

Research & Development Tax Credit and the Knowledge Development Box

Public Consultation

April 2022

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1 Background

The Department of Finance invites submissions from the public in relation to the following Corporation Tax measures:

- The Research and Development (R&D) tax credit, and
- The Knowledge Development Box (KDB).

A questionnaire at the end of this document indicates specific areas of interest on which the Department is requesting views. General commentary on the above measures is also welcomed.

The purpose of this public consultation is to consider the current challenges facing firms who are active in the R&D space, as well as the implications of recent domestic and international tax reforms for these two reliefs. All input will be considered in the context of this year's Budget and Finance Bill.

OECD BEPS

In October 2021, Ireland was one of almost 140 jurisdictions that reached agreement, through the OECD/G20 Inclusive Framework on BEPS, on a two-pillar solution to address tax challenges arising from the digitalisation of the economy.

- **Pillar One** will see a reallocation of 25% of residual profit (profit greater than 10% of turnover) to the jurisdiction of the consumer. Scope is initially confined to multinational groups with turnover in excess of €20 billion annually. The threshold will reduce to €10 billion after 7 years.
- **Pillar Two** will see the adoption of a new global minimum effective tax rate of 15%, applying to multi-nationals with global revenues in excess of €750m.

The agreement will continue to allow our tax system to support innovation and growth, and the long-standing 12.5% corporation tax rate will be retained for companies with a turnover below €750m annually.

The primary elements of Pillar Two are the Income Inclusion Rule (IIR) and the Undertaxed Profits Rule (UTPR), collectively referred to as the GloBE rules, which will provide for the new minimum effective rate of 15%. The importance of R&D activities has been recognised under the GloBE Rules, with “qualified refundable tax credits” to be treated as income in calculations of the effective minimum tax rate, rather than as reducing tax paid.

The third element of the Pillar Two agreement is the Subject to Tax Rule (STTR). This is to be a treaty-based rule that allows source jurisdictions to impose limited source-based taxation on certain related-party payments, such as interest and royalties, which are subject to tax in the recipient jurisdiction below a minimum rate of 9%. There is no minimum turnover threshold for application of the STTR. The STTR will be creditable as a covered tax under the GloBE rules.

Technical work is ongoing on both Pillars of the agreement at both the OECD and the EU. Officials from the Department of Finance and the Revenue Commissioners are actively engaged in all aspects of these discussions to ensure that Ireland's interests are protected and that the agreement is implemented effectively and in consultation with relevant stakeholders.

As part of this process, the Department is undertaking a review of the R&D tax credit and the KDB. This tax review will consider the potential impacts of the agreement reached at the OECD/G20 Inclusive Framework on BEPS on the R&D tax credit and the KDB, particularly the Pillar 2 global anti-base erosion (GloBE) rules.

It will also have regard to other aspects of international tax reforms that may be of relevance to the credits.

Research and Development Tax Credit

The Research and Development (R&D) tax credit was introduced in Finance Act 2004. The central purpose of the R&D tax credit is to encourage companies to undertake high-value-added R&D activity in Ireland, thereby supporting jobs and investment here. It supports companies in investing their own resources in R&D activities, thereby stimulating more activity than government resources could support through direct expenditure measures alone.

The principal benefit of the R&D Tax Credit is that it reduces the costs of undertaking R&D in Ireland by 25%. For every €4 spent on qualifying R&D, a tax credit of €1 will be provided to the company. It is flexible in terms of its operation as, where a company has offset the credit against its corporation tax liabilities and excess credit remains, the company can make a claim for payment of the excess credit over three instalments.

The latest cost figures for the credit are from 2019, when the cost was €626 million with 1,601 claims. The annual cost of the relief fluctuates over time as it is driven by the R&D investment cycles of claimant companies. It is expected that the cost may increase again in future years.

A key aim of the Government is building the knowledge exchange system, which is accomplished through three main channels: formal collaborations; human capital mobility; and knowledge transfer infrastructure. Both industrial and academic R&D have an important role to play in supporting innovation-based economic growth. Finance Act 2019 provided for an increase to the R&D tax credit outsourcing limit on expenditure to universities or institutes of higher education from 5% to 15%. The aim of this change is to encourage greater investment and partnership opportunities between industry and the education sector in pursuing practical applications of academic research.

Knowledge Development Box (KDB)

The Knowledge Development Box (KDB) is an OECD-compliant intellectual property (IP) regime, which provides for relief from Corporation Tax on income arising from qualifying assets such as computer programs and inventions protected by a qualifying patent. The objective of the KDB is to encourage companies to develop IP in Ireland and thereby engage in substantive operations that have a high 'value-add' for the Irish economy, both in the FDI and indigenous sectors.

The relief is given by way of a deduction equal to 50% of the qualifying profit from the qualifying asset, which in practice results in an effective tax rate of 6.25% on the qualifying profit. Small and Medium Enterprises (SMEs) benefit from an expansion of the definition of qualifying assets to include inventions that are certified by the Controller of Patents, Designs and Trademarks as being novel, non-obvious and useful.

Companies electing to avail of the KDB must do so within 24 months from the end of that accounting period. By contrast, most tax reliefs are claimed in a company's tax return, filed within nine months of the end of the accounting period.

The KDB may be claimed by companies with accounting periods commencing on or after 1 January 2016 and before 1 January 2023. As such, officials in the Department of Finance will be considering future policy options with respect to the KDB and how it may interact with the Pillar 2 agreement on minimum effective corporate tax rates, including in particular the Subject to Tax Rule (STTR).

Statistics

Annual cost and claimant figures for the Research and Development Tax Credit

Year	Exchequer Cost (€m)	Number of claimants
2014	553	1,570
2015	708	1,535
2016	670	1,506
2017	448	1,505
2018	355	1,303
2019	626	1,601

Annual cost and claimant figures for the Knowledge Development Box

Year	Exchequer Cost (€m)	Number of claimants
2016	6.1	10
2017	12.2	16
2018	10.3	15
2019 * (provisional)	12.2	15

* Due to the 24-month claim window for the KDB, data for 2019 is still incomplete. Final figures for 2019 are expected during quarter 2 of this year.

2 Consultation Period

The consultation period will run from Thursday 14 April to **Monday 30 May 2022**. Any submissions received after this date may not be considered.

How to Respond

The preferred means of response is by email to: ctreview@finance.gov.ie

E-mail submissions will receive an acknowledgement of receipt within 3 working days.

Alternatively, you may respond by post to:

R&D Tax Credit and KDB – Public Consultation
Tax Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2
D02 R583

Please include contact details if you are responding by post. When responding, please indicate whether you are contributing to the consultation process as a professional adviser, representative body, business representative, member of the public, or in any other capacity.

Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Acts. Parties should also note that responses to the consultation may be published on the website of the Department of Finance.

Meetings with key stakeholders

The Department of Finance and Revenue may also invite key stakeholders to meet with them, including representative bodies, tax professionals and other interested groups or individuals.

After the Consultation

Tax policy issues from this public consultation will form part of the Minister for Finance's considerations in relation to the applicable legislation.

3 Responses

In responding to this consultation you are invited to:

- Give your views on the specific questions set out below. You do not have to answer every question – you can choose to answer any or all of the questions.
- Provide details of any alternative approaches or options you feel might be beneficial in dealing with the issues being addressed.
- Provide details of relevant issues not covered in this paper.
- Where appropriate, provide some analysis of the Exchequer cost/yield of your preferred option.
- Comment generally on the direction you would like to see tax policy in this area develop.

Your views are important as they may help to influence future policy development in these areas.

4 Consultation Questions

Section 766 – Research and Development Tax Credit

1. What are the key considerations to be taken into account when deciding whether to base your R&D activity in Ireland?
2. When did you first claim, and what prompted you to do so? What do you value about the design of the R&D tax credit?
3. How do you think the Irish R&D tax credit can remain competitive in the evolving international tax landscape?
 - *In answering this question, please have regard to EU State aid considerations and to both multi-lateral and jurisdictional changes in the international tax landscape.*
4. In the absence of the R&D tax credit, can you say what proportion of your R&D would take place in Ireland?
5. One of the main policy rationales of the R&D tax credit is to promote high quality jobs and investment in the Irish economy. In your experience, has your decision to conduct R&D in Ireland resulted in you recruiting additional staff, interns or apprentices?
6. How many of your R&D staff are at PhD level or equivalent?
7. Section 766B Taxes Consolidation Act 1997 places limitations on the R&D credit to be paid under section 766 and 766A TCA 1997.
 - Do you consider the limits to be appropriate? What is the impact of these limits on your R&D activities?
 - If you claim R&D tax reliefs in other countries, are similar limitations in place? If so, how do the limitations differ and what are your views on this?

8. What changes might help R&D tax credit claims to be dealt with more smoothly, while ensuring better compliance?
- How could the Department of Finance and/or Revenue improve on the quality of information and/or guidance available to companies?
 - If you claim R&D tax reliefs in other countries, how does the claim process differ and what are your views on this?
9. If the rules in relation to how the credit is claimed or distributed were to be altered, for example in relation to the payment or carry-forward of excess credit, what transition provisions or other considerations would be required?
- *In responding to this question, please have regard to multi-lateral and jurisdictional changes in the international tax landscape and their potential consequences for the Irish tax system as a whole.*

SMEs and the R&D Tax Credit

10. Do you think there are ways of improving the current R&D tax credit system to make it more attractive to SMEs, taking account of EU State aid constraints that would militate against the introduction of a targeted element to the existing tax credit?
11. Having regard to overall Exchequer cost, what other measures could be taken to improve supports for SMEs carrying out R&D?

The Knowledge Development Box

12. Do you have any views as to how Ireland's KDB could develop in the evolving international tax environment?

- *In responding to this question, please have regard to the Subject To Tax Rule (STTR) element of the Pillar Two agreement and its potential consequences for KDB claimants and the Irish tax system as a whole.*

13. What do you perceive to be the factors behind the low uptake of the KDB to date among Irish companies?

14. Are there any particular elements of the KDB conditions that you have encountered difficulty with? Are there commercial situations which you feel should be in scope of the relief, but which fall outside the current rules?

- *In replying, businesses should be cognisant of the requirement for the KDB to be compliant with the OECD BEPS Action 5 agreement on the modified nexus approach for IP regimes.*

15. More generally, what do you think could be done to better support Ireland's indigenous innovation sector in pursuing productivity growth or the development of patentable advancements?



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