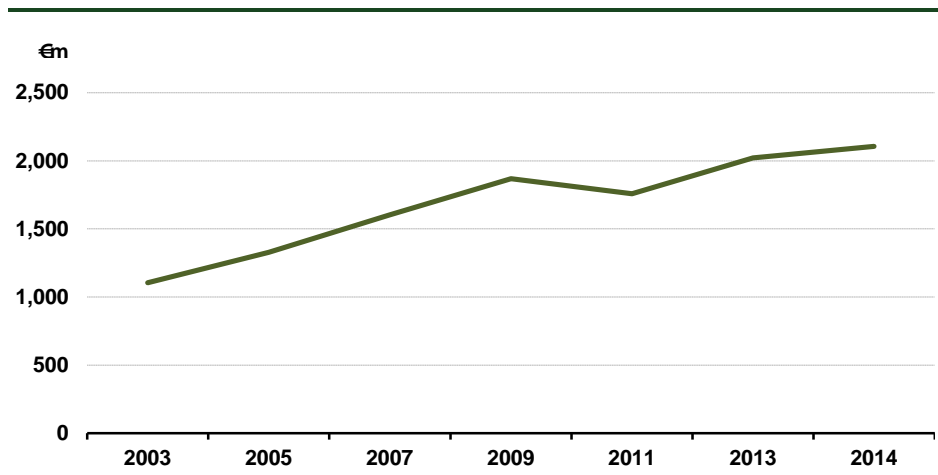


14 Research and Development Tax Credit

- 14.1** A tax credit for research and development (R&D) was introduced in the Finance Act 2004.¹ The credit is given at a rate of 25% of qualifying expenditure and can be claimed by companies undertaking in-house R&D within Ireland. A tax credit is also provided for expenditure on buildings and structures used for R&D. The R&D tax credit can be claimed in addition to the standard 12.5% corporation tax deduction. Therefore, the total tax benefit is 37.5%.
- 14.2** From 2009, a payable tax credit was introduced. This meant that when a company has offset the credit against its corporation tax liability for the current and preceding periods and an excess remains, the company can make a claim to have the remaining amount paid to it by the Revenue Commissioners (Revenue) in three instalments over a period of 33 months.
- 14.3** The primary objective of the tax credit is to incentivise Business Expenditure on Research and Development (BERD).² The following figure sets out the BERD from 2003-2014.

Figure 14.1 Business expenditure on R&D, 2003 to 2014^a



Source: Central Statistics Office

Note: a The BERD survey is jointly conducted by the Central Statistics Office and Forfás biennially. The most recent data (relating to 2013) was published in June 2015. Figures for 2014 are estimated.

1 Section 33, Finance Act 2004.

2 Department of Finance Review of Ireland's Research and Development Tax Credit, October 2013.

3 R&D intensity measures R&D expenditure as a percentage of Gross Domestic Product (GDP). Ireland has set a national target of 2.5% of Gross National Product which has been estimated to equal 2.0% of GDP.

- 14.4** The BERD survey is carried out in all EU member states. In 2014, Ireland's share of R&D expenditure performed in the business sector was second highest (at 73%) in the EU. The EU Strategy 2020 sets a 3% objective for R&D intensity and most member states have adopted their national R&D intensity target for 2020.³ In 2014, Ireland's R&D intensity was 1.55% while the EU average was 1.95%.

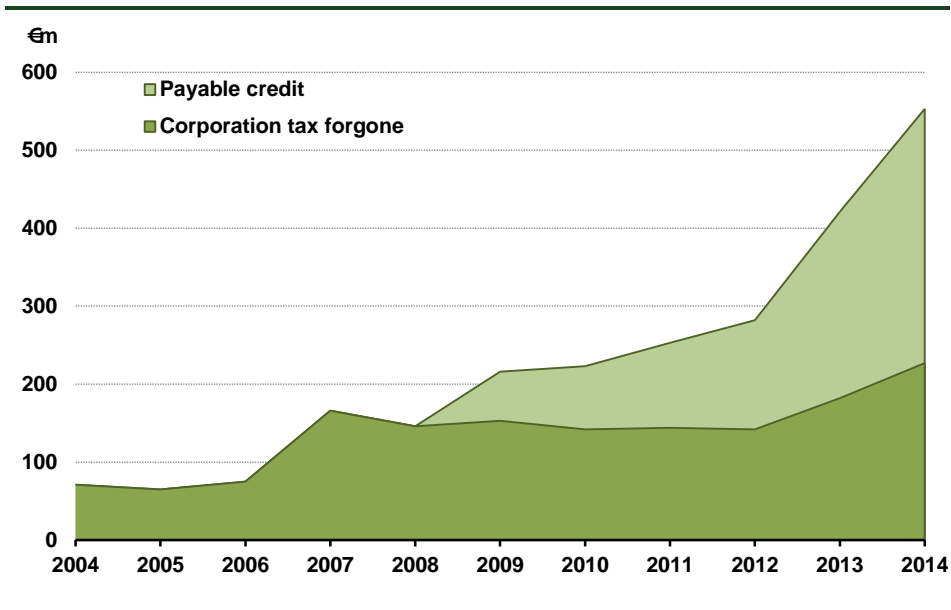
- 14.5** This chapter reviews

- the operation of the R&D credit, including the scale of non-compliance with the scheme conditions
- how Revenue systems and procedures can be improved in order to detect and deter non-compliance in this area.

Cost of the R&D Scheme

- 14.6** The number of beneficiaries of the R&D tax credit scheme increased from 73 companies in 2004 to around 1,600 companies in 2014. Over the same period, the cost of the scheme has increased from €71 million to €553 million (see Figure 14.2). The information on the cost and number of beneficiaries of the R&D tax credit scheme is not readily available. Revenue collated it for the purposes of this examination.

Figure 14.2 Cost of the R&D Scheme, 2004 to 2014



Source: Office of the Revenue Commissioners

- 14.7** The cost of the R&D tax credit scheme as a proportion of the amount of BERD has risen from 12% in 2009 to 26% in 2014.

Evolution of the R&D tax credit

- 14.8** The R&D tax credit regime has been amended and enhanced in most Finance Acts since its introduction (see Figure 14.3). The main changes include
- increase in the rate of relief from 20% to 25% in 2009
 - introduction of the payable credit
 - increases to the subcontracting limits
 - introduction of a 'key employee' provision – a company may transfer some or all of its R&D tax credit to key employee(s) engaged in R&D activities
 - removal of the base year requirement – the base year was originally set as 2003; this meant that when making a claim, the amount of R&D expenditure in 2003 had to be subtracted from the current year qualifying R&D expenditure when calculating a claim.¹

¹ A rolling base year was envisaged, which would be updated every three years i.e. a fixed 2003 base for spending in 2004-2006 and thereafter a rolling one year base – the base for 2007 will be 2004, for 2008 will be 2005 and so on.

Figure 14.3 Evolution of the R&D tax credit, 2004 to 2014

Finance Act	Amendment made
2004	Introduction of the R&D tax credit – 20% credit on R&D expenditure in excess of R&D expenditure incurred in 2003 (the base year).
2006	<ul style="list-style-type: none"> • An apportionment of the R&D related share of plant and machinery costs is eligible for the tax credit. • Allows Revenue to consult with experts when determining if claimed expenditure was incurred in the carrying on of R&D activities.
2007	<ul style="list-style-type: none"> • Base year fixed at 2003 until 2009. • Amendment to relief on expenditure to subcontractors (allowed the use of third parties, subject to a 10% ceiling, previously third level institutions only).
2008	<ul style="list-style-type: none"> • Base year fixed at 2003 until 2013.
No 2. 2008	<ul style="list-style-type: none"> • Increase in the rate of relief from 20% to 25%. • Introduction of the payable credit. • Proportion of expenditure on mixed used buildings and structures allowable for tax credit (subject to minimum 35% use for R&D activities). • Base year fixed at 2003 indefinitely.
2010	<ul style="list-style-type: none"> • Amended calculation of qualifying expenditure in base year where company closes one of its R&D centres on a permanent basis.
2011	<ul style="list-style-type: none"> • Excluded expenditure on specified intangible assets from the credit where this expenditure is already covered under a separate tax relief regime.
2012	<ul style="list-style-type: none"> • First €100,000 of R&D expenditure eligible for the credit regardless of expenditure in base year. • Key employee provision introduced.
2013	<ul style="list-style-type: none"> • First €200,000 of R&D expenditure eligible for the credit regardless of expenditure in base year (increased from €100,000 in 2012). • Key employee eligibility criteria reduced to 50% of working time on R&D activities (75% when introduced in 2012).
No 2. 2013	<ul style="list-style-type: none"> • First €300,000 of R&D expenditure eligible for the credit regardless of expenditure in base year (increased from €200,000 in 2013). • Outsourcing limits increased.
2014	<ul style="list-style-type: none"> • Removal of the base year with effect from 1 January 2015.

Source: Analysis by the Office of the Comptroller and Auditor General

Review of the operation of the R&D tax credit

14.9 In 2013, the Economic and Fiscal Division of the Department of Finance carried out a review of the R&D tax credit. The review concluded that a major overhaul of the R&D tax credit regime was not required and that the tax credit

- plays an important role in assisting Ireland in meeting its Europe 2020 target of achieving a level of expenditure on R&D of 2.5% of GNP
- is of significant importance to the R&D investment decisions of claimant companies
- stands up well in terms of international best practice
- is viewed as a very important element of Ireland's corporation tax regime in terms of attracting foreign direct investment to Ireland.

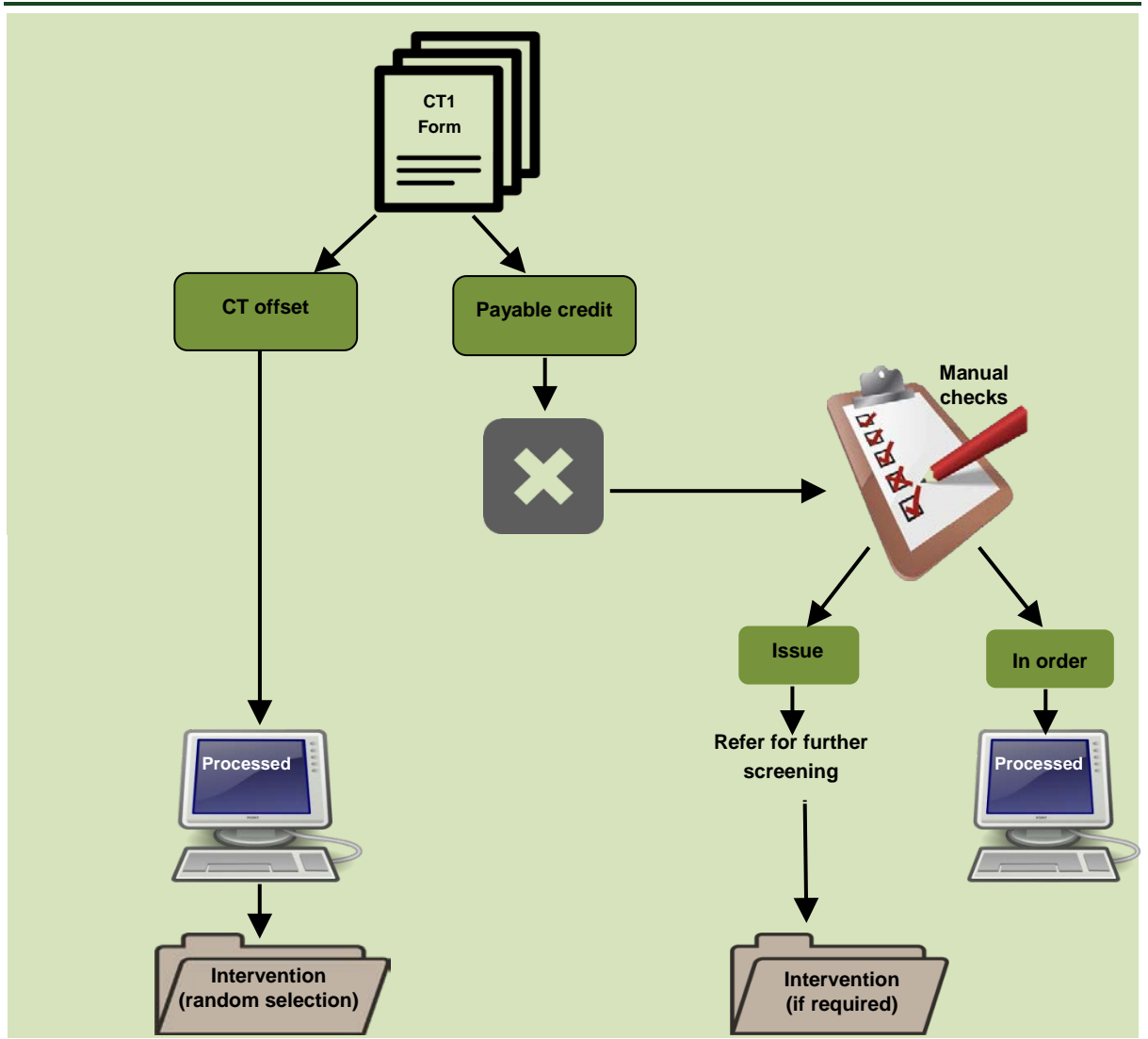
Administration of R&D tax credit

14.10 Companies submit their R&D tax credit claims to Revenue as part of their annual corporation tax return (CT1 form). The tax credit is first offset against the corporation tax liability of the current period, and then of the preceding year. If an excess remains, the company can carry it forward indefinitely to offset its corporation tax liabilities in the future or can elect to have it paid to the company by Revenue in three instalments in the form of a payable credit. The total amount of payable credits in respect of R&D expenditure in any accounting period is subject to a limit which is specified in Revenue's guidelines.¹

Processing of R&D claims

14.11 As set out in Figure 14.4, there are two alternative processes when claims are received. If an R&D credit is to be used solely to offset corporation tax liabilities, it is processed without any manual checks.

Figure 14.4 R&D claim processing



¹ Revenue's Research and Development Tax Credit Guidelines, April 2015.

Source: Office of the Comptroller and Auditor General

14.12 When a claim is received by Revenue for a payable credit, a 'stop' is automatically placed on the request. This generates a work item which has to be manually cleared by a Revenue caseworker before the payment is processed. Revenue stated that, in clearing the work item, the case worker will carry out certain verification checks, for example, ensure that all returns are up to date, confirm there is no compliance intervention ongoing, review the computation and check the previous claim (depending on the year of the claim). Revenue does not monitor the outcomes of the manual verification checks carried out. Revenue stated that where no issue arises normal processing continues and if an issue does arise an intervention (e.g. an audit) is opened and the result of that intervention is recorded in Revenue's case management system.¹

Revenue interventions

14.13 A Revenue intervention of an R&D claim comprises two tests

- a science test – to ensure that the activities included in the claim are consistent with the statutory definition of R&D activity
- an accounting test – to ensure that the costs incurred in the carrying on of a qualifying activity have been properly tracked and accounted for.

14.14 As part of this review, we requested information on the compliance activity by Revenue in the area of R&D. Figure 14.5 presents the information provided by Revenue.

Figure 14.5 Revenue R&D interventions, yield and number carried out, 2011 to 2015^a

Year	Number of interventions	Yield €000	Average yield per intervention €
2011	26	2,591	99,654
2012	49	5,413	110,469
2013	105	14,483	137,933
2014	162	10,106	62,383
2015	178	13,542	76,079
	520	46,135	

Source: Office of the Revenue Commissioners

Note: a Information is not available for all regions prior to 2011.

14.15 The information in Figure 14.5 was collated by Revenue for the purposes of this examination. Because Revenue records total audit yields under the relevant tax head, i.e. income tax, corporation tax etc, it was not possible to provide figures on the yield which is solely attributable to the R&D tax credit claims. The yield amount quoted in Figure 14.5 includes yield from other tax heads such as VAT, income tax etc. Revenue stated that since the introduction of its case management system in July 2015 all R&D interventions are recorded centrally. The case management system makes the identification of R&D intervention cases easier. However, analysis still needs to be carried out on a case-by-case basis to identify the specific R&D yield.

¹ Each Revenue district has a case selection process for screening cases suitable for possible compliance interventions.

Results of review

14.16 As part of this examination, 17 cases involving an element of R&D yield that closed in 2015 were reviewed.

Yield from interventions

14.17 The 17 cases selected as part of the review yielded a total of €8.8 million for collection or recoupment – of this €8.4 million (95%) related to R&D claims. Figure 14.6 sets out the total value of R&D claims submitted to Revenue and the yield from the interventions carried out on the sample of cases reviewed.

Figure 14.6 Yield from sample of files reviewed

Revenue region	Number of cases	Total R&D claim	Yield from R&D intervention	Yield as proportion of claim
		€000	€000	%
Large Cases Division	5	37,704	5,687	15%
Dublin	5	4,190	1,287	31%
South West	3	3,725	781	21%
East and South East	2	598	598	100%
Border, Midlands, West	2	160	21	13%
Total	17	46,377	8,374	18%

Source: Analysis by the Office of the Comptroller and Auditor General

14.18 The main reasons for the yield in the R&D cases reviewed included

- issues with the base year
- non-qualifying expenditure being claimed
- over claiming of expenses
- insufficient supporting documentation
- incorrect apportionment of costs
- payable credit disallowed/restricted.

Interest and penalties

14.19 For the 17 cases reviewed as part of this examination, interest and penalties were applied to the R&D yield in three cases. For the remaining cases

- interest and penalties did not apply to the R&D yield in 11 cases
- penalties did not apply in two cases (interest applied)
- interest did not apply in one case (penalties applied).

14.20 The main reasons provided by Revenue for interest and penalties not being applicable are set out in Figure 14.7.

Figure 14.7 Reasons interest and penalties not applied in cases selected for review

	Interest	Penalty
Expression of doubt ^a	1 case	1 case
Non-monetised amount ^b	11 cases	6 cases
Technical adjustment ^c	—	6 cases
	12 cases	13 cases

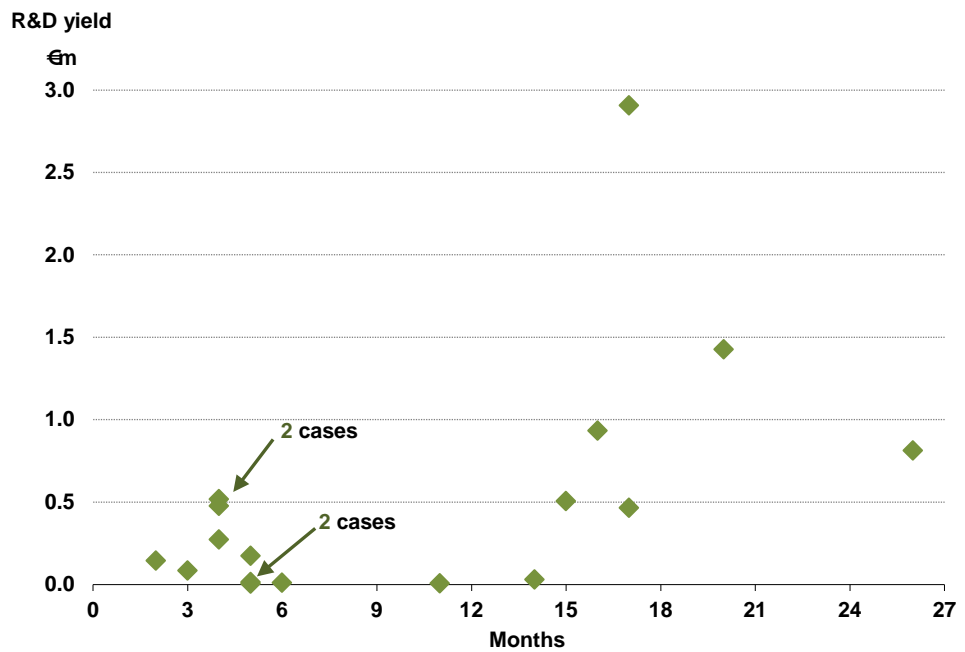
Source: Office of the Revenue Commissioners, and analysis by the Office of the C&AG

- Notes:
- a A taxpayer who has a genuine doubt as to the taxation treatment of a certain matter may submit an expression of doubt when they file their return.
 - b This refers to the restriction of losses or payable credits withheld.
 - c Adjustments to tax or duty liability that arise from differences in the interpretation or the application of legislation. Where Revenue are satisfied that a technical adjustment arises, penalties do not apply.

Timeliness of closing interventions

14.21 For the sample of 17 cases reviewed, the time to close the cases varied. As shown in Figure 14.8, ten cases were closed in under one year and two cases took over 18 months to close.

Figure 14.8 Timeliness in closing interventions, by value



Source: Analysis by the Office of the Comptroller and Auditor General

Engaging experts

- 14.22** Revenue has a panel of experts which it consults as required when completing the science test. Revenue has a centralised budget to allow for the engagement of experts to assist caseworkers when carrying out the science test. In 2015, 18 experts were engaged by Revenue at a cost of just over €140,000.
- 14.23** Revenue stated that a person can join the panel of experts at any time during the year and that in order to join the panel the applicant must
- hold a PhD in a relevant field and
 - be tax compliant.
- 14.24** Proof of academic qualifications is not requested by Revenue. Revenue stated the reason for this is because the majority of applicants are serving academics and their qualifications are published by the relevant college in their academic directory on their websites. All applicants must sign a declaration stating that their tax affairs are in order.
- 14.25** A condition of obtaining a public sector contract with a value of €10,000 or more (inclusive of VAT) within any 12 month period, is that the contractor is required to produce a tax clearance certificate or demonstrate a satisfactory level of tax compliance. Tax clearance certificates are issued by Revenue and there is an online verification facility to allow third party access to confirm the tax cleared status of an individual or company. This can only be accessed with the permission of the applicant who holds the tax clearance certificate.
- 14.26** In 2015, five experts were engaged by Revenue at a cumulative cost which was greater than €10,000 each. As part of this examination, Revenue was requested to provide evidence that the tax cleared status of the five experts was confirmed prior to making payments in excess of €10,000. While Revenue stated that the details regarding the tax compliance position of the experts was examined as part of the payments process, Revenue was unable to provide the required evidence. Revenue stated that while some did not hold a tax clearance certificate, they would have been entitled to one, or while Revenue did not hold a copy of the tax clearance certificate the taxpayer was in possession of same. For the sample of five experts selected, Revenue provided copies of the declarations stating that their tax affairs are fully in order and shall remain so for the duration of any contract that may be awarded.

Conclusions and recommendations

- 14.27** The cost of the R&D tax credit scheme has risen substantially since its inception in 2004. In 2014, the cost was over €550 million in corporation tax foregone and payments to companies. This represents 26% of the business expenditure on research and development for that year.

Data availability

- 14.28** Information on the number of R&D interventions and the specific R&D yield from those interventions is not readily available - it must be extracted on a case by case basis once an R&D case is identified. Revenue stated that the introduction of its case management system from July 2015 will allow it to more easily identify R&D cases. However, it does not change the manner in which total yield is recorded. Being able to readily identify the number of R&D interventions and the R&D related yield from those interventions would allow Revenue to assess the level of non-compliance in this area.

Recommendation 14.1

Given the annual cost of the R&D scheme and the fact that it is increasing each year, Revenue should investigate the possibility of collating information on the compliance work it carries out on R&D specifically.

Accounting Officer's response

Agreed. Revenue is actively considering how information on R&D compliance work can be collated. A Tax and Duty Manual is currently being prepared. Consideration is being given to mandating Section 766 of the Taxes Consolidation Act 1997 rather than simply reducing the amount of the credit claimed.¹ If this comes to pass, full visibility on the yield from R&D interventions will be available.

Engagement of experts

- 14.29** Revenue uses experts to assist caseworkers when carrying out the science test. Five of these experts received over €10,000 each in 2015. A condition of obtaining a public sector contract with a value of €10,000 or more (inclusive of VAT) within any 12 month period, is that the contractor is required to produce a tax clearance certificate or demonstrate a satisfactory level of tax compliance. However, in these five cases, Revenue was unable to provide evidence that the tax status of the experts was confirmed prior to processing payments.

Recommendation 14.2

Revenue should review its procedures for engaging experts and ensure that where the relevant limits are exceeded, evidence is retained to show that the tax cleared status of experts was confirmed prior to processing the relevant payments.

Accounting Officer's response

Agreed. Revenue will review and strengthen our engagement processes for experts and ensure that relevant tax clearance procedures are followed particularly when individual experts are hired for additional engagements in the course of a tax year.

¹ Section 766 TCA 1997 provides for a specific claw back mechanism via a Case IV assessment.

- 14.30** Revenue does not request copies of qualifications from individuals applying to be included on the panel of experts.

Recommendation 14.3

Prior to appointing an expert to the panel, Revenue should request a copy of the educational qualifications of the person applying. This should be retained on file by Revenue.

Accounting Officer's response

Agreed. This recommendation is being implemented. Revenue has recently implemented new procedures which entails requesting a copy of relevant qualifications when appointing an expert. Up to this, as the majority of applicants were serving academics, Revenue did not request copies of qualifications but rather reviewed the qualifications as published by the relevant college in its academic directory on its website.