Deloitte.

Public Consultation on the Research & Development Tax Credit and on options to support Innovation

May 2025

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Research & Development Tax Credit – Public Consultation
Department of Finance
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By email to: businesstaxpolicy@finance.gov.ie

Dear Sirs/Mesdames:

Re: Public Consultation on the Research & Development Tax Credit and on Options to support Innovation

We are pleased to submit comments on behalf of Deloitte in response to your 'Consultation on the Research & Development Tax Credit and on Options to support Innovation' of April 2025. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives, and we are available to discuss anything in this document, as needed. In the meantime, if you have any queries, please do not hesitate to contact us at 01-417-2200.

Yours sincerely,

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1. Executive Summary

Ireland has a robust and sustainable R&D ecosystem underpinned by several factors such as a strong innovative and internationally competitive enterprise base; growing employment, sales and exports; a renowned pool of talent; and a coherent joined-up innovation ecosystem that is responsive to emerging opportunities, delivering enhanced impact through the creation and application of knowledge. Ireland has the capacity to meet the needs of R&D investors and offers the ideal commercial, political and social environment in which to carry out successful and profitable R&D activities. But in our view the Irish R&D ecosystem requires ongoing protection in a highly mobile and competitive world.

In our view, it is critical that assurance be given to both companies with existing facilities and potential investors as to the future tax incentive landscape in Ireland; therefore, we would strongly recommend that where the recommended enhancements to the R&D tax credit regime are to be adopted, this should be communicated as part of the Ministers speech on Budget Day. In addition, an intention to adopt new tax incentives aimed at key areas of innovation should be communicated to the market in a timely manner so as to support investor and market confidence.

Accordingly, our key recommendations include:

- Amendment to section 766 TCA 1997 to add an additional cap which expands the ability to include related party expenditure, unrelated party expenditure and/or university spend within the scope of the R&D tax credit capped at 100% of the internal R&D spend. Expand the definition of “university or institute of higher education” to include affiliated entities of such institutes such as university hospitals and research centres.
- Introduction of a new digitalisation tax credit to provide relief for relevant expenditure related to the safe development, implementation and use of digitalisation including Artificial Intelligence (AI) and for certain categories of expenditure to assist businesses with the digitalisation process and its acceleration.
- Introduction of a new decarbonisation tax credit to provide relief for expenditure incurred by businesses to lower carbon emissions.
- Amendments to the definition of “expenditure on research and development” as follows:

i. Amend the definition in section 766 TCA 1997 to read as “*expenditure…, wholly and exclusively laid out or expended for the purposes of research and development activities….*”, as opposed to *“incurred by the company wholly and exclusively in the carrying on by it of research and development activities…”*

ii. Amend the definition to allow salary costs incurred by individuals travelling internationally (i.e. outside a relevant Member State).

iii. Amend the definition to remove the restriction currently placed on costs incurred by a company in the management and control of research and development activities.

- Remove the current cap applying to third level and agency staff and increasing the cap for unconnected party subcontracting currently in place in section 766 TCA 1997.
- Enhancements to reduce the administrative burden and risks associated with the R&D tax credit as follows:

i. To promote fair treatment and encourage SMEs to engage in R&D activities, penalties and interest should not be applied in cases of technical disagreements between taxpayers and Revenue.
ii. Establish a clear timeline for processing and payment of R&D refunds by the Revenue Commissioners, either legislatively or administratively.
iii. Develop a centralised audit process to ensure consistency and uniform interpretation for all R&D tax credit claimants.
iv. Reduce the administrative burden in the context of smaller, shorter-term projects similar to the approach adopted in the UK Research and Development Tax Credit regime.

Other related recommendations include:

- The introduction of an Investment Tax Credit to provide relief on the acquisition of eligible investments – such as those related to software development, digital infrastructure, and cybersecurity as well as for tangible assets (namely plant and machinery).
- The close company surcharge provisions should be amended to disapply the surcharge on undistributed income where it can be clearly demonstrated that the retained profits are earmarked for reinvestment in the business with a documented growth plan.
- The Digital Gaming Tax Credit should be amended to increase the rate to 38% and references to shareholder liability should be removed.
- Steps should be taken to shift the focus in terms of incentives away from the KDB, reallocating resources and budget instead towards the generation and development of IP in Ireland through enhancements to the R&D tax credit regime.

2. R&D Tax Credit – Consultation questions

2.1 General Queries

- For R&D-active companies, please provide a general overview of your company (sector, headcount, size) and the role that the R&D tax credit has played in supporting your company to survive, thrive, or to grow.
- Have the recent measures which were introduced in Finance Act 2022, Finance (No.2) Act 2023 and Finance Act 2024 encouraged additional spending on R&D in your organisation? Please provide some detail in your answer.
- What is the R&D outlook for the company over the short to medium term, both in terms of currently ongoing projects and potential future projects, and what are the key challenges to continuing R&D activities in Ireland?
- Is R&D a continuing activity every year, or an intermittent activity?
- Are you undertaking R&D activity for the benefit of your company or for an unconnected third-party?
- Are there instances where a claim for the credit has not been submitted in respect of potentially qualifying activities, and if so, what considerations informed this decision?
- What proportion of R&D activity and expenditure undertaken to date would have been incurred by the company / group in Ireland in the absence of the R&D tax credit?

There are significant challenges associated with the claims process for the R&D tax credit, particularly for SMEs. The process involves significant cost and uncertainty, reducing its attractiveness to businesses. We are of the view that implementing the below recommendations will enhance the attractiveness of the R&D tax credit regime, support innovation, and foster growth among SMEs. We urge the government to consider these changes to promote a more equitable and efficient R&D environment.

2.1.1 Definition of "expenditure on research and development"

An R&D credit is only allowable on expenditure falling within the definition of "*expenditure on research and development*" in section 766(1)(a) TCA 1997. That defines "*expenditure on research and development*" as *"expenditure…, incurred by the company wholly and exclusively in the carrying on by it of research and development activities in a relevant member state…."* . In our view, such wording and particularly the reference to "in the carrying on by it of research and development activities" can give rise to significant uncertainty for taxpayers.

For example, with regard to rental costs, Revenue Tax and Duty Manual 29-02-03 (updated January 2025) substantially limits the type of rental costs on which an R&D credit can be claimed. Revenue Tax and Duty Manual 29-02-03 states:

"Where a company rents a specialised laboratory or a clean room in order to advance its R&D, the question to ask is whether or not the company could have undertaken the R&D activity without the specialised nature of the laboratory or clean room. If the activity could not have been carried out, then the specialised nature of the rented space can be said to be integral to the R&D activity the company is carrying on and, to the extent that the expenditure is wholly and exclusively incurred in the carrying on of the R&D activity, rent may be qualifying expenditure.

In contrast, a company who rents an office space in which it carries on its R&D activities is unlikely to be able to demonstrate that there is anything specialised in the nature of the space that is integral to the R&D activities. While the company may require a space to house the R&D team, this requirement does not mean that the space is integral to the R&D activity. An office space is the setting in which R&D happens and does not itself perform a key function in relation to the R&D process; it is not integral to the R&D activity.

Where a company undertakes qualifying R&D activities on the manufacturing process, it is unlikely to be eligible to claim rent on the manufacturing facility as expenditure on R&D activities. While the R&D activities may not be undertaken away from the facility, the rent is not incurred wholly and exclusively in the carrying on of those R&D activities."

The removal of rent as an allowable expense in many claims has resulted in a reduction in the value of R&D tax credits for many claimants, thereby reducing the attractiveness of the R&D tax credit regime. We cannot see the policy rationale for denying an R&D credit on rental costs associated with genuine R&D activities.

We would recommend that this is addressed through an amendment to the definition of "expenditure on research and development" in section 766 TCA 1997. We would recommend that section 766 TCA 1997 is amended to read "*expenditure…, wholly and exclusively laid out or expended for the purposes of R&D activities*…." This wording is in line with the tried and tested Schedule D, Case I rules which taxpayers and advisers are familiar with and for which there is a significant body of case law. This should avoid potentially narrow interpretations of what is and what is not qualifying expenditure and give taxpayers more certainty. The suggested amendment would also ensure that companies get a credit for most costs that are essential to the R&D process.

<u>Activities carried on outside a relevant Member State</u>

Furthermore, the definition of "*expenditure on research and development*" is limited to research and development activities carried on "*in a relevant Member State*". In practice, it would be reasonable as part of a project for individuals to travel outside a *"relevant Member State"* in order to carry out part of the project. Such travel can be necessary to obtain additional insights into the project or to obtain additional knowledge and skills necessary to complete the required research in Ireland. However, companies can in practice find it difficult to track such international travel in order to disallow the salary costs incurred during this period of travel.

To ease this burden, we would recommend an amendment to the definition of "expenditure on research and development" to allow these costs without the need for tracking international travel and apportioning salary. Where an outright amendment is not preferred, an agreed term of no more than 90 days outside a relevant Member State (or greater than 50% of time spent to be within a relevant Member State) would effectively allow a measure of flexibility in international travel without the need for burdensome tracking to be carried out. In our view, such an amendment would not create an unnecessary risk that certain claims may include costs not incurred in relation to activities not carried on in a relevant Member State. The definition of "expenditure on research and development" already includes a restriction such that expenditure may not be taken into account where it has been allowed as an expense in computing income or otherwise relieved in any territory other than the State. Accordingly, in the event that an individual were to be present in a non-EU territory to such an extent that a Permanent Establishment (PE) were created and income and expenses attributed to same, such salary costs would necessarily be excluded from the remit of any R&D tax credit claim in any event. The legislation therefore provides an inbuilt mechanism to ensure that salary costs associated with international travel which are deducted outside the EU cannot be double counted for R&D tax credit purposes in Ireland. Therefore, we see no policy rationale for not proceeding with the recommended amendment as outlined above.

2.2.2 Administrative challenges

Interest and penalties on technical interpretations

The application of penalties and interest when R&D activities are not deemed to qualify from a technical perspective is unfair, especially for SMEs. Disagreements between taxpayers and Revenue on technical interpretations can result in large penalties, deterring smaller companies from claiming the credit. To ensure fairer treatment and encourage more SMEs to engage in R&D activities, penalties and interest should not be applied in cases of technical disagreements (other than fraud or neglect) between taxpayers and Revenue.

Timeliness of R&D tax credit refunds

In our experience there are considerable delays in receiving R&D refunds which are causing significant challenges for businesses. We recommend the establishment of a clear timeline for the processing and payment of R&D refunds by the Revenue Commissioners, either on a legislative basis or an agreed administrative basis. Consideration of such timeline should be part of the upcoming R&D review.

Technical Documentation requirements

Ireland is one of the few regimes globally that require a full technical compliance document to be prepared in order to claim for the R&D tax credit. Revenue guidance on the level of documentation required notes that an individual file should be retained on a project-by-project basis[1]. In the case of companies carrying out a high volume of projects that have either a low cost or take place over a shorter period (or in some cases, both), the administrative burden associated with the preparation of documentation can mean that administrative costs often exceed the benefits of claiming. In our experience, the nature of the projects that are claimed tend to be large scale experimental development, but the associated administrative costs around compliance and documentation can exclude applied and basic research which often take place on a short term or for a lower value per project. Such research nevertheless plays a valid role in the knowledge economy in Ireland. Accordingly, to incentivise such research the compliance load on a per project basis must be revised.

The UK R&D tax credit regime, by comparison, require a minimum of 3 projects to be documented but additional projects thereafter result in a reduced compliance burden. For example, if a taxpayer is claiming for more than 10 projects, the company must select 3 or more projects to treat as "relevant projects". These projects together must account for at least half of the qualifying expenditure being claimed as part of the R&D tax credit[2].

[1] Part 29-02-03 - Research & Development (R&D) Corporation Tax Credit
[2] Additional information you must submit before you claim for Research and Development tax relief - GOV.UK

In our view, such an approach would reduce the administrative burden significantly in the context of smaller, shorter-term projects.

2.2 Subcontracted R&D activities to a university or institute of higher education

- During the period in which R&D activities were undertaken by the company, did the proportion of the company's overall headcount with STEM qualifications increase? If so, what specific areas of STEM were of relevance?
- Where elements of R&D activity were outsourced to a university or institute of higher education, please provide information on relevant considerations. For example, was outsourcing required to access particular expertise or equipment? Was it a standalone project or did it result in longer-term collaboration?
- Are there instances where the current cap has specifically limited outsourcing plans to universities or institutes of higher education?
- Are there any factors other than the cap which would be relevant in encouraging additional collaboration on R&D between companies and universities or institutes of higher education?

Broadly, according to section 766(1)(a) TCA 1997, expenditure on research and development means expenditure incurred by the company wholly and exclusively in the carrying on by it of research and development activities. Thus, in the first instance, expenditure incurred on R&D activities carried out by third parties would not be expenditure on research and development for the purposes of the definition in section 766(1)(a) TCA 1997. However, section 766(1)(b)(vii) & (viii) TCA 1997 provide a number of exceptions to this rule. Where a company incurring expenditure in carrying out R&D activities also pays a sum to a university or institute of higher academic education in the EEA to enable that university or institute to carry out R&D work on behalf of the company, that sum, up to an amount not exceeding the greater of €100,000 or 15% of the expenditure incurred on R&D activities carried out by the company, will qualify for credit. Expenditure by a company on subcontracting research and development work to an unconnected party will qualify for relief up to a limit of the greater of €100,000 or 15% of qualifying R&D expenditure incurred by the company in any one year.

As a general observation, feedback received on the subcontracting of R&D activities to a university, or an institute of higher education would suggest that amounts paid rarely exceed the cap of €100,000 provided for in legislation. In any event, we would recommend that these limits on outsourcing are removed in Budget 2026 in the context of third level bodies and research institutes.

A removal of such limits, or at the very least a substantial increase, would encourage interaction and collaboration between Irish businesses and between businesses and Irish third level institutions.

Furthermore, we would recommend expanding the provisions of section 766(1)(b)(vii) TCA 1997 to include not only "*university or institute of higher education*" but also "*affiliated entities*" of such institutes such as, for example, university hospitals. At present, the definition of "university or institute of higher education" means:

(i) a college or institution of higher education in the State which—

(I) provides courses to which a scheme approved by the Minister for Education and Science under the Local Authorities (Higher Education Grants) Acts 1968 to 1992 applies, or

(II) operates in accordance with a code of standards which from time to time may, with the consent of the Minister for Finance, be laid down by the Minister for Education and Science, and which the Minister for Education and Science approves for the purposes of section 473A;

(ii) any university or similar institution of higher education in a relevant Member State (other than the State) which –

(I) is maintained or assisted by recurrent grants from public funds of that or any other relevant Member State (including the State), or

(II) is a duly accredited university or institution of higher education in the Member State in which it is situated.

Expansion of the above definition to include affiliated entities within the meaning of a "college or institution of higher education" is necessary to ensure that valuable research and development activities carried on by university hospitals and separate research centres may be brought within the remit of the R&D tax credit and appropriately incentivised. The objective here is to drive additional spend on clinical trial activities in our Hospitals. In the absence of such amendment, research centres can be fail to be treated as university subcontractors and are thus subject to the cap on subcontracted costs for research and development activities.

As an overall comment, we would refer the reader to Part 2.4 of this submission where we have outlined our views and recommendations regarding the current restriction on outsourcing in the context of the R&D tax credit.

2.3 Spillover effects of collaboration with universities and institutes of higher education

- Does your company have engagement with any university or institute of higher education other than for the outsourcing of elements of R&D activity, for example offering work placement opportunities to students; input into curriculum development, sponsorship of programmes at PhD level or at another level, etc?
- Does your company have any engagement on STEM initiatives with schools at primary or secondary level, or with other civil or social groups?

In our view, significant spillover effects are encountered with respect to collaboration with universities and third level institute. Stakeholders and industry bodies in this space are closely embedded and connected with such third level institutions and are proactive in providing sponsorship for events, guiding areas of focus and helping to develop curriculum to ensure industry ready graduates. In our view, higher volumes of collaboration with third level institutes on research and development would provide significant benefits to enhancing the skill set of Irish graduates.

We would refer the reader to Part 2.4 of this submission where we have outlined our views and recommendations regarding the current restriction on outsourcing in the context of the R&D tax credit.

2.4 Subcontracted R&D activities to other unconnected third parties

- Where elements of R&D activities were outsourced to unconnected third parties, please provide detail on the impetus for this action – for example was outsourcing required to access particular expertise, equipment or services?
- Having regard to the credit's policy objectives of supporting high value-add employment and economic activity, are there amendments to the outsourcing provision that you believe would be beneficial and cost-efficient for the Exchequer.
- Are there instances where the existing cap has limited plans to outsource activities, resulting in an overall reduction in R&D activities?

Many Irish businesses carrying out R&D work will often find that some elements or stages of that work cannot be completed in-house/in-country and have to be outsourced.

Yet in Ireland, we significantly limit tax relief on the cost of work outsourced or undertaken in collaboration with others. Where a company has incurred expenditure in the carrying on by it of qualifying R&D and pays a sum to a university or another person (who is not a connected person) to carry out qualifying R&D activities in a relevant Member State, relief will be restricted to the greater of 15% of the expenditure incurred by the company itself on R&D activities or €100,000. Accordingly, the existing R&D legislation completely prohibits related parties' expenditure from being claimed as part of the Irish R&D tax credit regime, even in cases where such expenditure is recharged to the Irish company, the Irish company is managing and directing the R&D activity in the related party's jurisdiction and the Irish company is the principal IP owner/IP hub location for the group.

In the context of a growing housing crisis and a tight labour market, intense competition for talent can mean that businesses may not be able to engage in the same level of research as is required by the market or at the very least the related tax credit benefit of outsourcing activity is significantly limited.

2.4.1 Inclusion of related party expenditure, unrelated party expenditure and/or university spend

We would recommend an amendment to section 766 TCA 1997 to add an additional cap which expands the ability to claim outsourced R&D activities. This should include related party expenditure, unrelated party expenditure and/or university expenditure within the scope of the R&D tax credit capped at 100% of the internal R&D spend. In order to avoid exploitation, this additional cap would only be available to companies who themselves have not been contracted or paid to carry out those activities by any related or unrelated parties, and thus provides the benefit only to companies who inherently adopt a role in managing and developing the activities and adopt a measure of risk associated with the IP generated on foot of such activities (i.e. "effective" IP owners). This approach would protect the integrity of the scheme, ensuring contract costs are not placed in Irish entities simply to flow through to the entity ultimately carrying out and financing the R&D activities. It would promote substance in Ireland by encouraging the creation of high-value strategic R&D roles, particularly within companies that oversee and direct global R&D activities from an Irish base. Additionally, this measure would offer businesses the flexibility to access global expertise when required, helping them to overcome capacity constraints driven by talent shortages or housing challenges.

In addition to permitting such expenditure to be included as part of an R&D credit claim by the company, such an amendment would provide additional benefits including:

- strengthening the company's position for transfer pricing purposes (to the extent applicable to the entity i.e. non-SME companies).
- strengthening substance in Ireland through the creation of additional higher value strategic R&D roles in Irish entities engaged to carry on subcontracted R&D work.
- removing the downside of outsourcing, a necessity in many sectors given capacity constraints around talent and housing which can limit R&D expansion in Ireland.

The additional cap would, in our view, be applicable to both SME and non-SME companies equally as the requirement to carry on the majority of the DEMPE functions in Ireland would act as a standalone test and not one contingent upon any Transfer Pricing analysis which would otherwise arise in Part 35A TCA 1997.

Ireland already has in place a strong legal framework and intellectual property system that offers IP right holders the opportunity to be rewarded for their creativity and innovation and enabling society at large and the economy to benefit from their achievements. In combination with a strong R&D tax credit regime, they will continue contributing sustainably to corporate tax receipts and allow our Irish IP owning companies stay and grow in Ireland.

While such an amendment would result in an increase in the quantum of R&D tax credits claimable in a given year, in our view the broader economic benefits associated with such change would far outweigh the costs. In particular:

- the amendment would be limited to companies who act as the entrepreneur with respect to the R&D activities and thus adopt a greater risk with respect to generation, retention and exploitation of IP within Ireland. With the Irish entity acting as the entrepreneur, higher profits can be retained in Ireland securing future tax takes from IP owners and ensuring the continued expansion of Ireland's Knowledge Economy.
- the job creation would accelerate and broaden to include more high value strategic positions leading global R&D projects and initiatives, resulting in higher overall payroll tax receipts from higher salaries. Placing senior leadership in Ireland would enable these staff to advocate for Ireland as centre for research and innovation and attract employment and expansion

The overall landscape for businesses operating in Ireland has changed significantly and so must the incentive regimes that are offered to reflect that. Not too long ago, a company could look to claim R&D tax credits on their Irish R&D spend and then pay a 6.25% corporation tax rate on the exploitation of the IP generated through the Knowledge Development box. A large number of tax payers are now getting the same net benefit from the R&D tax credit (thanks to the welcome rate increase) but paying a 15% rate of corporate tax on that tax credit, driven by the application of Pillar Two rules. In this context, limiting the R&D benefit only to activities within our boarders now makes less sense. The numerical basis for investment decisions that have been made previously are no longer valid. Increased global competition and rapidly evolving incentive strategies in other jurisdictions create significant risk to the competitiveness of Irish tax policy and our ability to attract and retain innovative, leading edge foreign direct investment.

Ireland has always been at the forefront of tax policy, but there are concerns amongst tax payers that we are starting to fall behind.

The removal of restrictions on outsourced related party R&D spend would bring Ireland in line with other jurisdictions and enhance our competitiveness globally. Examples of comparable tax regimes and their treatment of related party spend are outlined below:

	Belgium	**UK**	**France**
Related party rule	Costs of subcontracting to related parties are allowable	Contracting outside of the UK is restricted but exceptions are applied for the Life Sciences Industry (clinical trials allowed)	Costs of subcontracting to related parties are allowable
Cost Restrictions	No limits on the costs of related party spend in the claim calculation	No limits on the costs	Capped at the lesser of €2m and 3 times the internal R&D spend
Territorial Restrictions	No territorial restrictions	No territorial restrictions	Contractors can be based in EU or Iceland and Norway

2.4.2 Amendment to remove/increase cap on outsourced R&D (universities and unconnected parties)

In addition, we would recommend removing or substantially increasing the cap applying to third level subcontracting and increasing the cap applying to unconnected party subcontracting currently in place in section 766 TCA 1997.

2.4.3 Inclusion of agency staff within internal spend

Feedback received in consultation with clients and stakeholders have identified significant issues associated with the use of agency staff in the context of multiphase projects and the impact of same on qualifying expenditure for the purposes of the R&D tax credit. Where large scale projects are envisaged by many companies, it would not be unusual for such projects to take place on a phased basis with work initially being undertaken by agency staff to ensure flexibility and agility in the process prior to moving to taking on full time staff members as the project progresses and scales. However, costs incurred by companies on agency staff on R&D activities are subject to the existing limits placed on subcontracted expenditure, as noted in Revenue guidance on the matter:

"The use of agency staff is considered to be outsourcing for the purposes of computing the amount of qualifying activity and the related expenditure is, therefore, subject to the limitations on outsourcing as set out in Section 6. This relates to any individual not remunerated directly by the company for their services."

While Revenue guidance permits costs incurred in relation to individual consultants who are hired on a part time or short-term basis to be included as part of the direct employee costs of the company and not as agency staff, in our view such treatment is limited by the conditions attached to it. Such treatment is limited to instances where the following conditions are met:

- The individual works under the company's control and direction
- The individual works on the company's premises
- The individual must be able to contribute special knowledge, which cannot be supplied by an in-house research team, to a specific R&D project being undertaken by this in house team,
- The engagement period does not exceed 6 months.

In many instances, the above conditions may not be met with respect to individual agency staff members or individual external consultants. It would be unusual for the engagement period to be less than 6 months, particularly in the case of complex multiphase projects.

These types of roles are fulfilling the policy objective of creating highly paid STEM employment within the state. They also create an ecosystem within the state of highly specialised experts to facilitate wave after wave of similar type investments and projects to flow into Ireland, due to the availability of these resources. In our view therefore, costs incurred in respect of agency staff should be treated similarly to internal staffing costs and thus should be included as part of qualifying internal R&D expenditure. Such an amendment would allow companies to engage in projects in a more flexible manner and would permit faster scaling and growth in key knowledge-based industries.

2.5 Grant funding

- Has your company undertaken R&D which qualified for the R&D tax credit and which has also qualified for grant funding as set out below?
- If so, during the period in which R&D activity was carried on by the company, what proportion of R&D projects undertaken received grant support from:
  - The IDA or Enterprise Ireland
  - The European Union (such as Horizon Europe, Horizon 2020, European Framework Programmes etc) and/or
  - Other sources (such as the UK or from a body/institution/agency outside the European Union)

Are there any impediments to identifying and/or claiming grant supports?

Definition of R&D for grant vs Definition of R&D for credit purposes

While there are differences in the definition of R&D for the purpose of grants applications and the R&D tax credit, it is considered that the two definitions are very close. With a view to minimising the burden of engaging experts to verify the science test in R&D tax credit claims, Revenue have stated that they would not, as a rule, seek to challenge the science test in relation to a project where:

i. an Enterprise Ireland, Horizon 2020, Horizon Europe or IDA R&D grant has been approved in respect of the R&D project;
ii. the project is undertaken in a prescribed field of science or technology, as defined in regulations (S.I. No. 434 of 2004);
iii. the company is a micro or small enterprise within the meaning of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises; and
iv. the total R&D tax credit claimed by the company for an accounting period (of not less than 12 months) is €50,000 or less.

We welcome such decision but would recommend that this approach is extended to all companies in all circumstances. Companies often observe differences in Revenue's interpretation of the law. In particular, different divisions and districts. Inspectors apply different interpretations in audits resulting in a variation of allowable expenditure. Different external technical assessors engaged by Revenue have hugely varying interpretation of the definitions of R&D, resulting in a measure of uncertainty in this area.

Given the importance of the tax credit to many companies, and the bespoke expertise involved, developing a centralised audit/approval process for all incentives would promote consistency across all bodies and ensure the same interpretations are applied to all claimants. The current administration of incentives is spread across multiple different entities, most notably the Irish Revenue, the IDA, SEAI and Enterprise Ireland ("EI"), with almost identical rules being interpreted in very different ways and creating different compliance requirements and administrative burdens for the same R&D projects.

2.6 The future of research and development

- As we look to the future of the R&D tax credit and the economy, where do you believe the focus of future R&D in your sector will be and what emerging technologies or areas should be considered?
- What is the company's biggest threat or competitor to growth and in attracting R&D investment in the future?
- Are there specific categories or areas of R&D which are currently being undertaken in your sector which you believe may not currently qualify for the R&D tax credit? If yes, please indicate why such R&D activities are not encompassed in the existing definitions.
- How will decarbonisation and digitalisation play a role in your company and what opportunities are there more broadly for R&D in these areas?
- Other than amendments to the rate or scope of the tax credit, are there any measures or amendments to the current regime which you feel would encourage greater engagement with the R&D tax credit?

We would refer the reader to Part 3 of this document where we have outlined our specific recommendations with respect to decarbonisation and digitalisation and targeted measures to incentivise activity in these areas.

In addition to our specific recommendations contained in Part 2.4 of this submission, the current operation of the close company surcharge regime presents a structural barrier to productive reinvestment and prudent cashflow management for Irish-owned businesses. Under existing legislation, particularly sections 440 and 441 of the Taxes Consolidation Act 1997, close companies are subject to a 20% surcharge on certain undistributed investment and rental income. While intended as an anti-avoidance measure to discourage the accumulation of passive income within companies, in practice the regime disproportionately penalises small and medium-sized enterprises (SMEs) that choose to retain profits for legitimate commercial reasons including investment in R&D activities.

Our key recommendation is to modify the close company surcharge regime to disapply the surcharge on undistributed income where it can be clearly demonstrated that the retained profits are earmarked for reinvestment in the business or aligned with a documented growth plan. This could be achieved through a legislative amendment to provide an exemption from the surcharge where specific commercial use of funds— for example qualifying expenditure on R&D activities – is evidenced. Where existing close company surcharge provisions are linked to R&D activities and qualifying spend, we are of the view that such a linkage would undoubtedly act as an incentive to smaller companies to use existing cash reserves to fund such projects which previous to this may have been financially unfeasible.

2.7 Other observations or feedback

Section 766(1)(a)(iii)(IB) TCA97 provides that "expenditure on research and development" shall not include *"expenditure incurred by a company in the management or control of research and development activities where such activities are carried on by another person, and 'in the carrying on by it of research and development activities' shall be construed accordingly".*

In our opinion, this provision should be removed as it can have a disincentivising effect in terms of R&D projects being undertaken in Ireland. For example, in the context of clinical trials being undertaken, the above provision would prohibit the salary of the individual coordinating that clinical trial from being taken into account as "expenditure on research and development". The restriction therefore acts a disincentive to locate global R&D leadership roles in the State, as salaries payable to those individuals cannot be included within the scope of qualifying expenditure taken into account in calculating the R&D tax credit.

By removing the above restriction, the R&D regime would be more effectively equipped to attract senior strategic leadership into Ireland, enhancing the overall substance of the Irish entities. Such an amendment would also create Irish based advocates to encourage additional local R&D investment in Ireland.

3. Innovation – Consultation questions

- How would you define innovation, having regard to the need for definitions for policy purposes to be specific, unambiguous, and focused on delivering real additionality?
- Given the potentially broad scope of "innovation", are there specific government objectives that a support should target to ensure it is cost effective to the taxpayer, adds value to the economy, drives growth and ensures high quality employment?
- If an innovation support were to be targeted, for example at a specific sector, location or type of company, State aid considerations would arise. Is there a particular State aid framework or provision that you believe would be of relevance?
- What administrative oversights do you believe would be necessary to ensure that any incentives being claimed are for true innovation?

3.1 Establishment of new tax credits addressing key areas of innovation

In addition to the existing R&D tax credit regime, we are of the view that innovation may be incentivised elsewhere in the economy through a range of other, targeted measures. In particular we would recommend the establishment of standalone tax credits to address key areas of change. To this end we would recommend the establishment of the following tax credits:

- Decarbonisation tax credit
- Digitalisation tax credit; and
- Investment tax credit

3.1.1 Decarbonisation Tax Credit

The Summer Economic Statement[3] (2024) has noted that over the coming years, the Irish economy will face multiple structural fiscal challenges including decarbonisation. Global mega-trends, which include decarbonisation, are on the way and, according to the Chef Economist of the Department of Finance (2024)[4], they *" will have a profound impact on the Irish economy, society, well-being and other areas"*. It is clear that *"…the annual budgetary cycle cannot be divorced from these longer-term trends….".* Decarbonising economic activity should be one of the key parts of the tax policy response.

The Irish Government has an opportunity to leverage its existing and successful framework of the R&D tax credit and apply it to decarbonisation with adaptations to focus on emission reduction rather than scientific innovation. A decarbonisation tax credit could make Ireland a leading environment where businesses actively pursue carbon reduction not just to comply with rules, but because the tax system actively supports it.

To this end, we recommend that the Government introduce a new stand-alone decarbonisation tax credit for expenditure incurred by businesses in seeking to lower carbon emissions. Such a refundable

[3] gov.ie - Summer Economic Statement 2024

[4] McCarthy, John, Department of Finance, ""Mega-trends" – building economic and fiscal resilience," presented at University College Cork, 24 January 2024.

tax credit should be aligned with the Pillar Two definition of a "qualified refundable tax credit". The existing R&D tax credit is focused on scientific advancements and the new decarbonisation tax credit will not replace it, as instead of achieving scientific advancement, it will be focused on lowering carbon emissions. Such a programme could include tax credits for all companies investing in green technologies or adopting more sustainable business practices. By incentivising businesses of all sizes, Ireland could position itself as a leader in sustainable innovation and technology adoption, which would drive our continuous economic growth and global competitiveness.

The existing R&D tax credit has two tests:

i. the accounting test (that the expenditure claimed as being laid out on qualifying research and development activities is correctly so claimed);
ii. the science test (that the activities under review are consistent with the statutory definition of research and development activities).

We would recommend re-using the accounting test for the new decarbonisation tax credit but replace the science test with the new decarbonisation test. The amount of the credit could be fixed, or gradual increasing in line with the level of successful decarbonisation, the effect of which could be shown compared to a pre-established baseline, and subject to clearly defined bands. Furthermore, in line with R&D rules, businesses should also be supported where they seek to achieve decarbonisation but proven to be unsuccessful. In other words, there should be no minimum decarbonisation requirement to get the credit, even seeking to achieve decarbonisation should be sufficient, provided all other conditions are satisfied.

Qualifying Criteria

Regarding the qualifying criteria, we would recommend that it is aligned with the R&D criteria, namely:

A company may qualify for the decarbonisation tax credit if:

- It is within the charge of Corporation Tax in Ireland;
- It carries out qualifying carbon reduction activities in Ireland, the European Economic Area (EEA) or the United Kingdom (UK), and;
- The expenditure does not qualify for a tax deduction in another country.

Qualifying activities

To qualify for the decarbonisation tax credit, a company's carbon reduction activities may include:

- Projects and feasibility studies identifying alternative fuels for use within the business, trade or profession which is within the charge to Corporation Tax in Ireland, to include the costs relating to implementing such changes
- Projects and feasibility identifying the reduction in carbon output from manufacturing and/or distribution activities including costs of implementing such measures.

The above qualifying activities are indicative only, and a targeted public consultation process would need to be undertaken to identify what activities stakeholders and businesses expect to engage in with a view to decarbonisation in the near future.

Qualifying costs

- Accurately quantifying carbon footprint throughout the entire value chain.
- Assessing climate-related risks and opportunities.

- Establishing robust decarbonisation standards and strategies that set out clear targets and key performance indicators.
- Identifying and implementing technology solutions that can help enhance emissions monitoring and reporting.
- Developing robust regulatory compliance and risk mitigation programs.
- Creating a culture that promotes the benefits of decarbonisation[5].
- Receiving advice on the implementation of carbon reduction processes in the business (professional fees).
- Costs associated with the implementation of carbon reduction processes (i.e., staff costs, plant & Machinery, etc.) and technology and annual reviews and reporting.
- Costs associated with obtaining and an annual renewal of a decarbonisation certificate, something similar to the BER assessment for houses, but focused on carbon reduction during the qualifying period.
- Costs associated with developing the in-house carbon reduction technologies.
- Associated staff training and upskilling costs.

Qualified refundable tax credit

Such a refundable tax credit should be aligned with the definition of a "qualified refundable tax credit" for the purposes of Pillar Two and the US Foreign Tax Credit (FTC) Regulations.

The introduction of a decarbonisation tax credit would place Ireland on a more competitive footing with respect to our energy targets and inward investment compared to other tax regimes. In particular, the Finnish Government recently approved a new Tax Credit program targeting investments aiming to accelerate clean energy transition and reduce dependence on fossil fuels. The tax credit applies to investments in clean hydrogen, battery value chains, energy storage and industrial decarbonisation and amounts to 20% of eligible investment costs, with a minimum investment required of €50m per facility and subject to a maximum credit ceiling of €150m per group to be utilized between 2028 and 2047.

3.1.2 Digitalisation Tax Credit

The Programme for Government notes a commitment to ensuring that Ireland is a leader in the digital economy and Artificial Intelligence ("AI"), "realizing the full benefits of digitalisation including AI to increase productivity of Irish businesses". We would welcome commitments made by the Programme for Government to position Ireland as a leader in the digital economy focusing on[6]:

- The push for investment "to make Ireland an EU centre of expertise for digital and data regulation and being a regulatory hub for companies operating across the EU Digital Single Market".
- Investment in digital skills at all levels, from basic digital literacy for all citizens to being a leader in higher education and research in areas like Artificial Intelligence and Quantum Computing,

[5] For further details: Deloitte, *Pathways to decarbonization: The built environment*, 2024 and *The Built Environment – Pathways to decarbonization*, 2024.

[6] At pages 34 - 35

- Ensuring that the skills necessary for AI deployment, AI innovation and AI support are provided through education and professional learning networks.

The positive impacts of digitalisation can be felt most keenly across the financial services space, with OECD evidence demonstrating measurable performance upticks linked to increases in digital penetration. In particular, one OECD paper[7] highlighted positive effects on the productivity of downstream industries connected with financial sector digitalization, noting that *"Digitalisation in finance is also associated with an easing of credit constraints, particularly benefiting intangible-intensive industries and SMEs, via an improvement in credit allocation and market conditions. Results suggest that policy actions aimed at supporting digital infrastructure, promoting competition in communications, fostering finance innovation, and encouraging high-level skill formation (especially in STEM fields) could sustain and enhance productivity growth through financial sector digitalisation."*

Digitalisation was identified by the Summer Economic Statement of 2024 as one of the key structural challenges to the Irish economy; in our view however such a challenge represents an opportunity, and the Irish tax regime should be well positioned through forward thinking tax policy. The need for focus digitalisation is of concern not least due to its rapid growth, with many businesses spending substantial resources on developing and implementing generalist systems that can now act autonomously, doing incredible tasks in various fields including science, technology and art.[8]

Digitalisation is a broad term that refers to the increasingly widespread adoption and use of digital technologies with transformative effects on businesses and workers[9]. Key driving forces of the digital transformation are the automation of work (including AI capabilities) and the digitisation of processes.

Despite well-acknowledged risks, digitalisation safety research is lagging, particularly as it pertains to AI.[10] It is therefore not surprising that lack of trust related to safety, quality and reliability remains a major barrier to large-scale Generative AI adoption and deployment by many businesses.[11]

Accordingly, we would strongly recommend the introduction of a new standalone digitalisation tax credit (to be introduced as a "*qualified refundable tax credit*" for Pillar Two purposes and also for the purposes of the US Foreign Tax Credit Regulations) for relevant expenditure related to reliably safe development, implementation and use of digitalisation (including within its remit AI). This new stand-alone credit will be closely aligned to the existing R&D tax credit format, but with a different science test and lower bar in terms of advancing the field of computer science. This shift toward digitalisation will not only enhance Ireland's attractiveness as a business location but will also help drive future tax revenue by encouraging companies to stay and invest in Ireland. Digital transformation is key to ensuring that Ireland remains a top destination for global companies looking to maintain and expand their operations.

In terms of the potential economic impact of such a new regime, we would note that relatively recent reports from the Department of Finance on the use of digitalisation including AI have concluded that apart from the direct labour market impacts, there are also likely to be broader macroeconomic impacts associated with the adoption of digitalisation by businesses[12]. These include implications for

[7] Digitalisation of financial services, access to finance and aggregate economic performance, OECD Economics Department Working Papers, 9 August 2024 accessible here
[8] Deloitte, *Seeing the forest for the trees, and the forests beyond The future of AI*.
[9] Ethical digitalisation at work: From theory to practice | European Foundation for the Improvement of Living and Working Conditions
[10] Yoshua Bengio *et al*., "Managing extreme AI risks amid rapid progress", *Science,* Vol. 384(6698), (2024).
[11] Deloitte, *The State of Generative AI in the Enterprise: Getting real about Generative AI*, April 2024, p. 6.
[12] gov.ie - Artificial Intelligence: Friend or Foe

economic output, labour productivity, international competitiveness, the labour share of Gross Value Added (GVA), earnings, industrial concentration, and the distribution of wealth and income. The exact nature of each of these impacts is uncertain – and as with the early effects of AI adoption on the labour market – will depend on several factors. These factors will include the ultimate capabilities of digital technology, the speed and scope of adoption, including the impact of bottlenecks and capacity constraints that might act to limit adoption and investment, societal preferences regarding the respective roles of technology and labour, and the policy and regulatory responses at both an EU and domestic level. In our view, it reasonable to suggest that the introduction of a digitalisation tax credit in a similar manner to the existing R&D tax credit would have two positive outcomes namely increased business activity through enhanced expenditure on research but also the development of valuable IP within Ireland and the beneficial broader macroeconomic impacts noted above.

3.1.3 Investment Tax Credit

We would recommend the introduction of a new standalone investment tax credit in Ireland. Such an investment tax credit would bring Ireland's tax incentives in line with other competitor jurisdictions, notably Luxembourg.

Under the Luxembourg investment tax credit regime, eligible investments and expenses—such as those related to software development, digital infrastructure, and cybersecurity—qualify for an 18% tax credit. However, for tangible depreciable assets like hardware, the tax credit is 6%. The credit is calculated based on the acquisition or production cost of qualifying investments made during the financial year, or the amount of qualifying deductible operating expenses for that year. This incentive aims to encourage businesses to modernize their operations and enhance competitiveness through digital means. And to promote ecological and energy transitions, Luxembourg provides a tax credit to companies investing in environmentally friendly initiatives. Qualifying investments and business expenses—such as those aimed at improving energy efficiency or reducing carbon emissions—are eligible for an 18% tax credit. For investments in tangible depreciable assets like energy-efficient machinery, the tax credit is 6%. The credit is based on the acquisition or production cost of qualifying investments made during the financial year, or the amount of qualifying deductible operating expenses for that year.

While the previously mentioned new standalone credits recommended in this submission (decarbonisation credit and AI tax credit) would in our view achieve a number of the aims of the Luxembourg investment tax credit regime, we are of the view that a standalone tax credit for the acquisition of tangible assets is also required to effectively bridge the gap. Through the introduction of an investment tax credit for tangible assets (namely plant and machinery), Ireland can ensure that the incentives regimes in place are targeted towards supporting businesses to adopt sustainable practices and contributing to environmental goals.[13]

Targeted incentives designed in the above manner have also been introduced elsewhere in the world, notably in Japan in 2021 with the introduction of a temporary tax incentive was to promote business transformation-related digital investments, such as for example better internet connectivity, cloud services, updated IT systems, and cybersecurity. Eligible assets include certain new software, machinery, and equipment, or deferred assets for investments in cloud-based systems used for

[13] Deloitte Luxembourg (2025) Tax Highlights, https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-luxembourghighlights-2025.pdf and (2023) Tax credits will benefit companies investing in digital and green transformation, Tax credits will benefit companies investing in digital and green transformation | Deloitte Luxembourg.

business purposes in Japan. Businesses can either get a tax credit of 3% to 5% or claim a special 30% depreciation on the cost of these digital upgrades. However, they can only use these credits to reduce up to 20% of their total corporation tax bill, and this 20% cap also includes credits from green initiatives.

We would recommend that any new investment tax credit to be introduced in due course be considered as part of a public consultation so as to obtain stakeholder views on the scope, rate and other relevant aspects.

3.2 Amendments to Digital Gaming Tax Credit

3.2.1 Redesign

Our overarching comment on this credit would be that it needs a redesign as there are almost no digital game development companies develop games in isolation and behind closed doors (i.e., 95% of the market is creating games in a collaborative manner). There needs to be a flow through of the benefit to all the companies collaborating in the game development, not just an individual company aligned to a game. It also needs to be updated to allow for continuous post release expansions and features.

3.2.2 Rate

Changes to the digital gaming tax credit in Finance (No.2) Act 2023 ensured that it is treated as a qualified refundable tax credit and compliant with Pillar Two minimum effective tax rate and US foreign tax credit rules. This will ensure that the 32% benefit can be achieved by the claimant. However, as the benefit is now deemed a Qualifying Refundable Tax Credit, it is treated as income as opposed to a reduction in a company's effective tax rate. As such the net benefit secured by the claimant is significantly reduced from the original 32% rate intended. To ensure that the original 32% incentive is achieved, we would recommend increasing the rate to 38%. This will ensure that there is a sufficient incentive to attract ongoing investment in an attractive and high growth industry. This would help to secure further investment and jobs in Ireland.[14]

We had hoped that the Finance Act 2024 would have made a number of amendments to specific aspects of the R&D tax credit to make it more competitive internationally and changes to 481A relief for investment in digital games to enable companies to benefit from this scheme. However, Finance Act 2024 did not address the digital games tax credit. Failure to amend these schemes means that Ireland's competitiveness as a location for investment for significant innovative projects may wane as other countries outside of EU state aid rules continue to offer more attractive investment incentives.

3.2.3 Shareholder Liability

Section 481A(26) TCA 1997 provides for a clawback where it is subsequently found that the payment of all or some of the credit was not authorised. In such cases, the clawback may be assessed on:

- The company,
- Any director of the company, or
- Any person referred to in section 481A(13)(c) TCA 1997

[14] Deloitte, "Global investments and innovations incentives (Gi3), Budget 2024 & Finance (No.2) Bill 2023".

A person referred to in section 481A(13)(c) TCA 1997 means -

(c) the digital games development company, any company controlled by the digital games development company and each person who is either the beneficial owner of, or able directly or indirectly to control, more than 15 per cent of the ordinary share capital of the digital games development company (in this paragraph referred to as a ‘relevant person’), as the case may be, is not in compliance with all of the obligations imposed by the Tax Acts, the Capital Gains Tax Acts or the in relation to -

i. The payments or remittances of taxes, interest or penalties required to be paid or remitted under those Acts,
ii. The delivery of returns, and
iii. Requests to supply to an officer of the Revenue Commissioners accounts of, or other information about, any business carried on, by the digital games development company, or relevant person, as the case may be.

While the provision is to ensure that the clawback may be levied in an effective manner and to act as a disincentive to unauthorised claims, the inclusion of shareholder liability[15] is unworkable from the perspective of global groups who wish to invest in Ireland through a digital games development company. We would accordingly recommend that reference to such shareholder liability be removed from section 481A TCA 1997 and are of the view that a clawback on the company itself would be sufficient.

3.3 Knowledge Development Box (“KDB”)

While the interest in the KDB relief (or Patent Box as it is known in other jurisdictions) remains high, the uptake of the relief since its introduction remains limited.

For example, since its introduction in the Finance Act 2015, the highest number of claimants in a given year was 20 (2020), and the lowest 15 (2018 and 2023)[16]. This stands in comparison claims made under the equivalent “Patent Box” regime in place in the UK. Based on the latest HMRC statistics, in the tax year 2022 to 2023, it is provisionally estimated that 1,600 companies elected into the UK Patent Box regime, suggesting a greater uptake among taxpayers compared to the KDB.[17]

While the overall objective of our KDB regime is positive, however, our experience and that of our clients to date is that this is a highly complex regime to navigate and is no longer fit for purpose in a post Pillar Two environment. In our view, securing sustainable corporation tax returns for Ireland and developing the knowledge economy may be better achieved through enhanced focus on IP generation via amendments to the R&D tax credit as previously outlined which would shift the focus towards generation and development as opposed to merely exploiting valuable IP in Ireland. In our view, resources and budgetary measures dedicated to the operation of the KDB and the tax relief obtained under same would be more efficiently used through reallocation towards the R&D credit regime, specifically through the measures we have suggested in this submission. Reallocation of budget away from measures such as the KDB would likely offset our recommendations on the R&D tax credit to

[15] Referring to persons who are able directly or indirectly to control more than 15% of the share capital of the company.
[16] Revenue (2023) Corporation Tax 2024 Payments and 2023 Returns, Corporation Tax - 2024 payments and 2023 returns. This is the latest available data on KDB.
[17] HMRC, Patent Box relief statistics: September 2024, https://www.gov.uk/government/statistics/patent-box-reliefs-statistics/patent-box-relief-statistics-september-2024--2.

make such amendments not only tax neutral but beneficial for the development of the knowledge economy in the long term.