Grant Thornton

Navigating Ireland's R&D tax credit: A comprehensive guide

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First introduced in 2004, the research and development (R&D) tax credit is a financial incentive provided by the Irish government to encourage companies to invest in their R&D activities. Available to companies of all sizes undertaking research and development activities in the EU or the UK, the 30% credit is hugely beneficial to both multinational and domestic companies.

What is the R&D tax credit?

Finance Bill (No. 2) 2023 made some significant changes to Ireland's R&D tax credit, including increasing the credit from 25% to 30% for R&D activities conducted after 1 January 2024. As a result, companies within Ireland's tax charge can apply for a 30% tax credit on qualifying expenditures for R&D activities.

In other words, companies can claim a refund of €30 for every €100 spent on a qualifying R&D activity. This refund is in addition to the corporation tax deduction for R&D expenses: the effective tax savings is 42.5%.

An increase in the headline rate of the R&D tax credit from 25 to 30% ensures that there is no net impact of the taxation of the R&D tax credit under the Pillar Two GloBE rules. Companies within the scope of Pillar Two (broadly groups with turnover in excess of €750m) should be no worse off while all other companies will see a tangible benefit from the 5% increase.

As the credit focuses on scientific and technological advancement, businesses operating within the technology and life sciences industries should familiarise themselves with—and take full advantage of—the R&D tax credit. To avail of the credit, companies must demonstrate that they have made a qualifying expenditure on a qualifying R&D activity.

What counts as a qualifying R&D activity?

Only certain R&D activities qualify for the R&D tax credit, with reasonably strict eligibility criteria. The R&D activities must:

- be in a (Revenue-approved) field of science or technology,
- be systemic, investigative or experimental,
- seek to advance science or technology,
- involve either basic research, applied research and/or experimental development, and
- involve the resolution of scientific or technological uncertainty.

Additionally, the expenditure cannot qualify for a tax deduction in another country.

How can companies determine R&D activities meet qualifying criteria?

Revenue have laid out guidelines for each criterion to help companies determine whether their activities qualify.

To qualify, the R&D activities must be in one of four fields: natural sciences, engineering and technology, medical sciences and agricultural sciences. Revenue have further illustrated specific examples of activities that may qualify within each field, such as maths, computer sciences and chemical sciences for natural sciences and forestry and veterinary medicine for agricultural sciences.

Revenue have detailed activities that do not qualify, including research in the arts, humanities or social sciences (economics, business management and behavioural sciences); routine quality control testing and analysis, legal and administrative work related to patents; market research and testing; and prospecting, exploring or drilling for minerals, petroleum or natural gas.

When it comes to showing that R&D is systemic, investigative or experimental, Revenue expect companies to perform R&D activities in a planned, logical sequence using acknowledged methodologies. They should also maintain detailed records of their R&D process as Revenue are interested in both the outcomes and how the activities were carried out, including the original scientific/ technological goals, method, incremental progress and conclusions.

In other words, Revenue want to see the project's lifecycle, including milestones achieved or changes in direction, to determine that the decisions made and paths taken build systematically upon one another. When claiming the credit, companies will need to provide evidence of this contemporaneous documentation: insufficient evidence can result in Revenue rejecting a claim.

Scientific or technological advancement refers to an advancement in overall knowledge and capability in the field—not simply to an advance in the company's own state of knowledge or capability within the field. Revenue evaluate advancement based on the knowledge and capability that a field specialist could be reasonably expected to have.

Some companies may be working on their R&D in secret; they are not disqualified from the credit if another company is working towards the same advancement.

However, the advancement must also seek to remove a scientific or technical uncertainty, meaning that the general consensus in the field is that there is uncertainty as to whether a particular goal can be achieved or as to whether an alternative for achieving the goal—one that improves cost, reliability or reproducibility—exists. Removing uncertainty about the commercial viability of new materials, products, devices, etc. are commercially does not meet the criteria.

Importantly, the criterion only states that companies must seek to achieve scientific or technological advancement. If an R&D activity reveals that a certain project or hypothesis does not work, it can still qualify for the credit. Likewise, if an R&D activity ceases suddenly because another organisation achieves or reveals the advancement first, the work the company undertook before halting the activity may qualify.

01 What are some examples of qualifying activities for life science companies?

The life sciences industry contains a broad range of activities that may qualify for the R&D tax credit, including:

- **Drug discovery and pre-clinical work**, such as researching and developing new pharmaceuticals, making improvements upon existing therapies and developing generic drugs,
- **Medical devices**, such as creating new or improving existing devices and designing diagnostic methods/tests to detect diseases in a less invasive, faster and more accurate manner,
- **Clinical trials**, including the conducting of trials for both drug discovery and device development, and
- **Improving the manufacturing process** for either devices or drugs in a way that increases efficiency, reduces costs or improves the quality of the product.

02 What are some examples of qualifying activities for technology companies?

Technology companies will find that many of their R&D activities qualify for the credit.

The **development of new hardware**—chips, sensors or other electronic devices—as well as the creatin of methods that solve technical challenge of integrating new components into existing systems may both qualify.

For companies working in AI, **developing and testing algorithms**—especially those that solve complex problems and make advancement in natural language processing or computer vision—may qualify. Likewise, research that experiments with different methods of model training and optimisation with the aim of improving accuracy or efficiency may also qualify.

In the realm of cybersecurity, the **development of new security protocols, encryption methods and real-time threat detection and response systems** may fall within the scope of the credit. There is also potential for qualifying activities within cloud computing, such as infrastructure that optimises data storage, processing and retrieval.

New logistical solutions, such as those that improve supply chain management or provide transformative results for accurately tracking shipping in real time, may also qualify.

The creation of **new software solutions** that offer functionalities not previously available and the creation of new SaaS platforms that take innovative approaches to scalability, security or performance could qualify.

However, Revenue has specific rules and guidelines about software development and above criteria, noting that “much software development does not qualify as R&D activity” because it uses known methodologies and the functions of existing tools in standard development environments and does not advance technology or resolve technological uncertainty.

What counts as a qualifying expenditure?

When applying for the R&D tax credit, companies can only claim the credit on certain expenditures. To take full advantage of the credit, companies need to understand which expenditures qualify and be sure to capture all eligible costs in their claim. Importantly, the credit applies solely for expenditures incurred wholly and exclusively by the company in the carrying on of qualifying R&D activities.

For employees directly involved in the R&D activity, companies can claim on staffing costs. These costs include employees' salaries, bonus payments, pension contributions and PSRI contributions. However, the amount of the claim depends on the amount of time the employee dedicates exclusively to the carrying on of R&D activities.

For instance, if an employee spends 60 percent of their time on an R&D activity, then the company can claim 60 percent of the staffing costs associated with that employee. However, companies cannot claim any recruitment, payroll team or canteen costs as these costs are related to R&D staffing but not incurred wholly and exclusively for the purposes of carrying out an R&D activity.

When a company has subcontracted seconded employees or individual consultants to take on short-term or part-time work, Revenue considers these employees direct staff if they meet certain criteria related to work location, specialist knowledge and employment tenure. However, Revenue considers the use of agency staffing as an outsourcing expenditure.

Many companies will have involvement from other companies or rely on outsourcing for aspects of their R&D work. When companies incur expenditures in which they paid a third party to carry out a qualifying R&D activity, they can claim 15% of the expenditure or €100,000, whichever is the greater.

However, the company must notify the third party in writing that they are making a claim on the expenditure. Where payments are made to institutes of higher education or universities, Revenue have additional restrictions, such as requiring that the institution be located in the EU or UK.

Companies can claim on direct costs, such as equipment, materials and chemicals used during the R&D process. They can also claim on capital expenditure, such as plants, together with overheads, such as electricity, water and fuel, used specifically for R&D activities. Since 2023, payments on cloud computing costs have been within the scope of the R&D tax credit. Under certain conditions, companies can also claim on patent royalty payments to third parties.

Rental costs may be eligible if the company has modified the rented space, such as creating a clean room or laboratory, so that the room exists wholly and exclusively for the purpose of the R&D activity. In cases where the rental space is an area where the R&D activity takes place alongside other company activities, the rent is not eligible.

If a company has an expenditure for which it received grant from a designated list of sources—including the Irish State, an EAA or EU member state or the UK, then the qualifying expenditure is the total expenditure less the grant.

Do building expenditures qualify for the R&D tax credit?

Building, construction and structure expenditures qualify under specific conditions.

When a company uses a building directly for R&D activities—such as a factory, lab or other facility where R&D occurs—then construction on or refurbishments to that premise may qualify.

It is important that all construction, renovation, design and engineering costs claimed must be directly related to the R&D activity. For the first four years that the building is in use, at least 35% of its use must be dedicated to R&D activities.

In this case, a company may be eligible for an additional R&D credit of 25%. This relief is spread evenly over a three-year period. For instance, if the total qualifying expenditure is €500,000, then the company can claim approximately €41,667 each year for three years for a total of €125,000 (25% of the total expenditure).

The company must also use the building for R&D activities for at least 10 years after the company claims the tax relief; otherwise, Revenue will claw back the claim.

How is the claim paid out?

The R&D tax credit is paid in three instalments over the course of three years. The first instalment is the greater of either the 50% of the credit claimed or €50,000; the second instalment is 60% of the remaining balance; and the third instalment is the remaining balance. For companies whose claim is less than €50,000, they'll receive their full refund in the first instalment.

For each instalment, the company can select to have Revenue treat the credit as an overpayment of tax that will be used to offset any tax liabilities or to receive the credit as a payment from Revenue. Many large and established companies will select to reduce their tax liability, but the repayment scheme offers an important source of cash flow for loss-making or pre-revenue companies.

How to claim the R&D tax credit

Companies must claim the credit within 12 months of the end of the accounting period during which the R&D activities took place. They can claim the R&D tax credit as part of their annual corporation tax return, using the Form CT1. For each instalment, they must specify on the form whether Revenue should treat any portion of the refunded amount as an overpayment of tax or paid out to the company.

For companies claiming the credit for the first time as well as for those that have not claimed it in the past three years, Revenue require written notification of their intention to make a claim at least 90 days before they submit the claim; otherwise, the opportunity to make the claim will be lost.

In their pre-notification, companies must list their location and tax number, a description of the R&D activities carried out, the number of employees carrying on the activities, and details of R&D expenditure incurred that has meet bet directly or indirectly by grant or other assistance.

What documentation is required to meet the qualifying criteria?

The maintenance of supporting documentation regarding an R&D tax credit claim is critical. Revenue will thoroughly inspect all documentation and can ask for additional information before awarding the claim.

As part of its assessment, Revenue ask companies to show that they have a “valid claim” for the credit. To do so, companies must provide a reasonable amount of documentation and record keeping to pass two tests: the science test, which shows that their R&D activity is a qualifying activity, and the accounting test, which shows that the costs incurred in the carrying on of the R&D activity have been properly tracked and accounted for.

Revenue lay out a list of the records required to pass each test. For instance, in its requirements for the science test, Revenue asks for specific details about the systematic investigation, evidence that the scientific or technological advancement had not already been achieved, the qualifications of the project manager and more.

For the accounting test, Revenue require that companies provide details about the allocation of resources and associated costs to each stage of the R&D project, which the relevant accounting records. Such records should contain key dates, project plan with activity milestones and deliverables, a breakdown of costs associated with location, details of personnel involved complete with the amount of time they spent on the activity and more.

However, companies should be aware that Revenue also investigate whether they have the appropriate controls and processes in place to manage R&D time, track expenditures and more. This examination is effectively a third test—and companies availing of the credit need to be prepared to pass it.

Preparing for an R&D audit

The R&D tax credit relies on self-assessment. Revenue have the right to audit a claim after it is filed. When conducting an audit, Revenue thoroughly assesses whether the claim passed both the science and accounting tests. As the R&D tax credit has arguably more room for interpretation than other tax legislation, R&D audits can be especially difficult for companies.

During an audit, Revenue will perform an in-depth review of documentation, often with the assistance of technical experts. In the event of an audit, companies will need to furnish evidence generated during the time that activity took place. Companies should prepare in advance by documenting activity thoroughly as the R&D is occurring.

The number of R&D audits performed by Revenue has increased substantially over the past few years. As the tax credit is a complex, technical tax area that interacts with other tax legislations, companies run the risk of making many mistakes when claiming.

Common mistakes include overstating the claim (including an expenditure which is not eligible), underclaiming (overlooking eligible activities), insufficient documentation to justify claims, failing to meet technical criteria, using unreasonable apportionment methods, failing to prepare R&D reports on a timely basis and incorrectly filing the claim. Revenue recently indicated that more companies are failing the accounting—as opposed to the science—test.

While Revenue can select to audit any claim, certain factors can make it more likely that a claim triggers an audit, such as a lack of substantial evidence or inconsistencies or accounting errors in the application. Companies should take great care and provide significant documentation with their application.

How Grant Thornton can help

Revenue are increasing their interventions into both the technical and financial aspects of claims. Grant Thornton assists domestic and multinational businesses in managing their R&D tax credit claims.

Our clients benefit from the knowledge of specialised team, who are dually qualified with technical and financial expertise. Our teams are led by quadruple qualified consultants—scientist, lawyer, account and tax advisor.

We can assist you with:

- Training—we provide training on R&D regime and compliance and on best practices learned from our experience with Revenue interventions.
- Feasibility studies—we evaluate entitlement to claim and explore grant assistance.
- Science test—we support with the scientific write-up to substantiate the activities undertaken.
- Accounting test—we work with your financial team to identify and quantify eligible expenditure.
- Reporting—we collate the scientific and financial information into a comprehensive report to support the claim.
- Revenue audits—we assist companies with the preparation for an audit, including mock audit sessions, health checks and attendance at the audit.