Cash refunds for R&D expenditure in the Pharmaceutical and life science sectors.
Overview

As global economic activity shifts towards innovation and knowledge, Ireland’s future prosperity depends on its ability to create and expand scientific and technical expertise.

**Research and development (‘R&D’) is one of the key drivers of productivity and growth. Raising R&D levels in business is, therefore, a key priority for the Irish Government.**

To help foster R&D growth in Ireland, the Irish Government has continued to improve the R&D tax credit incentive and it has been enhanced significantly in recent years to offer companies cash refunds for R&D work performed.

This regime has enabled companies to reduce their payroll costs year-on-year and increase their cashflow which has allowed them to recruit targeted hires and increase margins on qualifying R&D projects. This has also helped global multinational companies attract further R&D investment onshore to Ireland.
R&D regime

The regime provides for a tax credit of 25% for incremental qualifying R&D expenditure in respect of R&D activities incurred by a company operating in the EEA. The credit is available over the amount of qualifying R&D spent in 2003. If no R&D was carried out in 2003, or the company did not exist in 2003, all qualifying R&D-related expenditure is eligible for the 25% benefit.

The credit is in addition to any existing deduction or capital allowances for R&D expenditure. In other words, for every €100 spent on qualifying R&D activity (revenue or capital expenditure), a company could be entitled to €25 cash back which is in addition to the 12.5% corporate tax deduction. Therefore, up to 37.5% effective tax relief could be obtained for R&D expenditure, if it falls within the scope of this scheme, equating to €37.50 of every €100 spent.

This coupled with the availability of grant support can help companies significantly reduce their cost of doing R&D in Ireland, as illustrated by the attached example:

A qualifying project in receipt of 20% grant funding:

<table>
<thead>
<tr>
<th>R&amp;D spend of</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant aid</td>
<td>-20</td>
</tr>
<tr>
<td>Net of grant aid</td>
<td>80</td>
</tr>
<tr>
<td>CT deduction @ 12.5%</td>
<td>(10)</td>
</tr>
<tr>
<td>R&amp;D credit @ 25%</td>
<td>(20)</td>
</tr>
<tr>
<td>Net cost</td>
<td>50</td>
</tr>
</tbody>
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1European Economic Area which includes Norway, Iceland and Liechtenstein.

What is R&D in the pharma and life sciences sectors?

Don’t miss out!

It’s not just about people in white coats working in labs; eligible R&D can include producing new, or improving existing, materials, products, devices, processes, systems or services. These areas which are typically embedded within the wider operations of companies tend to get overlooked.

The basic criteria to qualify as R&D relies on the project seeking to achieve a scientific or technological advance while attempting to overcome scientific or technological uncertainty. Qualifying R&D must also be:

- Systematic, investigative or experimental in nature,
- Conducted in a Revenue approved field of science or technology, and
- Involve basic research, applied research and/or experimental development.

It is widely recognised that R&D occurs in several areas in this industry such as the R&D Centre and Phase I to III Clinical Trials. Our experience shows that the definition of R&D for tax purposes extends beyond these typical areas and can include non-obvious R&D activities that are embedded in the wider commercial operations of your business.

Some examples of potentially eligible R&D:

- Design, construction, testing and trialing of new prototypes and pilot plants.
- Development of new technologies to support improvements to existing processes that are designed to increase efficiencies or decrease costs.
- Replacement of new or alternative materials, re-agents or excipients into existing processes as a result of change in supplier that was technically challenging to introduce.
- Scaling up manufacturing and packaging trials or prototypes to full scale production batches.
- Development of new or improved analytical tools with better sensitivity/range/accuracy.
- Development of new or improved techniques or technologies in response to changes in health, safety and environmental legislation.
- Overall project planning activities of new launch products, from R&D Centre to first commercial batches.
- Development of new or improved processes for existing post-marketed products (some generic drug development).
- Projects that include long-term safety and Phase IV clinical studies that continue after the new drug is released to market may also be eligible.
What we are seeing as current trends?

Not surprisingly, as the level of claims for cash refunds has begun to escalate, so too has the level of Revenue scrutiny, both in the form of formal audit notifications and requests for additional evidence to validate the R&D claims.

Companies have twelve months from the end of the accounting period in which the R&D expenditure was incurred to submit their R&D claim to the Revenue. Companies need to be aware that Revenue has the right to audit claims for four years after the return has been submitted. If adjustments arise during the course of an audit (such as overstated claims or insufficient supporting evidence), there may be a requirement to re-pay part or all of your credit previously claimed. In addition to this, in some cases Revenue can seek interest and penalties.

Companies need to be aware that Revenue has the right to audit claims for four years after the return has been submitted... companies should ensure they have the proper level of supporting evidence in place

This should not deter companies from making claims, but it does mean that companies should ensure they have the proper level of supporting evidence in place both on the financial and scientific aspects of their claim. Companies must be able to substantiate the level of relief claimed, through the provision of supporting scientific and costing data. It is imperative therefore that finance departments are closely linking in with their R&D departments in order to build the support for R&D claims.

We recommend that companies undertake contemporaneous data capture for financial and scientific/technical aspects of projects that may be eligible for relief. This not only ensures that sufficient accuracy and detail can be captured, and hence maximise claims, but also enables companies to be in a position to readily provide the support for any claims to Irish Revenue. Frameworks and systems can be built on existing business processes, implemented to facilitate data capture and in turn reduce the overhead it entails. Using such frameworks, a repeatable and robust process can be employed to support claims for future years.
How can EY help?

- Offer free feasibility study
- Grant assistance claims
- Provide full Revenue audit support
- Develop optimal claims methodology
- Calculate R&D expenditure
- Conduct technical interviews
- Prepare technical project reports
- Deliver in-house training sessions

The R&D tax team is a dedicated group providing a full range of services to help clients claim and maximise their R&D tax benefits

Who we are

> We are a dedicated and highly specialised team focusing on assisting clients maximise their R&D tax claims.
> A multi-disciplinary team made up of engineers, PhDs, industry specialists and tax professionals.
> Our team includes experienced R&D professionals from Ireland, Canada, US and Australia where the R&D regimes have been in place for many years.
> We have a proven methodology for building robust R&D tax claims.
> We have extensive experience in successfully agreeing claims with the Irish Revenue both in advance and on audit.
> We liaise regularly with the Irish Revenue on R&D tax credit matters including potential legislative improvements in this area.

Our experience

> We have had a 100% success rate in Revenue audits for clients who filed R&D tax credit claims.
> We secured the first Irish Revenue pre-approval for a client in the software sector, which encompassed a technical review by an industry expert engaged by Irish Revenue.
> EY conducts ongoing consultation and discussions with Revenue and the Department of Finance on R&D matters and what it means for businesses. We have lobbied for changes in law to improve the R&D tax credit regime such as:
  > increasing the rate for sub-contracting activity
  > increasing the rate of R&D credit from 20% to 25%
  > seeking cash refunds for companies incurring tax losses
Contacts
We would be delighted to meet with you to explore how this regime may offer benefits to your business.

Ian Collins
Head of R&D Tax Services
+353 1 221 2638
ian.collins@ie.ey.com
www.ey.com/ie/rd
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Ernst & Young, Harcourt Centre, Harcourt Street, Dublin 2, Ireland.

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