In March 2019, Revenue published updated guidelines for the R&D tax credit (Tax and Duty Manual Part 29-02-03), superseding the April 2015 guidelines. Below is a high level analysis of the changes made by the new guidelines and how they might impact R&D tax credit claims.

**Subcontracted R&D activities**

Two important, positive changes have been included in the guidelines:

- The guidelines previously restricted the ability of a company to claim for any subcontracted R&D other than activities that were qualifying R&D activities in their own right. For example, PharmaCo subcontracted potency testing (which was required to resolve scientific uncertainty associated with its newly developed drug product) to PotencyCo. If the potency testing is a routine task from PotencyCo’s perspective then the testing would have not qualified under Revenue’s previous interpretation.

  The guidelines now state that “the outsourced activity must constitute qualifying R&D activity of the company which appointed the sub-contractor, and not necessarily R&D of the subcontractor.” So now PharmaCo should be in a position to claim for its subcontracted potency testing.

- Revenue has also confirmed that notification letters are not required for subcontractors who cannot claim the R&D tax credit (e.g. a self-employed individual or a third-party outside the charge of Irish corporation tax). This reduces the administrative burden on claimant companies.

**Employee remuneration**

The guidelines contain a positive update that provides greater clarity in relation to payments to staff. They state “All expenses borne by the company in relation to the employment contract of the staff member which are operated through the PAYE/PREM payroll system should be considered to be emoluments, and apportioned.” In addition, Revenue has updated the example illustrating that there is no longer a need to restrict expenditure on medical insurance premiums to the employee only.

**Documentation**

Revenue has made two significant amendments in relation to documentation:

- Clarification that failure to have “sufficient documentation” will not lead to an entire R&D claim being rejected – rather it will apply on a project-by-project basis. In the previous iteration of the guidelines it was suggested that failure to have the required documentation may result in failure of the entire claim.

- Inclusion of a “suggested file layout” for supporting documentation in relation to claims made. This is a significant departure from Revenue’s previous stance that a company should not need to maintain documentation above and beyond what is required to enable it to carry on its R&D activities.

Revenue describes the file, which contains 37 questions/requirements, as “a basic guide to the contemporaneous documentation that Revenue would expect to see.” Given the language used we believe that it is reasonable to expect that Revenue Inspectors will soon default to the “suggested file layout” and require this file format to be in place for every claim. We would have a concern that this requirement will increase the level of administration on companies claiming the credit.
The relevance of a number of questions is unclear, for example the “alternative action plan” when developing products for internal use, or the suggested inclusion of a report from a third-party expert.

**Recording qualifying R&D work**

We note that Revenue did not specify that companies should maintain timesheets in order to support the staffing costs included in the claim. However, the “suggested file layout” asks for “a description of the system used to record work on qualifying and non-qualifying projects should be included, and should at a minimum identify when staff record their work, who reviews, in that regard how the qualifying element of the project is identified.”

Where timesheets are not maintained this requirement could result in Revenue Inspectors seeking to disallow claims on the basis of insufficient evidence to support staffing time. We will monitor Revenue’s application of this requirement in practice.

**Employee secondment**

A positive update in relation to seconded employees is likely to be of benefit to multinational companies. The costs of employment of individuals seconded to a company, borne by the company carrying on R&D activities, can now be treated as direct employee costs (i.e. not subject to the “subcontracted R&D” rules) if the individual(s) carries on the R&D activities in Ireland and contributes specialist knowledge to a specific R&D project.

**Materials & process development activities**

The guidelines include a number of updates:

- The guidelines now state, “Where it is reasonable to consider that there will be a saleable product, then the lower of cost, or net realisable value of any materials or other saleable product which remain after the R&D activity should be deducted from the expenditure claimed.”

This is a significant departure from the 2015 guidelines, which still required material costs to be deducted, but only where the materials had further commercial value after the R&D had concluded. The new guidelines place greater onus on the claimant company to make an assessment as to what the outcome of the R&D process will be in advance of its conclusion.

Due to the uncertain nature of R&D, it may not be known whether any saleable product will arise from an R&D activity until after the R&D has concluded, or indeed well after the claim for the cost of input material has been made. Additional consideration will likely be required when determining the best approach for claiming for materials.

- Example 15 describes the production of a number of batches as part of a biopharma manufacturing process development activity. Some important points arise in this example:
  - On the positive side: (a) it indicates that Revenue is of the view that development batches used for scale-up activities can qualify, in line with our long-held view, and (b) it provides an example of where materials expenditure may be claimed due to the ongoing presence of scientific uncertainty about the stability of the product.
  - However, without providing any further detail, it refers to the exclusion of non-qualifying aspects of a process under development. We would have a concern that this example could lead Revenue or their technical reviewers to seek to challenge and exclude elements of a process under development rather than taking a more holistic system-level view.

- Example 16 considers process development undertaken by a generic pharma company. It suggests that scale-up activities carried out by a generic pharma manufacturer would not qualify due to a lack of scientific/technological uncertainty. We don’t believe the example reflects the reality of R&D in this sector, and would be concerned that Revenue Inspectors may use this as a basis for challenging R&D claims in the generic pharma sector without considering each case on its merits. In our experience process development activities in this sector frequently involve the resolution of scientific or technological uncertainty.

**Apportionment of costs**

Revenue notes that it is willing to accept an overhead allocation factor (or apportionment basis) used by a company where there is a reasonable nexus with the costs involved and where the percentage of costs to be allocated is: (a) selected by a person in the company with the required knowledge; (b) bone fide; (c) reasonable; and (d) based on the facts of the individual claim.

**Payable tax credits**

Revenue has clarified a technical point on how the cash refund instalments are calculated where a company’s R&D tax credit claim exceeds its payroll tax liability limit. This ensures that companies can receive cash refunds of their R&D tax credit at the earliest opportunity.
KPMG’s R&D Incentives Practice

We prepare R&D tax credit claims on either a contemporaneous or retrospective basis, tailored to each client’s requirements. Our bespoke claim methodologies have been tried and tested under a significant number of Revenue audits; we also provide support during Revenue audits of claims prepared without KPMG assistance.

Concession for micro company / SME in receipt of an R&D grant

Given the parallels between the definition of R&D for the R&D tax credit and R&D grants regimes, Revenue will not seek to apply the science test to projects financed by an Enterprise Ireland, IDA, or Horizon 2020 R&D grant, provided the value of the credit does not exceed €50,000. The accounting test would still be applicable.

Mergers and transfer of the trade

The guidelines now include an example which states that either a transfer of the trade or a merger would generally appear to satisfy the requirements for transferring unused R&D tax credits from one group company to another.

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