The R&D Tax Credit Regime

An American Chamber Perspective

Making Ireland a globally competitive location for R&D investment

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AMERICAN CHAMBER of COMMERCE IRELAND

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Leadership Comments

Demonstrates Ireland's Commitment:

"It's a very strong message that the Irish Government supports technology development, and this helps our ability to upskill and hire top talent to respond to emerging business requirements. It helps the Ireland-based organisation to continue to attract and sustain critical R&D jobs"

"Significant reduction in cost base for R&D and reflective of Ireland's commitment to attract R&D and support functions."

Long Term Incentive:

"Given the continuous change in the global tax landscape the R&D tax credit is very important in helping Ireland compete for new investment and continue the growth of our operations in Ireland."

Fit for Purpose:

"The R&D regime has become one of the biggest incentives in helping to locate investment in Ireland."

Retains Investment:

"The credit is critical to maintaining the existing level of R&D activity, as well as ensuring future growth, in our Ireland operations."

Executive Summary

The leadership of the American Chamber of Commerce Ireland are firmly of the view that the R&D tax credit regime has been, and can continue to be, a critical tool in ensuring that Ireland is competitive for research, product development and process innovation projects. The regime encourages companies to undertake high-value-add R&D activity in Ireland and thereby supports wider investment and employment. It is now an integral part of Ireland's corporate taxation proposition to retain and attract this investment. Member feedback suggests that within the knowledge intensive sectors some 37% of the total employment base is dependent on the existence of a competitive R&D tax credit regime.

Small open economies are increasingly competing against each other in access to talent and global innovation leadership in business, science and technology. Inward investment is key to the R&D ecosystem in Ireland; 69% BERD (Business Expenditure on Research and Development) in Ireland is by foreign companies. Research shows that tax incentives have a clear advantage over direct funding FDI investments and tax credits have become an increasingly popular method of driving R&D investment across OECD countries. It is vital that Ireland continues to have an R&D incentive program that matches or exceeds the best available to ensure that we remain globally competitive and continues to attract the best R&D investment.

Summary of R&D Credit Regime Survey

To inform this submission, the American Chamber conducted a survey of its R&D active members during May 2019 regarding the R&D's Tax Credit Regime's fit for purpose by examining the role of the credit in the business case for R&D-led investment, the impact of the regime in building additional R&D capacity and growing/securing the employment base in Ireland. It also considered the optimum design and structure of the credit to make it internationally competitive.

The American Chamber survey represented companies which employ over 36,000 people in Ireland, of which more than 5500 were in science or technology development roles. Key Findings of the survey are reflected below:

- **78% of our respondents confirmed that the tax credit is important, or critically important, for locating R&D investment in Ireland,** and that the tax credit is important in the context of encouraging broader investment in setting up operations (59% agreement) and creating new jobs within and beyond R&D roles (80% agreement) within Ireland.
- Detailed employment data provided by 30 member firms employing almost 20,000 in largely knowledge intensive organisations (including just under 4000 in research and development roles) suggests that **without the existence of the R&D Credit Regime, they would lose 2100 roles in research and development with a knock on impact of over 7000 in total employment – or 37% of the employment base of these organisations.**
- The credit has enabled our members to create additional jobs at an early career stage; 73% of our respondents have used the R&D credit provide more PhD positions; 76% have created more internship opportunities; as well as 40% more apprenticeship opportunities.
- Our survey showed the main differentiator between Ireland and other locations for R&D investment is our R&D incentives and our business-friendly tax environment; Ireland is at a disadvantage both in terms of cost as well as market & network access, amongst other key investment considerations. We cannot risk the deterioration in one of our significant advantages of the R&D tax credit scheme.
- Our respondents identified the simplification of documentation requirements; increased certainty on the application of the technical criteria for qualification; and widening the criteria to allow latitude on innovative products.

Ireland's Open and Outward Looking Economy

The American Chamber represents the Irish-based enterprises that form an important hub for the two-way Transatlantic economy between the United States and Europe. The American Chamber's vision is that Ireland should remain an inclusive location of talent and innovation with global impact. Realising this ambition will be achieved by addressing the factors that drive and build Ireland's global standing including a world class innovation environment that allow companies to grow their teams and enhance the footprint of their operations in Ireland.

The competition for foreign direct investment (FDI) is intense, and jurisdictions are responding by continuously improving their inward investment offering. A recent survey of the leadership of American Chamber member companies identified the strategic priority areas to keep business competitive for inward investment as; developing, rewarding and attracting talent; access to residential accommodation and physical and digital infrastructure. In parallel, leadership called out factors that are influencing investment decisions on the pipeline of individual projects including;

- enhancing the competitiveness of investment incentives;
- encouraging innovation and,
- controlling the cost base.

In its review of Ireland's inward investment strategy twenty-five years ago, the OECD noted that Ireland was an early adopter of OECD pro-growth policy by focusing on the benefits of inward investment to globalise its economy. Since the 1950's there has been a deliberate Government industrial and economic policy to move away from import substitution, protectionism and restrictions on business ownership - creating an enterprise environment that is open and outward-looking to trade and investment in pursuit of employment growth, innovation and talent development.

In 2004 the 'Ahead of Curve Report[1]' on industrial strategy pointed Ireland in a new direction; building on strong manufacturing and transaction activity there was a clear need to transform with new strengths across the entire value chain especially in developing new products and services. The report found that the Irish research system was suffering from years of underfunding, which had led to high levels of fragmentation, low levels of collaboration and a lack of critical mass. In the last decade, Government has correctly identified 'connected world leading research' – having one of the most enterprisealigned science, technology & innovation systems in the world, as one of three pillars in Ireland's competition for inward investment[2]. That ambition, reflected in Enterprise 2025 and Innovation 2020, promotes a national innovation system that will be globally renowned for its alignment with industry, excellence in research, connecting and collaborating with enterprise, delivering sustainable economic impact, and attracting investment and exceptional talent.

Inward investment remains hugely important to Ireland and was instrumental in helping the country recover from its economic challenges following the 2008 financial crisis. Ireland is now home to over 1,200 overseas company operations that directly employ well over 230,000 people. Today, as well as seeing an accelerating indigenous start-up culture taking root, the country continues to attract businesses from sectors such as ICT, life sciences, financial services, engineering and business services. These investments in manufacturing, research and development and international service centres continue to make a pivotal contribution to Ireland's evolution into a modern and diverse society; and an economy that trades with confidence and ambition on the world stage.

No two other regions in the world are as deeply integrated as the U.S. and Europe, with Ireland a key hub for the transatlantic economy that generates some $5.5 trillion in total commercial sales each year. According to figures from the U.S. Bureau of Economic Analysis, Ireland's share of U.S. investment stock in Europe was 12.6% in 2017. Reflecting this, U.S. direct investment stock in Ireland grew by 14%, to reach a new high, in 2017 of $446bn supporting over 155,000 direct jobs in over 700 enterprises.

Manufacturing employment among U.S. foreign affiliates totals roughly 52,000. Notably, 45% of U.S. affiliate output

[1] Enterprise Strategy Group, Forfas 2004 (now the Department of Business, Enterprise and Innovation)

[2] Department of Business Enterprise and Innovation Policy Statement on FDI in Ireland

in Ireland in 2016 was classified as "manufacturing", reflecting the fact that U.S. affiliates are in the business of developing products in-country, transacting business, creating good paying jobs, and providing good incomes to Irish employees in the process. Complementing this, Ireland's investment stock in the U.S. totalled $147.8 billion in 2017. Irish Government figures suggest that close to 800 Irish companies are active in the US market, collectively employing more than 100,000 people. Ireland's investment stakes in the U.S. are significant, generating an estimated $116 billion in affiliate sales in 2017 and $41 billion in U.S. economic output.

Ireland's FDI sector has proven to be robust and resilient, providing a source of stability for the entire Irish economy. **CSO data for 2017-2018, shows that 69% of the €2.77b of business expenditure on research and development (BERD) is by foreign companies[3], and since the introduction of the credit in 2004 nearly 600 new R&D projects have been announced by multinational clients of IDA[4].** These new investments have enhanced the strategic importance of Irish operations of multinationals and helped to modernise this base of industry since the turn of the century. This has bestowed macro-economic benefits not only on the country in general but also to the building of our research, development and increasingly, our innovation and commercialisation capacity.

For the competitiveness of our innovation system four significant R&D system pathways emerge from American Chamber member consultations on R&D policy including the need to: **(1) remove complexity and confusion within the current RD&I system, (2) invest and build ecosystem investment, (3) increased focus on the impact/ commercialisation and the application of technological innovation, and (4) develop, retain and attract key human capital. Focusing on these imperatives from a policy and investment perspective has broad appeal within the FDI community.**

Fiscal incentives remain a key differentiator and attractor for R&D driven FDI and thus Ireland must be strategic in employing competitive tax and grant incentives to drive the required increase in investment.

Research and Development Driving Growth

According to the OECD[5] tax incentives have become an increasingly popular policy instrument to boost research and experimental development activities of businesses internationally. Within the OECD, investment in building innovative capacity has been a key focus in the drive for economic growth especially in developed economies of Europe. In this pursuit, Governments worldwide have sought to introduce and adapt financial support instruments to promote business-led R&D activity. Their research suggests that nearly **70% of all R&D performed in OECD members is linked to fiscal incentives to invest in R&D.** Indeed, between 2006-2015 the relative importance of tax incentives within fiscal incentives to encourage innovation within the private sector increased in 24 of 33 OECD countries assessed[6].

The optimal balance of direct/grant and tax support for R&D varies from country to country and can evolve over time but many of **the strongest empirical studies that have been conducted throughout OECD countries over the past two decades show that research and development significantly improves firms' performances,** however measured. The economic performance of a country thus depends on its capacity to provide the right incentives to encourage R&D investment.

For enterprise, appropriately designed tax-based incentives have some advantages over directed funding.

- Firstly, they tend to be **more market-based** – allowing industry to determine which R&D projects they wish to pursue without political/ administration prioritization. Indeed, in some cases this is helpful to Government itself in meeting competition and trade law obligations.

[3] Central Statistics Offices; https://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2017-2018/

[4] From IDA End of Year Statements 2004-2018.

[5] OECD Science, Technology and Industry Policy Papers No 32 2016

[6] OECD, Research and Development Statistics on Tax Expenditures 2017

- Secondly, OECD research suggest strongly that tax incentives are **more suited to encouraging R&D activities that are closer to market, development and applied research** that has positive outputs in terms of employment and productivity in the short to medium term.

- Thirdly, the most rigorous studies available to the OECD **demonstrate a positive relationship between the levels of research and development activity/investment and the availability of financial incentives to enterprise and the benefit rises over the long term (10 years+)**. There is clear evidence from these studies that stable and predictable incentives have the strongest impacts on overall investment and employment levels.

- Fourthly, there is clear evidence from international studies that **R&D tax incentives encourage better outcomes in terms of new product innovations** and launches as firm's improve their innovative capacity and ability to absorb external knowledge.

- Finally, while more empirical evidence is needed, the available research landscape suggest that the **volume of research and development led activity/investment does respond to changes in the cost of doing R&D in competitive environments.** The evidence from the membership of the American Chamber corroborates surveys of international investors that show that while a country must have good fundamental conditions (talent base, physical and digital infrastructure, rule of law and IP protection), the cost base is an important factor for project leaders in allocating resources within a more globalised value chain for innovative activities. Hence – **wage levels and the fiscal incentives for investment matter, especially in the latter stages of deciding on a short list of suitable locations in which to invest[7].**

Small open economies will increasingly compete on talent and fields of global innovation leadership in business, science and technology. In addition to this, in 2019 there are new uncertainties weighing on investor sentiment including the direction of the global economy and rising geo-political and trade tensions around the world. The American Chamber believes that Research and Development (R&D) activity is fundamental to growing the Irish economy and that competition has intensified for this knowledge-based investment in recent years. This is mirrored on a global scale with locations such as Israel and Singapore establishing themselves as technological hubs for international companies. A more activist industrial policy in the UK is anticipated post-Brexit, especially focused on knowledge intensive investment. Countries such as Switzerland are at the early stages of introducing an R&D tax incentive for the first time, which will involve an R&D super deduction at the cantonal level up to 150% of effective qualifying expenses. It is expected that a wide range of R&D activities may qualify, including based research, as well as scientific application and knowledge-based R&D. Hong Kong is actively seeking to enhance its rules for incentives available for R&D to improve competitiveness for investment.

In Germany, the Government is proposing an R&D tax credit which is expected to be in the form of a cash grant for fundamental and industrial research, and certain experimental development. In response to perceived complexity with the existing application processes, the Germany plans include the adoption of a relatively simple electronic form, accompanied by specific supporting documentation providing the basis for the claim, which will be processed by the local tax office.

Where they exist, R&D credit regimes have become an integral part of the investment proposition. **Best in class schemes are highly aligned between the principles underpinning the regime, its promotion and its implementation guidelines. Certainty within the enterprise community regarding eligible expenditure promotes the effective use of this incentive to retain and win new innovative-led investment and employment.** These kind of projects and jobs are highly sought after as they often provide the beachhead for new business units and support wider manufacturing, innovation and strategic support functions of an existing operation. The American Chamber has argued consistently that the Ireland's regime needs to be clear and consistent if it is to be effective. As such, it needs to reflect the overarching policy, as outlined by Government, to be strategically focussed on reducing the business cost of undertaking R&D in Ireland as an incentive to invest.

[7] Belderbos, R. et al. (2016-07-12), "Where to Locate Innovative Activities in Global Value Chains"

American Chamber Member Feedback

The American Chamber shares the Government's objective to ensure that the R&D Tax Credit remains 'best in class' internationally, represents value for money for taxpayers and supports the retention and attraction of investment and jobs. The American Chamber recognises the key positive aspects of the current R&D Tax Credit Regime which include:

- **Rate of credit:** The current rate of the credit, at 25%, is generally perceived as competitive. It has enabled many members to tender and compete for mobile global R&D projects, not only on past performance and talent but critically on cost.
- **Above the Line:** The ability to recognise the R&D credit "above the line" for accounting purposes is an important factor and recognised by our members as one of the critical improvements in the regime. It has been an enabling factor that has driven more and more business decisions to locate R&D in Ireland.
- **Scope of activities:** Our members are reasonably content with the scope of activities eligible for the R&D tax credit, although differences do exist across certain industry sectors and can depend substantially on the nature of the activities undertaken by members.

It is also critical to understand the broader impact that performing R&D can have on the rest of an organisation. When considering this R&D Credit Review within the American Chamber, **leadership were strongly of the view that performing R&D has enabled them to engage in other activities, like manufacturing, commercialising and services,** for example, that would not have been available to them had they not been engaged in part of the R&D process. It is important to point out that these **related non-R&D jobs tend to be larger in number than the R&D jobs themselves but potentially only possible to create where R&D takes place within the organisation** itself here in Ireland.

To inform this submission, the American Chamber conducted a survey of its R&D active members during May 2019 regarding the R&D's Tax Credit Regime's fitness for purpose by examining the role of the credit in the business case for R&D-led investment, the impact of the regime in building additional R&D capacity and growing/securing the employment base in Ireland. It also considered the optimum design and structure of the credit to make it internationally competitive.

The American Chamber survey represented companies which employ over 36,000 people in Ireland, of which more than 5500 were in science or technology development roles. The companies that completed the survey claimed over €105m of R&D tax credit in 2017, which represents nearly 25% of the R&D tax credit claimed in that year in Ireland. They represented all major industries with 32% of companies within the life sciences sector, 25% in Software/ Digital/Gaming and the remaining 33% in electronics, financial services, food and beverage, manufacturing and other industries. 7 out of 10 of our leaders believe Ireland is a better place today to invest than it was three years ago and according to our survey respondents' **R&D investments have grown by 41% between 2013-2018;** with 40% of respondents growing this R&D investment by more than 50%.

Encouraging Investment in Research & Development

Leadership on Attracting Projects

"This credit reduces the cost of doing R&D in Ireland by 25% and, as an above-the-line credit, it will be directly attributed to the business making the investment."

"The R&D tax credit is a highly visible item to overseas management, which helps to maintain the competitiveness of the Irish talent base."

"The cost of employment is high in Ireland, compared to other countries, so the R&D is a key factor in considering whether to allocate investment and R&D here."

Within our membership there are many examples of how R&D tax credits have fuelled the investment and growth of R&D organisations in Ireland. Our survey has provided confirmation of the extent to which this applies across the R&D performing sectors to show that the R&D tax credit is fulfilling this purpose. This is not only in respect of encouraging R&D activity, as indicated by **78% of our respondents confirming that the tax credit is important or critically important for locating R&D investment in Ireland,** but that the tax credit is also important in the context of encouraging broader investment in setting up operations (59% agreement) and creating new jobs within and beyond R&D roles (80% agreement) within Ireland.

RESPONDENTS SAID

78% confirmed that the tax credit is important,or critically important, for locating R&D	**41%** growth in R&D investments between 2013-2018
75% considered that Ireland has an advantage in our Business-Friendly environment to other countries	**60%** Almost 60% said that Irish Government support and Incentives had advantages over other countrie

Supporting Wider Investment and Employment

Leadership Comments

Supports Manufacturing:

"Critical to attract the complex, strategic development projects & has a significant impact on production pull through."

Tech Differentiator:

"Ireland's R&D credit regime is a key differentiator for Ireland in its bid for high quality investment opportunities."

Business Model Driver:

"R&D is a value driver in our business and the location of where these R&D activities are undertaken is critical to our underlying business models."

Life Science Leadership:

"The R&D tax credit significantly increases the company's scope to pioneer very specific areas in Ireland and thus enhances not only our company's capability and talent base, it also contributes to Ireland's future healthcare landscape in terms of economy and community."

Additionality:

"It's an important tool and incentive for attracting R&D activities to Ireland. It is a tool that assists bringing additional projects to Ireland which would not otherwise locate here."

The benefit of a thriving R&D function is multifaceted. Ireland cannot compete with low cost countries for high volume manufacturing. R&D roles drive the knowledge economy, creating competitive advantage with established expertise providing the high value roles required to offer a fulfilling and financially rewarding career, and providing support for increasing the proportion of school leavers entering higher level education and high skill professions. **Over 70% of our survey responses said that their investment in R&D in Ireland has resulted in more PhD employment and intern opportunities in Ireland.** In addition to this direct benefit of a successful R&D function, downstream of the R&D activities are often high-tech manufacturing operations that are located near to the R&D organisations. **The manufacturing jobs, product exports and the supply chain that support this manufacturing activity should not be overlooked when considering the overall benefit of the Government's investment in R&D through the tax credit.** To illustrate this, many of our respondents undertake R&D in product development and manufacturing process <u>and</u> equipment R&D.

The complex development work that attracts the R&D tax credits results in a critical mass of highly qualified personnel. The projects that are undertaken lead to adjacent projects and on-going product maintenance. This development work requires further resources and although this may not meet the technical criteria for claiming tax credits, it is required to complement the research and bring products to market. Our survey response shows that the personnel levels that attract the tax credit are only 64% of the total R&D function in those companies, and only 54% of the overall R&D expenditure invested in this country by those companies.

An examination of the detailed employment data provided by 30 member firms employing almost 20,000 in largely knowledge intensive organisations (including just under 4000 in research and development roles) suggest that without the existence of the R&D Credit Regime, they would lose 2100 roles in research and development with a knock on negative impact of over 7000 in total employment – or 37% of the employment base of these organisations. Furthermore, to support this evidence, over 70% of respondents agreed that the tax credits are important in sustaining and retaining existing Irish jobs.

Global Competition

Leadership Comments

Manufacturing Operation:

"The R&D Tax Credit regime coupled with IDA grants enables Ireland to compete for R&D programs on a cost basis globally. Without these incentives, our ability to win R&D programs would be significantly diminished & this would have a significant knock on impact on operations."

Technology Development:

"The R&D Tax Credit makes Ireland extremely competitive from a cost perspective and additionally supports our business models."

Financial Services:

"One of the factors we can use when determining how we allocate resources in Europe, important incentive to our company."

Medical Devices:

"The R&D credit makes Ireland a competitive location for basing our engineering activities despite the higher labour cost when compared to certain other hubs for industry globally"

As American Chamber members are investing globally, the American Chamber sought to understand what factors in the investment decision made Ireland an attractive location for R&D investment. Of the companies that provided answers to our questions on competitive locations, over 70% of them stated that more than two thirds of their R&D investment decisions compare Ireland to another country. That **competition is global reflecting the sophistication of global value chains and is evenly split between north America (USA & Canada), Europe (including Israel) and Asia (including a strong showing from India).**

When answering questions on how Ireland compares to competitor locations, 75% of the companies considered that Ireland has an advantage in our Business-Friendly environment and nearly 60% said that our Government support and Incentives had advantages over other countries. Ireland also scored better than other countries for our Legal / IP Environment and our Quality Reputation/Track Record for R&D investment. These statistics validate the success of the Government policy to create an attractive investment environment through legislation.

However, where the Government is less in control of the influencing factors for investment Ireland does not have a noticeable advantage. In the other investment considerations, typically 50% to 60% of responses put Ireland on a level par with other countries, but for those that felt there was a difference, between 28% and 35% of respondents considered that other countries were better than Ireland for Cost of Doing Business, Market/Customer Access, Access to Industry Clusters/Networks, Availability of Qualified Staff, Quality of Physical and Digital Infrastructure and Calibre of Local Universities and Research Centres. Based on this data it would be reasonable to conclude that **Ireland's favourable legislative environment, in which the R&D tax credit plays a significant role, is the main factor that makes Ireland a globally competitive location for R&D investment.** While it is the American Chamber's strong position that the R&D tax credit should be maintained and enhanced to ensure ongoing effectiveness, it is also critically important that Ireland addresses the other non-tax/incentives areas that will be critical to driving the knowledge economy and R&D ecosystem here. The areas noted above where Ireland is viewed as on a par or under scale compared to other countries are important policy areas that require attention also.

Enhancing the Effectiveness of the Regime

Leadership Comments

Competition Increasing:
"Not as business friendly as competitor locations e.g. Singapore. Definitely investment decisions are being influenced by these comparators."

Risks are Daunting:
"Submitting a claim is a daunting task… the penalties for making claims that could be deemed as non-qualifying are very off putting. Sometimes companies are taking the approach, it's not worth the hassle and risk."

Importance of Certainty:
"Certainty with respect to the application of the regime as well as the future of the tax credit is critically important."

When asked about how the scheme can be improved, the most common responses related to **simplification of documentation requirements, getting increased certainty on the application of the technical criteria for qualification and widening the criteria to allow latitude on innovative products.** Our view is that this latter requirement is reflecting the changes in science and technology and the advent of Industry 4.0 where new products are increasingly being born from highly innovative use of technology and that this exciting revolution is not fully supported by R&D incentives. As this sector grows Ireland would be well placed if it could demonstrate that it was encouraging investment and would be likely to reap the reward of the job growth that will be associated with it. Several suggested enhancements to the existing regime have been included in the section on **'Enhancing the Existing Regime: Fit for Globalisation 4.0**' further in this submission.

Implications

The American Chamber believes that our survey results are representative of many FDI R&D performing companies. CSO data for 2017-2018, shows that 69% of the €2.77b of business expenditure on research and development (BERD) is by foreign companies. This investment is mobile, and vulnerable to a changing global economic environment. With other countries that have never had a tax credit scheme preparing to introduce R&D schemes in the near future (Switzerland and Germany) and a post-Brexit UK more likely than not to use tax incentives as a counter measure to potentially wider challenging trading conditions, with India and China producing hundreds of thousands of well qualified science and technology graduates every year, the attractiveness of other locations is likely to grow.

In the context of remaining attractive for US inward investment, it's important to consider that the R&D credit regime was designed when the federal corporate income tax rate in the United States was 35 per cent. As noted by economist Seamus Coffey the 'credit significantly improved Ireland's competitiveness in such an environment. Of course, recent changes in the US mean that the federal rate is no longer 35 per cent and it may be worth assessing the level of Ireland's R&D credit in the light of these changes.'[8] **These conditions reinforce the need to ensure that Ireland continues to have an R&D incentive program that matches or exceeds the best available to ensure that we remain competitive** and continue to attract the best R&D investment. The external changes are not unnoticed with several comments in our survey making favourable statements with regards to other countries such as the UK and Singapore.

Our survey showed how a critical differentiator between Ireland and other locations for R&D investment is our R&D incentives and our business friendly tax environment, but Ireland is at best neutral and at worst is at a disadvantage in terms of cost and market & network access amongst other key investment considerations. As such we cannot risk the deterioration in one of our significant advantages of the R&D tax credit scheme.

Emerging Trend?

The American Chamber survey confirmed that between 2013-17 there had been an increase in member's R&D investment and expenditure and the level of tax credit claims over those years.

Recent Revenue Commissioner's data[9] shows that the cost to the exchequer is reducing, yet this is in the context that BERD spend has grown over the same period. The American Chamber would be concerned if this reflected companies being deterred from claiming due to the uncertainty relating to reliability of the credit for use in project costings. This may be a short-term trend reflecting the ending of a small set of large R&D eligible projects – but the danger is that it is an indicator of falling competitiveness.

In particular, given the transformation and industrial upheaval due to pervasive digitalisation and connectivity, qualitative feedback from our membership suggests that more non-qualifying activity is taking place which if the trend continues might negatively reduce our international competitiveness for critical process and development innovations that attract the best projects and retain the best personnel.

[8] Evidence given by Seamus Coffey, Chair, Fiscal Advisory Committee, to the Committee on Budgetary Oversight,16 May 2018

[9] https://www.revenue.ie/en/corporate/documents/statistics/tax-expenditures/r-and-d-tax-credit-statistics.pdf

Driving Community Outreach

Leadership Comments

Promoting stem

"R&D leadership teams have developed a cross functional program which is designed to encourage employees to volunteer and play a key role in promoting STEM relating activities."

Community linkages

"As we grow our R&D activities, our level of volunteer activity to the community grows."

3Rd level engagement

"Building R&D capacity has opened a new vista of engagement with 3rd level institutions and peer companies"

Wider ecosystem

"More R&D engineers naturally increases our outreach as R&D engineers tend to engage in the wider ecosystem more than other functions"

"A stronger R&D presence in the Irish based operation promotes closer ecosystem ties and builds the international reputation of our operation"

"Supports linkages with local suppliers and allows us invest significantly in our collaboration with schools and universities"

The inward investment of American Chamber members goes beyond an economic (employment and taxation revenues) contribution. These additions include the provision of undergraduate internships, postgraduate/trainee work experience, research investment and programme review, participation on government authorities and skills for a, consultancy investment as well as direct support (in cash and/or kind) for courses and curriculum development. A 2016 report commissioned by the American Chamber with the University of Notre Dame[10] found that **US firms and 50,000 of their employees were engaged in over 7000 community projects countrywide with 89% of in-kind donations, 32% of cash donations, 43% of volunteer hours was focused on supporting education.** Benefits flowing from this engagement include strengthened learning outcomes, greater skills alignment and greater strategic linkages between industry and the sector.

RESPONDENTS SAID

73% have used the R&D credit to provide more PhD positions

76% have created more internship opportunities

[10] 'Beyond Business', The Social Impact of US Investment in Ireland, 2016

Enhancing the Existing Regime: Fit for Globalisation 4.0

As the American Chamber has put forward, the location of an R&D activity has a significant impact on long term economic growth potential of a jurisdiction by anchoring related manufacturing and service activities and driving enhanced skill levels. The R&D tax credit not only has a direct effect on the creation of 'new' R&D jobs, it is directly related to Irish-based facilities being engaged in additional development, manufacturing and commercialisation projects that would not have been possible in the absence of having R&D activities/projects in Ireland in the first instance. Importantly, these jobs tend to be larger in number than the R&D jobs themselves.

The American Chamber's very considered assessment that **the regime requires targeted changes to address what our members view as a "mismatch" that has emerged between the principles underpinning the regime, its promotion and its implementation. The regime needs to be clear and consistent if it is to be effective.** As such, it needs to reflect the overarching policy, as outlined by Government and the Department of Finance, to be strategically focussed on reducing the business cost of undertaking R&D in Ireland.

The American Chamber believes that to remove the current level of considerable uncertainty, the following enhancements should be considered to address the increasing competition in this area:

1. **Increasing the current limits imposed on third party payments for providing contracted R&D services.** The regime currently provides insufficient incentive and support to companies to collaborate with Higher Education Institutes. To further encourage companies to work with third level institutions and invest in the 'R' activities which are the foundation of longer term progress in science and technology-based products and production methods, the American Chamber recommends that the limits applied to such expenditure are reviewed with a view to increasing them. This would encourage large investors in R&D to place more expenditure within academic institutions and assist in knowledge transfer to industry.
2. **The American Chamber recommends that the R&D tax credit refund mechanism should be altered to facilitate the offset of the refund arising from the R&D tax credit against other taxes.** This simple adjustment to how the refund is utilised will provide further flexibility to companies whilst being cost neutral to the Exchequer.
3. **Section 766 TCA 1997 should be amended to delete the term "wholly and exclusively in the carrying on… of research and development" and replaced with "for the purposes of research and development."** This is a broader test and is more aligned with the aim of reducing the business cost of undertaking R&D in Ireland. It is also more in keeping with the broader Revenue interpretation previously outlined in pre-December 2013 Guidelines.
4. The nature of the R&D which qualifies for grant aid administered by IDA and that which qualifies for R&D tax credits is not consistent. Evolving the regime to reduce this inconsistency would be beneficial to the companies which are awarded RD&I grant aid for their investment programmes into Ireland. In addition to any changes in legislation to clarify the level of novelty outlined above, **utilising the State's own technical resource as per the IDA's grant assessments to review the technical basis of R&D tax credits claims would assist in this alignment and allow reduced administration** and increased clarity for those companies claiming both incentives.
5. The **R&D legislation should be amended to ensure that certain costs incurred in undertaking a qualifying R&D activity under the general framework of S.766 TCA 1997 should be allowable** notwithstanding that they may be capitalised as a component of the valuation of an IP asset and potentially come within the ambit of S.291A TCA 1997.

6. **To support global R&D projects the regime needs to recognise how Irish subsidiaries engage with connected parties (i.e. parent companies in the US).** Therefore, the territoriality and connected party's restrictions contained in S.766 TCA 1997 need to be amended to allow Irish subsidiaries' collaborations to be catered for in the legislation. In the UK for example, research activities can take place outside the UK and are not bound by an EU/EEA restriction. Post Brexit, the UK, outside the constraints of the EU, will have the ability to make their R&D regime even more flexible so it is imperative Ireland's regime remains as competitive as possible

7. **The regime, while remaining based on the OECD Frascati model, needs to evolve to expand the qualifying fields of science to emerging areas (e.g. such as the interaction between technology and human behaviour).** This can be done by amending Statutory Instrument No.425 of 2004 and in particular, 'Appendix 2' that outlines categories of activity that are not research and development activities.

8. The concept of 'scientific or technological advancement' contained in S.766 TCA 1997 needs to be more aligned to the specific requirements of a small island economy like Ireland. International R&D regimes have different novelty requirements, the most common being 'new to the company' rather than the more stringent "new to the world" approach. Typically, the "new to the world" approach is difficult to administer and is unlikely to capture the very significant 'D' that is undertaken in Ireland as it focuses more specifically on the pure 'R'. The American Chamber recommends that **the level of novelty required to be sought in the Irish regime is clarified to reflect conditions on the ground and to allow Irish companies to continue on the path from 'D' to 'R' over time.**

9. At present Ireland promotes the benefits available in respect of R&D investment as an effective 37.5% benefit, being a 25% R&D credit and a 12.5% corporate tax deduction for qualifying expenditure. A further **potential innovation which would be welcomed by the American Chamber would be an election option for the R&D credit regime to allow claimants with a tax base to forgo corporate tax deductions and take the benefit foregone by way of R&D credit.** Such an election would lead to a 50% increase in the potential "above the line" benefit. This increase in "above the line" R&D credits would make Ireland significantly more competitive when competing for mobile R&D investment. The denial of a corporate tax deduction at 12.5% on the qualifying R&D expenditure means that the proposal is a cost neutral for the Exchequer. The American Chamber is conscious that without an appropriate restriction, a loss-making company could claim an unintended benefit but believe that this can be avoided by building appropriate safeguards into the legislation.

10. The American Chamber continues to encourage the NSAI to work with our members to integrate an understanding and development of standards and regulations for emerging technologies. This should include the capacity to access the international standards' networks via the operations of multinational firms based in Ireland. In the expected review of the R&D tax credit in 2019, the American Chamber would **encourage exploring the inclusion of research and development costs associated with contributions to standards development as a pathway to encourage 'standards by design' amongst enterprise.**

Conclusion

The American Chamber of Commerce Ireland will continue to work closely with our members in bringing forward recommendations where we believe the suggestions can make a meaningful difference in terms of strengthening Ireland's investment and employment competitiveness. The R&D Tax credit is essential to this.

We believe that Ireland's modern exporting technology and service sectors are leading the process of economic leadership and have more to contribute in terms of economic growth and jobs if the Government remains steadfast in its strategic focus and pragmatic actions to support the enterprise sector. Given the role played by US business in Ireland it is vital that an environment that supports the retention and growth of Foreign Direct Investment continues to be fostered.

Our members have communicated to us that this Review is a high priority for the retention and growth of their operations in Ireland. They believe that the R&D tax credit has been, and can continue to be, a critical tool in ensuring that Ireland is competitive for research, product development and process innovation projects and they are of the view that there is scope to enhance its ability to attract further investment.

We remain available for further consultation with the Department on this matter and look forward to continuing our dialogue.

"The R&D tax credit is very important in helping Ireland compete for new investment and helps us continue the growth of our operations in Ireland."

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