FEATURE ARTICLE – IRELAND

The Research and Development Tax Credit – Finance Act 2022 updates

This month, Eoin Brennan of SciMet R&D takes us through the significant changes to the Research and Development Tax Credit introduced by Finance Act 2022.

The Research and Development (R&D) Tax Credit is a core element in Ireland's suite of supports for R&D companies. Finance Act 2022 (FA22) made significant changes to the tax credit. As with the introduction of payable credits (FA08) and the phasing out of the base year (FA12), FA22 shall be recognised as another major milestone in the ongoing evolution of the R&D Tax Credit in Ireland.

The new rules are already operational. For claims made in respect of expenditure on R&D incurred in accounting periods that commenced during 2022, companies are in a unique position of being able to choose between applying pre or post FA22 rules. Each company's position should be carefully reviewed to determine which is most advantageous. For expenditure on R&D incurred in accounting periods commencing on or after 1 January 2023, the new rules must be applied.

All companies should fully familiarise themselves with the FA22 changes. To assist with this, we review the new measures below. First, we look at what led to their introduction.

Why now?

In October 2021, as part of the OECD's Base Erosion and Profit Shifting (BEPS) project, agreement in principle was reached on a two-pillar solution to reform international taxation. Pillar Two introduces new Global Anti-Base Erosion (GloBE) rules, initially targeted at large multinational enterprises (MNEs) to ensure a minimum level of tax is paid in each jurisdiction in which they operate. The scope of the GloBE rules has since been extended to also cover domestic groups/companies with annual turnover exceeding €750 million.

Under GloBE, a top-up tax is applied if the effective tax rate in a jurisdiction is below the specified minimum rate of 15 percent. In December 2022, EU Member States unanimously adopted the EU Minimum Tax Directive and work on its transposition into Irish legislation is underway.

In recognition of the valuable role played by R&D in driving innovation and economic growth, it was agreed that R&D Tax Credits meeting the OECD's definition of a "Qualified Refundable Credit" (QRC) can be treated as income rather than reducing tax paid. This distinction is important for jurisdictions like Ireland with corporation tax rates lower than the Pillar Two minimum rate. If the R&D Tax Credit was treated as reducing corporation tax paid in such jurisdictions, top-up tax would be required to meet the Pillar Two minimum rate, thereby wiping out the benefit of the tax credit.

The Irish R&D Tax Credit in its existing form was close to the QRC definition. However, one notable divergence was that a QRC must be paid as cash or available as a cash equivalent within four years. While the payable element of the Irish R&D Tax Credit was generally refundable within 33 months, the

payable credit restriction imposed by section 766B TCA 1997 meant that it was not certain that the credit would be refundable within four years and so the QRC definition may not have been met.

In parallel with OECD developments, changes in the US tax landscape also had to be considered. In January 2022, new Foreign Tax Credit (FTC) Regulations in the US included new provisions relating to "Refundable Credits". The new provisions distinguish between qualifying and non-qualifying refundable credits with the latter treated as reducing (rather than paying) the tax liability, and therefore not qualifying for US FTC purposes. A qualifying refundable credit is only recognised as paying a tax liability where the taxpayer has the option to receive the full amount of the tax credit in cash.

To preserve the value of the Irish R&D Tax Credit in this shifting international tax landscape, changes were required.

While international tax reforms were the main driver behind the FA22 measures, domestically there is increased recognition of the important role played by SMEs in our economy and the need to support these companies in availing of the R&D Tax Credit. An attempt had been made in FA19 to introduce measures targeted at SMEs, including an increase in the rate of the credit from 25 percent to 30 percent. However, due to EU State Aid rules, these measures never became operational. FA22 includes some SME friendly measures such as the ability for claims of up to €25,000 to be received as a single instalment and improved benefits from pre-trading expenditure. We now examine these and the other FA22 changes in more detail.

How FA22 Impacts the R&D Tax Credit

- A new three-year fixed payment schedule now applies under which the tax credit is payable in three annual instalments.

  The first instalment is calculated as the greater of:

  i) €25,000 (or if lower, the amount of the credit claimed), or
  ii) 50 percent of the tax credit amount.

  The second instalment is equal to 3/5 of the amount of the tax credit remaining after the first instalment and the third instalment shall be the balance of the tax credit.

  This replaces the current system under which the tax credit is first offset against corporation tax liabilities with any excess payable in three instalments.

- For each instalment, the company must specify the amount to be:

  (a) treated as an overpayment of tax, or
  (b) paid to the company by the Revenue Commissioners.

- Existing restrictions on the amount receivable as payable credits (section 766B TCA 1997) have been removed.

- Where a "valid claim" is made, the first instalment is payable on the making of the tax return for the period. Similarly, where subsequent accounting periods are 12 months in duration, the second and third instalments become payable upon submission of the relevant tax returns.

  This differs from previous legislation which provided that the tax return filing deadline was the earliest date on which instalments became payable.

  The new legislation provides for payment of the tax credit in full within 48 months of a "valid claim" being made.

- Instalments carried forward from accounting periods that commenced before 1 January 2022 can be claimed on the tax return for the accounting period commencing on or after 1 January 2022.

- Pre-trading expenditure incurred on R&D activities now qualifies for payable credits from the year that the company commences to trade.

  Previously, the tax credit on pre-trading expenditure was only available as an offset against corporation tax.

- FA22 introduces the term "valid claim" into section 766 TCA 1997. This is defined as

  "a claim…in respect of which all information which the Revenue Commissioners may reasonably require to enable them determine if, and to what extent, the credit is due to a company in respect of an accounting period, has been furnished by that company."

While the concept of a "valid claim" already exists in the

Taxes Acts (i.e. section 865 TCA 1997), this is the first time it is explicitly included in the R&D Tax Credit legislation.

What next for the R&D Tax Credit?

The FA22 measures were welcome news for some companies as they accelerate receipt of payable credits. However, for companies that can offset their R&D Tax Credits against corporation tax, the move to a three-year fixed payment schedule is less positive and has cash flow implications.

The changes are not trivial and there will be a time lag before their impact becomes apparent. It is hoped that through active monitoring, any unintended, adverse impacts are quickly addressed.

For example, despite assurances from Revenue that as the concept of a "Valid Claim" already exists in the Taxes Acts, its inclusion in section 766 TCA 1997 should have no impact, there remains concerns in some quarters that the subjective nature of the definition could lead to inconsistencies in its application and delays in the processing of claims.

With corporation tax rates playing a reduced role in the decision-making of MNEs in a post-BEPS world, tax incentives over which jurisdictions retain some control, such as the R&D Tax Credit, assume increased importance as international competition for FDI intensifies. Our offering should be continuously benchmarked against competitor jurisdictions, and this applies equally to the administration of the scheme.

Likewise, if the level of R&D being carried out within indigenous companies is to increase sufficiently to enable Ireland to meet its target R&D spend of 2.5 percent of GNI* by 2030, the tax credit must remain fit for purpose.

As to how the R&D Tax Credit may further evolve, the Department of Enterprise, Trade and Employment recently confirmed in its White Paper on Enterprise 2022 – 2030 that they are examining the Commission on Taxation's recommendation for an advanced-assurance scheme aimed at providing comfort to claimants regarding their eligibility to claim the tax credit.

An improvement that should be possible in the shorter term is the introduction of sector specific guidance. This has been on the agenda of the R&D Tax Credit Discussion Group (a group consisting of the Revenue Commissioners and various other stakeholders) for several years and it is therefore hoped that the issuing of guidance is imminent.

Another potential enhancement that has been generating interest of late is the use of the R&D Tax Credit to target "Green" initiatives. If the tax credit can contribute to Ireland meeting its climate action goals, this will be another string to the bow of this important tax incentive.

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