grant incentives, Ireland's enhanced R&D tax credit regime makes Ireland an excellent location for R&D activities for both indigenous and international investors.

A series of positive R&D tax credit changes have been introduced since 2004, and extensive and welcome amendments have also recently been introduced. Essentially, the new regime supplements the existing tax credit scheme and provides for the monetisation of unutilised R&D tax credits in certain circumstances for the first time.

The Commission on Taxation, established in 2008 to review the structure, efficiency and appropriateness of the Irish taxation system, contained a strong endorsement of the R&D tax credit regime in its September 2009 report. The report also included a proposal to allow companies offset the R&D credit "above the line" against employers PRSI. The proposals in the report will be considered by the Irish government in the coming months.

Details of the main provisions of Ireland's R&D tax credit regime are provided overleaf. In addition, we include a summary of the R&D grant assistance available in Ireland.

Please contact a member of the R&D team, or your usual PwC contact, if you would like to discuss these matters further.

The R&D tax credit reduces the real cost of R&D by up to 37.5%

R&D tax credits

Introduction

Extensive and welcome amendments have recently been introduced to the R&D tax credit regime in Ireland. Probably the most significant amendment is the 'monetisation' of the R&D tax credit. This now enables companies to obtain cash for new unutilised credits and to generate cash tax refunds by carrying back R&D tax credits to the prior year. The ability to generate cash in the current environment is an extremely attractive proposition that merits serious consideration.

Through our recent collaborations with various relevant bodies, there is widespread acceptance that the R&D tax credit can now be accounted for 'above the line' in the Profit & Loss account, thereby increasing the attractiveness of the regime to R&D teams seeking to factor the benefits into pre-tax budgets. The recent Commission on Taxation report also proposes to allow companies to offset the R&D credit 'above the line' against employers' PRSI.

The above, taken together with an enhanced regime for claiming the R&D tax credit on expenditure incurred on qualifying R&D buildings, encourages companies to re-evaluate their current R&D focus.

Background

A 25% tax credit that can be offset against corporate taxes (previously 20%) applies to incremental expenditure on qualifying R&D incurred by companies that are themselves trading or are members (more than 50% owned) of a trading group. This tax credit is in addition to the corporate tax deduction (at the 12.5% rate) that is otherwise available for the expenditure, giving an effective benefit of 37.5%.

The incentive is aimed predominantly at in-house R&D activity, although expenditure incurred by companies on sub-contracting R&D work to unconnected parties may qualify for a tax credit, up to a limit of 10% of the qualifying R&D expenditure in any one year. A similar provision exists in relation to R&D work sub-contracted to Universities, with the limit set at 5% of the qualifying R&D expenditure in any one year.

Expenditure incurred by companies under 51% common ultimate ownership is aggregated and the resulting credit can be allocated between the trading members of the group in proportions nominated by the taxpaying company. In the absence of an election, the R&D credit is allocated to group companies on a pro rata basis.

Recent enhancements

Monetisation of the R&D tax credit

Tax credits are available for offset against a company's current year corporation tax liability in the first instance. Companies now have the ability to carry back excess R&D tax credits to the prior year thereby generating cash refunds of tax paid.

Companies also now have the ability to claim repayment of excess R&D tax credits over a three year cycle. The repayment is limited to the greater of the corporation tax payable by the company in the preceding ten years or the payroll liabilities (PAYE/PRSI/Levies) for the period in which the relevant R&D expenditure is incurred.

This is a very important and welcome development as it allows companies to access cash tax benefits from R&D tax credits much earlier in the R&D/IP lifecycle.

Accounting treatment

Companies now have the ability to account for the credit 'above the line' in the Irish Profit & Loss account thereby immediately impacting on the unit cost of R&D, which is the key measurement used by MNC's when considering the locations of R&D projects. This is extremely helpful to Irish subsidiaries of MNC's in terms of being able to compete with lower cost jurisdictions.



Revenue has confirmed that where a company accounts for the R&D tax credit through the Profit and Loss account before tax, the tax credit will not be regarded as taxable income of that company or another company to which the credit has been surrendered.

There may also be scope to take the benefit of the credit 'above the line' for group consolidated accounting purposes (eg under US GAAP for MNCs) for credits that arose post 1 January 2009. Credits that arose before 1 January 2009 would continue to be presented in the tax line. The impact on group consolidated accounting treatment as well as the group effective tax rate should be considered.

Enhanced regime for buildings

A company may now claim the full credit in the year the relevant expenditure on buildings is incurred rather than spread over four years as previously was the case. The definition of qualifying building has also been made more flexible as the requirement that the building has to be used 'wholly & exclusively' for R&D purposes has been relaxed. Instead, a 35% R&D activity 'hurdle' over a four year period is the required benchmark going forward. This is particularly beneficial where R&D is carried out in a manufacturing environment.

Key requirements

Base period

The R&D tax credit system is based on incremental expenditure on R&D. In the case of a company with a calendar year end, the incremental R&D expenditure incurred in a particular year over that incurred in the year ended 31 December 2003 qualifies for R&D tax credits. The base year has been set as 2003 indefinitely.

Qualifying expenditure

To qualify for the R&D credit, a company must incur expenditure in carrying on qualifying R&D activities in the European Economic Area. The expenditure must be tax deductible only in Ireland and not in any other country (eg in a branch outside Ireland). The expenditure must be incurred on systematic, investigative or experimental activities in a field of science or technology that falls within any of the following categories:

- Basic research to acquire new scientific or technical knowledge without a specific practical application in mind
- Applied research to acquire scientific or technical knowledge and directed towards a specific practical application
- Experimental work which draws on scientific or technical knowledge or practical experience for the purpose of achieving technological advancement and which is directed towards producing new, or improving existing, materials, products, devices, processes, systems or services.

Science or technology

Regulations have been issued outlining the categories of activities that fall within the field of science or technology under the headings of natural sciences (specifically including mathematics, computer science and software), engineering and technology, medical sciences and agricultural sciences.

Systematic, investigative or experimental activities

The R&D activities must be systematic, investigative or experimental in nature. The guidelines issued by Irish Revenue require documentation to be maintained on:

- The nature of the project, the objective of the research and the research method
- The field of science or technology concerned
- The scientific or technological uncertainty that is being addressed by the R&D and the project's scientific or technological goals
- A detailed research programme
- The skills and qualifications of the research team
- Time records
- Expenditure analysis, including third party expenses and royalty payments.

Irish Revenue is prepared to give an advance opinion as to whether a particular project would qualify for an R&D tax credit.

Where a project is subject to review or audit by Irish Revenue, it may seek input from a third party expert to examine whether or not qualifying R&D activities are taking place.

Irish Revenue guidelines

The Irish Revenue has also provided guidelines outlining its interpretation of the legislation. The guidelines state that seeking to achieve scientific or technological advancement involves the removal of scientific or technological uncertainty through systematic, investigative or experimental activity.

The guidelines also state that an advance in technology means an advance in the overall knowledge or capability in the relevant field and not a company's own state of knowledge. Work which uses science or technology but which does not advance scientific or technological capability as a whole is not an advance in science or technology, nor is it resolving uncertainty as to whether new products or process will be commercially viable.

Technological uncertainty, in Revenue's opinion, arises in two situations:

1. Uncertainty as to whether a particular goal can be achieved at all, or
2. Where there is certainty that the goal can be achieved there may be uncertainty in relation to other specifications such as reliability or reproducibility.

R&D grants

Ireland offers a dynamic research environment resulting from the co-ordinated support of Government departments, funding agencies, regulatory authorities and academia. An essential part of this support is in the form of grants awarded by Enterprise Ireland (for Irish owned companies) and IDA Ireland (for foreign owned companies). To be eligible for grant assistance, companies must be involved in manufacturing or internationally traded services.

The fund available for R&D grants is €500 million.

Irish owned companies – Enterprise Ireland

Enterprise Ireland offers a range of assistance for R&D activities including:

- specialist consultancy
- early stage investigations
- planning
- feasibility
- development of new or improved products, processes and services.

The rate and level of grant available varies according to each programme. The main scheme is known as the 'R&D Fund'. The R&D Fund helps companies to fund new or improved products, processes and services. The rate of grant ranges from 25% to 45% depending on the size of the company. A bonus rate of 15% is available where there is collaboration between 2 or more companies. Eligible costs include



capital expenditure, personnel, travel, consultancy, materials, technology acquisition and overheads.

Applications for the R&D Fund are invited through a public call on the last working day of each month.

Foreign owned companies – IDA Ireland

The main R&D grant scheme available to foreign owned companies in Ireland is the Research, Development and Innovation ('RD&I') programme which is administered by the government agency, IDA Ireland. Two types of support are available under the RD&I programme as follows:

RD&I programme

Feasibility - assistance provided to companies is to enable them to investigate potential RD&I projects that may be carried out in Ireland. If a company is successful in identifying a specific area and/ or in gaining a corporate mandate for an RD&I project for Ireland, the company can then apply for further support for the specific project or programme to be carried out in Ireland (see below). The grant rate available for the feasibility stage is 50% or 40% of eligible costs depending on the type of research being considered.



Training - assistance is available to up-skill a company's staff to ensure that they will have the appropriate skills to carry out a small pilot RD&I project or a full RD&I project. The training grants can be used to provide formal internal training to staff, send staff to formal training programmes in Ireland or abroad or to send staff to existing corporate RD&I facilities to acquire technology and RD&I management skills. The grant rates available for training are up to 50% for general training and up to 25% for specific training.

Pilot project - to the extent that the feasibility/training stage requires a company to implement a small pilot project, assistance is available towards the costs associated with the pilot project (eg salary costs, overheads, travel costs, consultancy, and materials). The grant rate available is either 50% or 25% depending on the type of research being considered.

The total amount of grant assistance available for feasibility/training/pilot project is a combined €250,000.

RD&I project support

The aim of the RD&I project support grant is to encourage companies to expand and deepen their R&D capabilities and facilities in Ireland. The RD&I grant can provide significant levels of grant assistance for R&D projects ranging from small scale projects to large scale programmes and the development of dedicated R&D functions.

Eligible costs include:

- Capital expenditure
- Personnel
- Travel
- Consultancy
- Materials
- Technology acquisition
- Overheads.

The grant rate can range from 25% to 50% depending on the type of research being carried out and the degree of collaboration with a third level institute or other industrial parties. In practice, grant rates for successful R&D project applications average 20% to 25%.

Each application must undergo a strategic, commercial and technical assessment as part of the IDA Ireland approval process. Projects seeking grant support in excess of €7.5 million (for experimental research*) or €10 million (for industrial research*) require

EU approval. No retrospective assistance can be awarded therefore applications must be submitted before work commences on the R&D project.

**the definitions of experimental and industrial research are set out in pages 9 & 10 of the EU Commission's publication "Community Framework for State Aid for Research and Development and Innovation" (2006/C 323/01).*

Other R&D grants

Innovation Partnership grants

The Innovation Partnership initiative provides financial support to encourage companies to undertake collaborative research projects with Irish universities and Institutes of Technology. The projects must be in the area of science, engineering or technology and must seek to develop innovative new products and/or processes for Irish-based industry.

The initiative provides financial assistance to companies for the cost of third level research and development expertise. Typically a company will work in conjunction with a third level institution to jointly define the research project. The third level institution completes and submits the proposal for funding and if successful, the company and the institution jointly manage the progress of the project. If appropriate, the third level

institution can apply for a feasibility study grant to explore the technological issues involved before embarking on a project. The grant rate for this scheme is up to 80% of eligible costs.

EU 7th Framework Programme

The EU provides substantial amounts of grant funding for R&D under its Framework Programmes for Research & Development; the current 7th Framework Programme runs until 2013.

Projects are competitive and normally have to be transnational in nature. For research projects, only consortia of partners from different countries are eligible.

The Framework Programme provides an opportunity for Irish based companies to collaborate with leading European companies and research organisations at the cutting edge of technology with the support of EU funding.

Advice and financial assistance is available to companies in Ireland to encourage participation in this programme.

How can PwC help?

- 1. R&D tax credit eligibility**
We can help to determine eligibility for the R&D tax credit.
- 2. R&D tax credit claim**
We can assist you with the preparation of an R&D tax credit claim and supporting documentation required.
- 3. Grant eligibility, applications and audit**
We can help you to determine eligibility for new grant assistance and identify the types of grant available. We can also assist you with the application, negotiation process and required audit of claims.
- 4. Grants review**
If you are unclear about your grant status and the outstanding obligations or entitlements you have, we can review your existing Grant Agreements and provide you with a full status report.
- 5. Grant repayments/ clawback**
In the event that things do not go according to the company's original plans, we will advise you on how to manage any clawback or repayment issues that arise.

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