

Revenue Guidelines
for
Research and
Development
Tax
Credit

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1. Introduction.

Section 766 provides for a 25% tax credit for incremental expenditure on certain research and development (R&D) activities over such expenditure in a base year (2003) defined as the “threshold amount”. The first €100,000 of expenditure incurred on research and development is excluded from the incremental basis. *Section 766A* provides for a 25% tax credit for expenditure on buildings or structures used for research and development.

2. General Scheme

To qualify for the credit the following must apply:

- The applicant must be a company.
- The company must be within the charge to Irish tax.
- The company must undertake research and development activities within the European Economic Area (EEA).
- In the case of an Irish tax resident the expenditure must not qualify for a tax deduction under the law of another territory.

The Finance (No 2) Act 2008 established 2003 as the base year for all accounting periods. This means that if a company had expenditure on R&D in 2003 that amount must always be subtracted from the current year expenditure.

For expenditure incurred in accounting periods commencing on or after 1/1/2009 the relief is calculated as 25% of qualifying expenditure. The credit is then used to first reduce the liability to Corporation Tax for that accounting period.

Where a company has insufficient corporation tax against which to claim the R&D tax credit in a given accounting period, the tax credit may be carried forward indefinitely, or if a member of a group, allocated to other group members.

The tax credit is in addition to any allowable deductions for R&D expenditure in the accounts of the company and companies claiming the R&D tax credit are not required to hold the intellectual property rights resulting from the R&D work. Equally, there is no requirement for the R&D work to be successful. The definition is concerned with seeking to achieve a technological advancement.

EXAMPLE No. 1-

In the 12 months ended 31/12/2009 CBA Ltd incurred €250,000 R&D expenditure. In the 12 months ended 31/12/2003 they incurred €100,000 R&D expenditure.

Their tax credit for 2009 is calculated as follows.

Expenditure in relevant period ended 31/12/09	250,000
Less Threshold Amount	<u>(100,000)</u>
Qualifying Expenditure	150,000
Tax Credit 150,000 @ 25% =	€37,500

How to treat Grants received.

Any expenditure, which is met directly or indirectly by any grant aid or assistance from

- The State, OR
- Any board established by statute, OR
- Any public or local authority or any other agency of the State

Will not qualify for relief.

Finance Act 2012 broadened this restriction to include

- Any expenditure, which is met directly or indirectly by any grant aid or assistance from another relevant member state.

EXAMPLE No. 2-

If in the case of CBA Ltd in example No. 1 the company was entitled to a State grant of €20,000 in respect of R&D expenditure the tax credit for 2009 is calculated as follows.

Expenditure in relevant period ended 31/12/09 (250,000-20,000) =	230,000
Less Threshold Amount	<u>(100,000)</u>
Qualifying Expenditure	130,000
Tax Credit 130,000 @ 25% =	€32,500

Unused Credits.

The Finance (N0.2) Act 2008 changed the way unused tax credits may be used.

In respect of expenditure incurred in accounting periods commencing on or after 1 January 2009 the company may first offset that unused portion of the credit against the corporation tax of the preceding accounting period.

Where a company has offset the credit against the corporation tax of the preceding accounting period or where no corporation tax arises for that period, and an excess amount still remains, the company may make a claim to have the amount of that excess amount paid to them by the Revenue Commissioners in 3 instalments over a period of 33 months

The 3 instalments will be paid over these 33 months from the end of the accounting period in which the expenditure was incurred. The first instalment to be paid will amount to 33 per cent of the excess amount.

The remaining balance will then be used to first reduce the corporation tax of the next accounting period and if any excess still remains, a second instalment amounting to 50 per cent of that remaining excess will be paid to the company.

Any further excess will then be used to reduce the corporation tax of the following accounting period and if an excess still remains, that amount will be paid to the company as the third instalment.

Please note:

Such payable credits are subject to a limit. This limit is applied as follows:

The limit is the greater of

- (i) The corporation tax payable by the company for accounting periods ending in the 10 years prior to the relevant period OR
- (ii) The aggregate of payroll liabilities for the relevant period and the preceding accounting period.

The change to two accounting periods in respect of payroll liabilities applies to accounting periods commencing on or after 22nd of June 2011. For most companies with 31st of December year-ends the change will apply for the first time in 2012.

In the absence of such a claim for payment, the excess will be carried forward for offset against corporation tax in the subsequent accounting period.

Any claim to offset unused credits against the corporation tax of the preceding accounting period, and/or to have any excess paid by the Revenue Commissioners in 3 instalments may be made by completing the relevant section of the Form CT1 but must in any event, be made within 12 months of the end of the accounting period, in which the expenditure giving rise to the claim occurs.

EXAMPLE No. 3

In the accounting period ended 31/12/2009 PQR Ltd incurred €400,000 qualifying expenditure (after deduction the threshold amount) on research and development. The following shows the company's corporation tax liability.

<u>Accounting Period</u>	<u>Liability</u>
12 months ended 31/12/2008	€30,000
12 months ended 31/12/2009	€10,000
12 months ended 31/12/2010	€15,000
12 months ended 31/12/2011	€10,000

The tax credit due in respect of the accounting period ended 31/12/2009 is (€400,000 @ 25%) €100,000.

€10,000 of the available tax credit is first used to reduce to Nil the corporation tax liability for the accounting period ended 31/12/2009. The remaining tax credit of €90,000 may be carried forward and used to reduce the corporation tax of the next accounting period.

Alternatively the company may make a claim to:

1. Offset a further €30,000 of the remaining tax credit against the liability for the accounting period ended 31/12/2008. That liability will be reduced to Nil and a refund of €30,000 will be due.
2. Revenue will pay 33% of the remaining tax credit to the company as a first installment. That payment of (€60,000 @ 33%) €19,800 will be paid no earlier than 21/9/2010. €40,200 unused credit will then remain.
3. €15,000 of the unused credit will be offset against the liability for the accounting period ended 31/12/2010, leaving a balance of unused tax credit of €25,200.
4. Revenue will pay 50% of the remaining balance to the company as a second installment. That payment of (€25,200 @ 50%) €12,600 will be paid no earlier than 21/9/2011.

5. €10,000 of the remaining unused credit will be offset against the liability for the accounting period ended 31/12/2011, leaving a balance of unused tax credit of €2,600.
6. Revenue will pay the balance of €2,600 to the company as the third installment no earlier than 21/9/2012.

Finance Act 2012 introduced a new measure of relief to apply where a company, which has made a claim under section 766, ceases to carry on a trade and another company commences to carry on that trade and the research and development activities. The successor company may claim any R&D tax credit amounts not used by the predecessor company against corporation tax provided both companies were members of the same group of companies at the time of the transfer of the trade.

3. Group Expenditure on R&D

Rules on group structures.

Companies will be regarded as members of a group if one is a 51 per cent subsidiary of the other, **OR** both are 51 per cent subsidiaries of a third company, irrespective of the country of residence of each company.

In determining whether this is the case, ownership of shares by a company dealing in the shares is ignored.

EXAMPLE No. 4

ABC Ltd own 60% of the shares of DEF Ltd. DEF Ltd own 90% of the shares of XYZ Ltd. As ABC Ltd effectively controls 60% of DEF Ltd, and 54% (60 @ 90%) of XYZ Ltd, all three companies are members of a group for the purpose of claiming the R&D tax credit.

Qualifying group expenditure for a relevant period is the excess group expenditure on research and development activities in that relevant period over the threshold amount for that group.

The *first relevant period will generally* be the first period of one year, ending at the end of the first common accounting period of the member companies of the group that commences on or after 1st January 2004. If the companies do not have a common accounting period, they must jointly elect which accounting date should be used.

For all relevant periods commencing at any time after 31 December 2003 the base period is one year ending on a date in 2003 that corresponds with the end of the relevant period.

The members of the group may by election allocate the tax credit between group members as they wish, or alternatively the credit is allocated by reference to the following formula:

$$Q \frac{C}{G}$$

where-

- Q is the qualifying group expenditure on research and development in the relevant period,
- C is the amount of expenditure on research and development incurred by the company in the relevant period at a time when the company is a member of the group, and
- G is the group expenditure on research and development in the relevant period

EXAMPLE No. 5

A group of companies had an aggregate R&D expenditure of €500,000 in the 12 months ended 30/9/2010, and an aggregate R&D expenditure of €30,000 in the 12 months ended 30/9/2003.

The incremental amount for the 12 months ended 30/9/2010 is therefore (500,000 – 30,000) €470,000.

The members of the group who have incurred the R&D expenditure may allocate the tax credit of (470,000 @ 25%) €117,500 to group members, in a manner decided by them.

EXAMPLE No. 6

AB USA Corp, AB Ire Ltd and BA Ire Ltd are all members of a group according to S 766 TCA 1997. AB USA Corp is not within the charge to Irish tax, while the other two members of the group are. They incurred R&D expenditure as follows:

	2003	2009
AB USA Corp	€40,000 ***	€75,000 ***
AB Ire Ltd	€30,000	€65,000
BA Ire Ltd	€10,000	€32,000

***As AB USA Corp is not within the charge to Irish tax their R&D expenditure incurred is not taken into account for the purpose of calculating qualifying group expenditure on R&D activities.

Qualifying group expenditure in 2009 is €57,000, calculated as follows:

2009 (65,000 + 32,000)	=	€97,000
2003 (30,000 + 10,000)	=	<u>€40,000</u>
Incremental expenditure 2009		€57,000

4. Threshold Amount

Expenditure to be included in Threshold Amount

“threshold amount” is defined in relation to a relevant period of a group of companies. It is the amount of expenditure on research and development in a base period (the threshold period). This amount, which is then compared with the expenditure on research and development by that group in the relevant period in order to determine the level of incremental expenditure. The base period is 2003.

Where a company is a member of a group for a proportion only of the threshold period expenditure is counted only if it was incurred at a time when the company was a member of the group.

Closure of a Research and Development Centre

Section 54 of the Finance Act 2010 changed the way in which the threshold amount is calculated where a group of companies operated two or more research and development centres in 2003 in separate geographical locations, and subsequently closes down one of those centres on a permanent basis. For relevant periods commencing on or after 1 January 2010 the R&D expenditure incurred in respect of the centre, which has been closed, is excluded from the threshold amount. The principal features of this provision are as follows:

- A “Research and Development Centre” is defined as a fixed base or bases established in buildings or structures, which is used by a company for the carrying on of R&D activities.
- Two Research and Development Centres will only be treated as being in separate geographical locations where they are at least 20 kilometres from each other.
- A claw-back of any benefit gained under this provision will apply if-
 1. The R&D centre which has been closed down is subsequently used for the purposes of a trade by any company which is a member of that group, or
 2. The R&D activities which had been carried on in the closed centre in the 48 months preceding the closure are subsequently carried on by any company which is a member of that group, or
 3. Within a period of ten years commencing on the date the R&D centre was closed, no company, which is a member of the group, remains within the charge to corporation tax.

5. Expenditure on Buildings or Structures used for R&D activities.

S 766A TCA 1997.

- Section 766A TCA 1997 deals with the tax credit for expenditure on buildings or structures used for research and development. To qualify the company must be entitled to claim industrial buildings capital allowances on the building/structure.
- The incremental basis does not apply for expenditure on buildings. There is no base year for Section 766A.
- The relief is calculated as 25% of the relevant expenditure. The credit is then used to reduce the liability to Corporation Tax for the accounting period in which the expenditure was incurred.
- Prior to the changes introduced by the Finance (No.2) Act 2008 relevant expenditure by a qualified company was claimed over 4 years on a straight -line basis. Following changes introduced by the Finance (No.2) Act 2008 the full amount of the credit may now be claimed in the accounting period in which the relevant expenditure is incurred. This applies to expenditure incurred after 24 September 2009 in an accounting period commencing on or after 1 January 2009.
- Where a company has insufficient corporation tax to claim the tax credit in that accounting period, the tax credit may be carried forward indefinitely. Changes introduced in the Finance (No.2) Act 2008 allow a company, on receipt of a claim, to use any excess credit as set out in paragraph 2.2 above. This applies to expenditure incurred after 24 September 2009 in an accounting period commencing on or after 1 January 2009.
- The tax credit is in addition to Capital Allowances.

- Any expenditure, which is met directly or indirectly by the State or another relevant member state, will not be treated as qualifying expenditure.
- Where a building or structure to be used for R&D is part of a building or structure, or is one of a number of buildings in a single development, such apportionments as is necessary should be used to determine the expenditure on R&D. (See example No. 5)

The company should maintain records to show:

1. Computation of any apportionment, and
 2. the rationale for the use of such basis of apportionment.
- The Finance (No.2) Act 2008 has provided that the credit will now be available in respect of new expenditure on the construction, including refurbishment, of a building or structure, where the research and development activities carried on by a company in that building or structure over a period of 4 years (referred to as the “specified relevant period”) represents at least 35 per cent of all activities carried on in the building or structure. The credit is calculated by reference **only to the portion of the building or structure to be used for research and development activities**. This applies to expenditure incurred after 24 September 2009 in an accounting period commencing on or after 1 January 2009.

EXAMPLE No. 7-PRE 2009

XYZ Ltd incurred relevant R&D expenditure in 2008 of €100,000 on an building used for R&D. The total relief due is $(100,000 @ 20\%) = €20,000$. This relief will be allowable over the four years 2008-2011 inc. The relief for each year will be $(20,000/4) = €5,000$. For each of the four years XYZ Ltd can use the credit of €5,000 to reduce its Corporation Tax liability.

EXAMPLE No. 8-PRE 2009

If in the above example No. 4 part of the building was to be used solely for qualifying R&D activities, an apportionment of cost is necessary. If the total floor area of the building was 2,500 sq ft, and 1,500 sq ft of that area was used for R&D activities, XYZ could decide to use floor area as a basis of apportionment as follows:

	€
Expenditure incurred	100,000
Relevant expenditure = $100,000 \times \frac{1,500}{2,500}$ =	60,000

The total relief due is (60,000 @ 20%) €12,000. This relief will be allowable over the four years 2008-2011 inc. For each of those four years XYZ Ltd can use the credit of €3,000 to reduce its Corporation Tax liability.

EXAMPLE No. 9-

Rev Ltd incurred relevant R&D expenditure in the accounting period ended 31/12/2009 of €1,000,000 in respect of a building. The expenditure was incurred on 1/10/2009. The research and development activities to be carried on by the company in that building over the specified relevant period will represent 40 per cent of all activities carried on in the building or structure. The tax credit under S766A is calculated as follows.

Specified Relevant Expenditure = €1,000,000 @ 40% = €400,000

Tax Credit = €400,000 @ 25% = €100,000.

The full amount of tax credit of €100,000 is used to first reduce the corporation tax liability in respect of the accounting period ended 31/12/2009. If any excess remains it may be carried forward to reduce the corporation tax of the next accounting period, or alternatively if a claim is made, it may be used as set out in paragraph 2.2 above.

Building or Structure sold or ceases to be used for R&D activity.

The tax credit is clawed back if, within 10 years of the accounting period for which a credit is claimed, the building or structure is sold or commences to be used for purposes other than the carrying on by the company of R&D activities.

Following changes introduced in the Finance (N0.2) Act 2008, the claw-back provisions now apply where the building or structure is sold or ceases to be used by the company for

research and development activities or for the purpose of the same trade that was carried on by the company at the start of the “specified relevant period”.

EXAMPLE No. 10-PRE 2009

In 2008 DEF Ltd incurred relevant R&D expenditure of €100,000 on the construction of a building to be used wholly and exclusively for R&D activities. The building was sold in 2010.

Tax credits granted 2008-2009 are as follows:

2008	(100,000/4) @ 20%	=	5,000
2009	(100,000/4) @ 20%	=	<u>5,000</u>
Total granted			10,000

In 2010 DEF Ltd will be taxed on the following amount under Schedule D Case IV.

Total relief granted as above			10,000
Multiply by 4	=		40,000
Taxed @ 25%	= (40,000 @ 25%) =		€10,000

NOTE: The net effect is that the total relief granted 2008-2009 inclusive is clawed back.

EXAMPLE No.11-PRE 2009

The charge to tax under Schedule D Case IV is based on “the aggregate amount by which corporation tax of the company or another company was reduced”.

If in the example at No. 7 above DEF Ltd used the credits due for 2008-2009 as follows:

2008	Used credit of €3,000 and carried forward €2,000.
2009	Used credit of €6,000 and carried forward €1,000

The “the aggregate amount by which corporation tax of the company or another company was reduced” amounts to (3,000 + 6,000) €9,000.

In 2010 DEF Ltd would be taxed as follows under Schedule D Case IV:

Total relief granted			9,000
Multiply by 4	=		36,000
Taxed @ 25%	= (36,000 @ 25%) =		€9,000

6. Order of Offsets

S766 TCA 1997

If excess credits have been carried forward from accounting periods commencing before 1 January 2009 and credits are also due in respect of accounting periods commencing on or after 1 January 2009, current period credits must be used first.

Example No.12 – Order of Offsets

PQR Ltd makes the following claim:

R&D tax credit due for 31/12/2009 in respect of expenditure incurred after 1 January 2009 is €9,000,000

Unused credit carried forward from 31/12/ 2008 is €4,000,000

Corporation Tax liability for accounting period ending 31/12/09	10,000,000
Less current year R&D credit	(9,000,000)
Balance of liability	1,000,000
Less unused credit from 2008	(1,000,000)
Balance liability	Nil

- The tax credit in respect of expenditure incurred in 2009 is allowed in priority to an excess carried forward.
- The balance from 2008 (4,000,000 – 1,000,000) 3,000,000 will be carried forward to be set against the corporation tax liability for the next succeeding accounting period.
- An excess credit carried forward from an accounting period commencing before 1 January 2009 can only be carried forward and cannot become a payable credit.

S766A TCA 1997

The order of offsets for unused credits arising in accordance with S766A TCA 1997 is identical to the order that apply to S766 TCA 1997.

7. Subcontracting Research and Development Activities.

There are two situations where the law provides for relief for a company that has not carried out the research and development itself:

1. A company, which incurs expenditure on research and development, and pays a sum to a university or institute to carry out such activities in a relevant Member State, can claim relief. Relief will be restricted to 5% of the expenditure incurred by the company itself on research and development activities. Finance Bill 2012 has amended this provision so that the first €100,000 of such expenditure will qualify, to the extent that it is matched by the company's own R&D expenditure, irrespective of whether that amount is greater than the 5 per cent limit.
2. A company, which incurs expenditure on research and development, and pays a sum to another person (other than in 1 above) who is not a connected person, in order for that person to carry on research and development activities, can claim relief. Relief will be restricted to 10% of the expenditure incurred by the company itself on research and development activities. Finance Bill 2012 has amended this provision so that the first €100,000 of such expenditure will qualify, to the extent that it is matched by the company's own R&D expenditure, irrespective of whether that amount is greater than the 10 per cent limit.
3. Where the payment is made to an unconnected third party the company may only claim the tax credit where they have issued a written notification to that party notifying them that they are not also entitled to claim the tax credit in respect of the same activities.

EXAMPLE No. 13

RD Ltd incurred €250,000 expenditure on R&D activities in the period ended 30/6/2010. In addition it paid €10,000 to a university to carry out R&D activities. RD Ltd also subcontracted some of its R&D work to JK Ltd. They paid an additional €28,000 to JK Ltd (unconnected person).

- a) As the €10,000 paid to the university is less than €12,500 (250,000 @ 5%), this amount will also qualify for relief.
- b) As the €28,000 subcontracted out exceeds €25,000 (250,000 @ 10%) by €3,000, then the total claim must be restricted to €285,000.
[250,000+10,000+(28,000-3,000)].

8. Research and Development Activities

Qualifying activities must satisfy all of the following conditions. They must be:

1. Systematic, investigative or experimental activities
2. In a field of science or technology
3. One or more of the following categories of research and development:
 - Basic research,
 - Applied research, or
 - Experimental development.

In addition they must:

4. Seek to achieve scientific or technological advancement, **AND**
5. Involve the resolution of scientific or technological uncertainty.

8.1 Systematic Investigative and Experimental Activities

- The Act requires research and development activities to be systematic, investigative or experimental in nature. It is expected that activities be to a planned logical sequence, generally to a recognised methodology, with detailed records being maintained. It is important that the claimant is able to provide records and details of the activities carried on NOT just the outcomes. It is necessary for companies to document and be in a position to present evidence of qualifying activities, including dated documents of the original scientific or technological goals of the activity, the progress of the work and how it has been carried out, and the conclusions.
- Each project should be documented showing clearly why each major element is required, and how it fits into the research activity as a whole. To build on the results of testing in a systematic way requires the organised documentation of work undertaken by way of experimentation or investigation.

- Relevant metrics should be used to determine if the scientific or technological objectives of the research and development activity are met. Revenue would expect to see documentation that would chart the lifetime of the project from start to finish. Within that lifetime framework there should be reference to milestones achieved along the lifeline. Where there has been a failure and a different path required then documentation to support these decisions should be available if needed.
- It is important that claimants realise the importance of contemporaneous and relevant documentation to support the claim. Failure to keep such documentation may, in the event of an audit, result in a company not being able to support its claim.

8.2 Field of Science & Technology

The categories of activities that qualify for relief are set out in S.I. No. 434 of 2004, Taxes Consolidation Act 1997 (Prescribed Research and Development Activities) Regulations 2004. The categories are:

1. Natural Sciences
2. Engineering and Technology
3. Medical Sciences
4. Agricultural Sciences.

The regulations define each category. Further details are contained in Appendix 1.

8.3 Types of Research

Basic research means “experimental or theoretical work undertaken primarily to acquire new scientific or technical knowledge without a specific practical application in view”.

Applied research means, “work undertaken in order to gain scientific or technical knowledge and directed towards a specific practical application”. Applied research is usually undertaken either to determine possible uses for the findings of basic research or to determine new methods or ways of creating practical applications.

Experimental development means, "work undertaken which draws on scientific or technical knowledge or practical experience for the purpose of achieving technological advancement and which is directed at producing new, or improving existing, materials,

products, devices, processes, systems or services including incremental improvements thereto".

8.4 Scientific or Technological Advancement

An advance in science or technology means an advance in the **overall knowledge or capability** in the field of **science or technology** (not a company's own state of knowledge or capability alone). The test relates to knowledge or capability reasonably available to the company or to a competent professional working in the field. Where knowledge of an advance in science or technology is not reasonably available, for example, where it has not been published, is not in the public domain or it is a trade secret of a competitor, companies would not be disqualified from claiming the credit where they undertake activities seeking to independently achieve the same scientific or technological advancement.

A scientific or technological uncertainty may exist for one company although a competitor has resolved that uncertainty but retained the resulting knowledge as a trade secret or proprietary information. A number of companies may be working to resolve the same scientific or technological uncertainty at the same time. Reasonably available scientific or technological knowledge or experience includes information, which is reasonably available to a company from both internal and external sources. Thus if the solution to a scientific or technological uncertainty is reasonably available to a competent professional working in the field, lack of knowledge by a company due to lack of diligence in seeking that solution or lack of appropriate expertise within the company does not constitute scientific or technological uncertainty.

8.4.1.

The Act requires that the activity must **seek** to achieve as opposed to succeed in achieving scientific or technological advancement. Even if the advance in science or technology sought by a project is not achieved or not fully realised, R&D still takes place. For example, a particular research and development activity may cease or radically change if the advance originally sought becomes available from a scientific journal or

newly published patent. This does not undermine the validity of the activity from the perspective of this test. Equally determining that a hypothesis is incorrect may advance scientific knowledge. Similarly, in experimental development, discovering that a certain technological alternative does not work can advance the technological knowledge base. Such a result would not of itself preclude a claim being made for the R & D credit.

8.4.2.

Where a research and development **activity** is shown to be systematic, investigative or experimental and is undertaken to resolve a clearly defined scientific or technological uncertainty, the requirements of attempting to achieve scientific or technological advancement will generally be met.

Work carried out in incremental stages, the aim of which is the achievement of scientific or technological advancement and involves resolution of scientific or technological uncertainty will qualify as R & D.

8.4.3.

New materials/products/systems. Systematic, experimental or investigative activities directed at producing new or improved materials, products, devices, process systems or services may qualify for the tax credit provided the activities seek to achieve the goals set out above. However a process, material, device, product, service or source of knowledge does not become an **advance in science or technology** simply because **science or technology** is used in its creation. 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**. Normal technology transfer, or making improvements to materials, products, devices, processes, systems or services through the purchase of rights or licence, or through the adaptation of known principles or knowledge, would not represent scientific or technological advancement.

Neither would solving technical problems or trouble shooting using generally available scientific or technological knowledge or experience meet this test. In addition work in the development of a new or improved product will not of itself constitute research and development activities. The work may, for example, entail the resolution of extensive design issues but may not involve a scientific advancement.

EXAMPLE

1. A project which seeks to, for example:
 - (a) extend overall knowledge or capability in a field of science or technology; or
 - (b) create a process, material, device, product or service which incorporates or represents an increase in overall knowledge or capability in a field of science or technology; or
 - (c) make an **appreciable improvement** to an existing process, material, device, product or service through an advance in science or technology; or
 - (d) duplicate the effect of an existing process, material, device, product or service in a new or appreciably improved way through an advance in science or technology (e.g. a product that has exactly the same performance characteristics as existing models, but is built in a fundamentally different manner),

will therefore be R&D.

8.4.4.

Scientific or technological uncertainty arises in two situations viz.

- a) Uncertainty as to whether a particular goal can be achieved or
- b) Uncertainty (from a scientific or technological perspective) in relation to alternative methods that will meet desired cost or other specifications such as reliability or reproducibility.

If, on the basis of reasonably available scientific or technological knowledge or experience such technological or scientific uncertainty exists, research and development activity would aim to remove that uncertainty through systematic, investigative or experimental activity.

Uncertainty as to whether new materials, products, devices, processes, systems or services will be commercially viable *is not scientific or technological uncertainty*. In commercial settings, however, a reasonable cost target is always an objective. As mentioned above, attempting to achieve a particular cost target can require the resolution of a scientific or technological uncertainty. Cost targets may require that scientifically or technologically uncertain alternatives, approaches or configurations etc. have to be attempted, although more costly alternatives exist.

A scientific advance always resolves uncertainty.

8.4.5.

Software The OECD Frascati Manual states “for software development to be classified as R&D, its completion must be *dependent* on the development of a scientific and/or technical advance, and the aim of the project must be resolution of a scientific and/or technical uncertainty on a systematic basis.

Software developments using known methodologies, in standard development environments using the standard features and functions of existing tools would not typically advance technology and would not exhibit technological uncertainty.

Undertaking routine analysis, copying or adaptation of an existing product, process, service or material would not be considered to be R&D activities. Advances are typically made through innovation in software architectures, designs, algorithms, techniques or constructs.

To develop software at the leading edge of today's technologies generally requires the developer to devise new constructs, such as new architectures, algorithms or database management techniques (i.e., make Technological Advancements), and there are then specific uncertainties as to the viability of these (i.e., Technological Uncertainty). If the software's competitive edge stems from advance in an area other than technology, such as business management, or improvements in financial management techniques, the project is unlikely to be eligible.

8.5.

Categories of Activity that are not research and development activities

- (a) S.I. No. 434 of 2004 specifies **a non-exhaustive list** of categories of activities, which are **not** research and development activities. Further details are contained in Appendix 2.

9. When a Research and Development activity ends

The resolution of scientific or technological uncertainty is a determining factor when considering where a research and development activity ceases and activity associated with commercial exploitation begins. *Generally this point is reached when the scientific or technological uncertainty, which the research and development activity sought to resolve, has been resolved.*

The basic criterion for determining when a scientific research and experimental development project has been completed is reaching the point at which the project's initial technological objectives have been achieved. Generally, this occurs when the application of standard operating practices will permit the achievement of the technological performance objectives, which were established for the project.

Costs incurred after the research and development activity ends will not qualify for the relief.

The concept of a project's lifecycle is intrinsic to R&D. The project should have a start date and should continue along the critical path of the project until it reaches an end point and a corresponding end date. Along the critical path of the project the costs can be calculated. There should be documentation that supports a project initiation. There should also be a mid project review document that should outline the progress that has been made and whether or not there has been a milestone reached.

The end point of the critical path should correspond with the resolution of the technological uncertainty and should also correspond to an end date. The start and end dates should be clear from relevant documentation and costs should only be claimed accordingly.

10. Machinery or Plant

Expenditure on research and development, in accordance with S766 TCA 1997, includes expenditure on plant and machinery. However where machinery or plant which is used for R&D and other purposes form part of the claim, the cost of the machinery or plant should be apportioned on a just and reasonable basis.

If an apportionment that has already been made in this manner is later shown not to be “just and reasonable” a revised apportionment must be made. The new apportionment then supersedes the previous apportionment. The revised apportionments may give rise to an underpayment or overpayment of corporation tax.

EXAMPLE 14

QE Ltd had expenditure on R&D of €150,000 in the 12 months ended 31/12/09. This figure includes machinery or plant at cost of €100,000 to be used for R&D activities and production processing. QE Ltd have analysed the machinery or plant usage on a “machine hour basis”. They found that in a typical week it is used 25 hours for R&D and 30 hours for production processing. Therefore they should apportion the cost of the machinery or plant as follows:

Cost €100,000

Cost relevant to R&D €100,000 X 25/55 = €45,455

Tax credit due in 2009 €45,455 @ 25% = €11,364

11. Payment to Key Employee

Finance Bill 2012 has introduced a new provision as a support to hiring and retaining “key employees”. This allows the company to transfer the R&D credit to key employees.

The employee must satisfy the following criteria however:

The employee must perform 75% of their duties in “the conception or creation of new knowledge, products, methods and systems” in the relevant accounting period and

75% of the cost of earnings from their employment must qualify as R&D expenditure

The employee must not be a director or an individual holding more than 5% of the shares of the company or an associated company

It is important to note that the amount of the credit that can be surrendered to key employees is limited to the amount the company could otherwise have used to reduce the corporation tax liability of the accounting period in respect of which the credit arises. The option to surrender any part of the credit is not available to loss making companies.

The company cannot surrender an amount that would have been due as a payable credit.

To surrender all or part of the credit, a company **MUST**:

1. Pay the amount of Corporation Tax which it could otherwise have reduced,
2. Make a claim to the Revenue Commissioners, and
3. Notify each key employee in writing of the amount surrendered to that employee.

If the company has any outstanding tax liabilities, including any balance of Corporation Tax payable in respect of the accounting period in respect of which the credit arises, they will not be entitled to surrender any amount.

A key employee can claim the credit in the tax year following the tax year in which the accounting period of the company that surrendered the credit ends.

Example:

A company's accounting period ends in June 2013, and it surrenders credit for that accounting period, the employee can claim the credit in 2014.

12. Qualifying Expenditure.

12.1

Activities undertaken in-house by the claimant company

The tax credit will be available in respect of expenditure incurred —

1. in the carrying on
2. by it

of research and development activities.

The phrase in the carrying on must be distinguished from “for the purposes of” or “in connection with” used elsewhere in the Taxes consolidation Act 1997. Additionally it should not be confused with expenditure incurred to enable a company to carry on R&D. The phrase “in the carrying on” is more narrow in scope.

The requirement that R&D be carried on “by it” denotes that the activities must be carried on by the claimant company and not by another person. Where a company contracts with another person (including a company) for the provision of services, or the performance of activities to be used in connection with research and development activities, expenditure so incurred by the claimant company does not fulfil the requirements of section 766(1)(a) as those activities in respect of which the expenditure was incurred were not carried on “by it” and will the expenditure will thus not be considered to be expenditure on research and development activities carried on by it, except to the extent so treated by the 5% and 10% limits placed on payments to universities and subcontractors respectively as outlined above. Decisions by both the Appeal Commissioners and the Circuit Court, have upheld this view. Finance Act 2012 confirms this point.

Such payments would not include the purchase of utilities (light heat power etc used in the carrying on of R&D), nor would it include materials consumed in the process.

Expenditure on research and development can qualify for the tax credit even though it may be brought into account for accounting purposes in determining the value of an asset.

Interest cannot be taken into account as expenditure on research and development for the purposes of the tax credit even though, for accounting purposes, it may be included in the value of an asset.

12.2

Royalty payments

Expenditure on research and developments shall not include a royalty or other sum paid by a company in respect of the user of an invention:

- a) If it is paid to a person connected with the company and the royalty is exempt from tax in the hands of the recipient,
- or
- b) The payment is not an arm's length fee

Royalty payments not subject to the above exclusion would qualify provided they are incurred in the carrying on of research and development activities as defined in the law.

Pre-Trading Expenditure

- Where expenditure has been incurred by a company in carrying on research and development activities before the company commenced to trade, a claim in respect of that expenditure must be made within 12 months from the end of the accounting period beginning at the date the company first carried on a trade.
- The amount of the credit due is the amount, which the company would have been entitled to claim, if it had been trading when the expenditure was incurred.

That amount may be then carried forward and used against future periods.

13. Information to be retained by the Company in support of claims

To avail of the R&D tax credit the company must be in a position to demonstrate that its claim can satisfy two essential tests. Records must be kept to satisfy **both tests**. This requirement applies equally to the threshold period as it does to the relevant period. In the event of a claim being selected for examination by Revenue records for the threshold period (2003) must be available for inspection.

The Science Test - That the activities under review are consistent with the statutory definition of research and development activities.

The Accounting Test - That the expenditure claimed as being laid out on qualifying research and development activities are correctly so claimed.

Records Required To Be Maintained To Satisfy The Science Test

- a) A description of the research and development activities, the methods to be used and what the company seeks to achieve by the undertaking the activities concerned
- b) The field of science and technology concerned
- c) The scientific or technological advancement that is the goal of the research and development activities, and
- d) The scientific and technological uncertainty the company is seeking to resolve by those activities,
- e) Details of systematic investigation outlined at paragraph 8.1 including
 - the hypothesis advanced
 - the series of experiments or investigations undertaken to test the hypothesis
 - documentary evidence of the necessity for each major element and how it fits into the project as a whole

- dated documents of the original scientific or technological goals, the progress of the work, how it was carried out and the conclusions
 - indicators or measures identified at the commencement of the project to determine if the scientific or technological objectives of the research and development activities are met
- f) the qualifications, skill and experience of the project manager
- g) the numbers, qualifications and skill levels of other personnel working on the project

Given the high cost of research and development activities and the requirement for ongoing monitoring inherent in such projects, the records required for Revenue purposes should generally be available within a company for its own internal purposes. The company will, in any event, need to document the project and the information required may be contained in:

- status and/or progress reports
- notebooks, lab reports, patents, and patent applications
- notes of problems encountered in the course of the project that identified areas of technological uncertainty and experimental development
- feasibility plan and/or outline methodology adopted
- files on personnel involved in the project

Records Required To Be Maintained To Satisfy The Accounting Test

Sections 886, 887 and 903 of Taxes Consolidated Act 1997, Section 16 VAT Act 1972 and VAT Regulations 1979 all impose obligations on a taxpayer to keep certain books and records. The maintenance of these records is required to enable a taxpayer to make true tax returns and in the event of Revenue audit to demonstrate that the credit claimed is correct.

Manner of Record Keeping

It is important that-

- All entries are made on a timely and consistent basis.
- All records are kept on a continuous basis.
- All linking papers to accounts are kept.

Where data is stored electronically the claimant company must be able to provide a reliable assurance as to the integrity of the record from the time when it was first generated into its final electronic form

Section 766 provides that a company will not be a qualified company unless it maintains a record of expenditure incurred by it in the carrying out by it of research and development activities.

Claiming the Credit.

Where a company is satisfied that it can comply with the requirements of the legislation and has maintained the necessary supporting records, a claim to relief may be made by completing the relevant sections of the form CT1. It is important to note that no supporting documentation is required to be submitted with the return. In this respect, claiming a research and development tax credit is no different from claiming any other corporation tax relief or tax credit.

From 1/1/2009 all claims for research and development tax credit must be made within 12 months from the end of the accounting period in which the expenditure was incurred.

14. Consultation with other persons (Experts)

To ensure compliance with legislation, Revenue may examine the entitlement of certain claims to tax credit for R&D activities. For this Revenue normally require the assistance of qualified individuals with specialised knowledge in the relevant field of science or technology. That individual acts on a consultancy basis for Revenue. They report to Revenue as to whether, in their opinion, the activities examined constitute R&D activities, as defined. Where the opinion of such expert is disputed by a claimant company, the expert may be required to give evidence before the Appeal Commissioners or a court of law.

Before disclosing information to that person, Revenue will notify the company of:

- The identity of that person, and
- The information they intend to disclose.

And

- Obtain a signed confidentiality agreement from the expert.

The claimant company may object to the use of that particular expert where they can demonstrate a genuine conflict of interests. In any case of dispute the claimant company will have the right of appeal to The Appeal Commissioners, against the use of a particular expert.

15. Advance Opinion

The Revenue Commissioners are prepared, in limited circumstances, to give an advance opinion as to whether a proposed project would satisfy the requirements of the legislation. When such requests are received Revenue normally engage an expert under the conditions set out at paragraph No. 14. It is envisaged that such opinions will only be given in respect of projects that have commenced within the last 12 months.

Applications for an advance opinion containing the information as outlined in paragraph 12 should be made to:

rdadmin@revenue.ie

Appendix 1

Field of Science & Technology

Natural Sciences

1. Mathematics and computer sciences, including mathematics and other allied fields, computer sciences and other allied subjects, software development,
2. Physical sciences including astronomy and space sciences, physics, and other allied subjects,
3. Chemical sciences including chemistry and other allied subjects,
4. Earth and related environmental sciences including geology, geophysics, mineralogy, physical geography and other geosciences, meteorology and other atmospheric sciences including climatic research, oceanography, vulcanology, palaeoecology, and other allied sciences,
5. Biological sciences including biology, botany, bacteriology, microbiology, zoology, entomology, genetics, biochemistry, biophysics, other allied sciences, excluding clinical and veterinary sciences.

Engineering and Technology

1. Civil engineering including architecture engineering, building science and engineering, construction engineering, municipal and structural engineering and other allied subjects,
2. Electrical engineering, electronics including communication engineering and systems, computer engineering (hardware) and other allied subjects,
3. Other engineering sciences such as chemical, aeronautical and space, mechanical, metallurgical and materials engineering, and their specialised subdivisions; forest products; applied sciences such as geodesy and industrial chemistry; the science and technology of food production, specialised technologies of interdisciplinary fields, *e.g.* systems analysis, metallurgy, mining, textile technology and other allied subjects.

Medical Sciences

1. Basic medicine including anatomy, cytology, physiology, genetics, pharmacy, pharmacology, toxicology, immunology and immunohaematology, clinical chemistry, clinical microbiology, pathology,
2. Clinical medicine including anaesthesiology, paediatrics, obstetrics and gynaecology, internal medicine, surgery, dentistry, neurology, psychiatry, radiology, therapeutics, otorhinolaryngology and ophthalmology,
3. Health sciences including public health services, social medicine, hygiene, nursing, epidemiology.

Agricultural Science

1. Agriculture, forestry, fisheries and allied sciences including agronomy, animal husbandry, fisheries, forestry, horticulture, and other allied subjects,
2. Veterinary medicine.

Appendix 2

Categories of Activity that are not research and development activities

- (a) research in the social sciences (including economics, business management, and behavioral sciences), arts, or humanities;
- (b) routine testing and analysis for purposes of quality or quantity control;
- (c) alterations of a cosmetic or stylistic nature to existing products, services or processes whether or not these alterations represent some improvement;
- (d) operational research such as management studies or efficiency surveys which are not wholly and exclusively undertaken for the purposes of a research and development activity;
- (e) corrective action in connection with breakdowns during commercial production of a product;
- (f) legal and administrative work in connection with patent applications, records and litigation and the sale or licensing of patents;
- (g) activity, including design and construction engineering, relating to the construction, relocation, rearrangement or start-up of facilities or equipment other than facilities or equipment which is to be used wholly and exclusively for the purposes of carrying on by the company of research and development activities;
- (h) market research, market testing, market development, sales promotion or consumer surveys;
- (i) prospecting, exploring or drilling for, or producing, minerals, petroleum or natural gas;
- (j) the commercial and financial steps necessary for the marketing or the commercial production or distribution of a new or improved material, product, device, process, system or service.
- (k) administration and general support services (such as transportation, storage, cleaning, repair, maintenance and security) which are not wholly and exclusively undertaken in connection with a research and development activity.