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Re: Knowledge Development Box (KDB) – Feedback Statement

To whom it may concern,

The publication of the KDB Consultation Feedback Statement (the Statement) is a very welcome development on this important tax policy issue, following the open consultation process earlier in the year. It provides stakeholders with the opportunity to have early input into the detail of the regime's design and the draft accompanying legislation. The opportunity to comment on draft legislation in this way is in line with best practice internationally and is valuable to the wide range of businesses and others that can be impacted by legislative change. The short timeframe that exists between the announcement of Budgetary measures and their enactment in the Finance Act is not conducive to having a considered review of the legislation and can lead to unintended consequences. Advance consultation such as this is therefore very welcome.

As regards this KDB consultation process, we all have a common aim to ensure that the Minister's vision is realised i.e. that Ireland provides a KDB offering which is the "most competitive in class" within the parameters set by the OECD's "modified nexus" approach. We do have concerns about the impact of the "modified nexus approach" as it is currently understood, particularly for a small economy such as Ireland. These are important concerns impacting on the potential competitiveness of the regime. However, for the purposes of this Statement, we have limited our remarks to details on the mechanics and design of the relief.

Definition of "Qualifying assets" – Research and Development activities, page 3

A "qualifying asset" is defined in the Statement as:

> *"an asset which is intellectual property, other than marketing related intellectual property, which is the result of research and development activities";*

Research and Development (R&D) activities are then defined on page 3 and the wording of the definition is largely in line with the definition of R&D activities in S766 TCA 1997 – with one important exception. "Experimental or theoretical work" is defined in the Statement for the purposes of the KDB as:

> (i) *experimental or theoretical work undertaken primarily to acquire new scientific or technical knowledge, with a specific or practical application in view"* (emphasis added).

However, the R&D definition of experimental or theoretical work in S766 TCA 1997 refers to:

> (i) *"basic research, namely, experimental or theoretical work undertaken primarily to acquire new scientific or technical knowledge without a specific practical application in view"* (emphasis added).

This may be an unintentional difference and clarity on the matter would be welcome.

"Qualifying expenditure" - pages 4 and 5

a) Outsourcing

i) Geographical scope

An important statement is included on page 4 that:

> *"… the KDB could allow for outsourcing that takes place anywhere in the world to qualify, in line with the criteria in the R&D tax credit".*

However, the suggested wording of the draft legislation (supporting the policy statement and also contained on page 4, states that:

> "*qualifying expenditure on the qualifying asset, in relation to a company, means expenditure incurred by the company in any accounting period in carrying on research and development activities in a relevant Member State*…"

The ability to outsource activity to any other country in the world is very important in ensuring that our regime is competitive and is "best in class." However, it is not fully clear from the approach outlined on pages 4 and 5 whether outsourcing activities can be carried on in any jurisdiction or will be limited to EU or EEA Member States. Particular concerns have been raised on this issue by our members who regularly experience R&D audits where Revenue take the view that outsourcing costs can only qualify for the R&D tax credit to the extent the activities are carried on in the EU or EEA.

This is despite the fact that S766 (1)(b)(viii) TCA 1997 contains no such limitation, other than in cases which involve payments to universities or institutes of higher education.

We would welcome confirmation in the legislation and in any accompanying Guidance that outsourcing for KDB purposes (as well as R&D purposes) is allowed anywhere in the world.

(ii) Foreign PEs

Subparagraph (b)(v)(i) on page 5 of the Statement notes that "qualifying expenditure" will not include any amount that:

> *"(I) may be taken into account as an expense in computing income of the company"*
>
> *and*
>
> *(III) may otherwise be allowed or relieved in relation to the company, for the purposes of tax in a territory other than the State*"

This would exclude "qualifying expenditure" incurred by a foreign permanent establishment (PE) from qualifying for the purposes of the KBD, notwithstanding that the PE's income could potentially include income generated from the IP asset that is taxed in Ireland. This would distort the calculation of the income that qualifies for the KBD and the related tax due. To the extent that the income of a PE includes "qualifying income" for KDB purposes, then expenditure of the PE should be included within the scope of "qualifying expenditure" - earlier discussions on the KDB regime had suggested that this would be the case.

If the provision above is aimed at excluding expenditure that has qualified for relief under a "patent box" or similar regime in another jurisdiction this could be addressed by the legislation in a more focussed way.

(b) Treatment of charges

The treatment of charges in relation to "qualifying expenditure" is somewhat unclear.
On page 4, paragraph (a)(ii) includes within the definition of "qualifying expenditure" amounts:

> *"relieved under Chapter 2 of Part 8*" (i.e. charges on income for corporation tax purposes.)

However, paragraph (b), on page 5, states that:

> *"qualifying expenditure shall not include –*
>
> *(i) A royalty or other sum paid or payable by a company in respect of the use of intellectual property,*
> *(ii) Any amount of interest paid or payable, directly or indirectly",*

These two statements would seem to conflict with each other and certainty on the policy position would be welcome.

Method of calculation of profits – page 8

a) Interaction with the calculation of excess credit for S766(4B)(a)TCA 1997

On page 8 of the Statement, paragraph (b) (ii) of the proposed approach for the calculation of the profits of the specified trade states that:

> *"for the purposes of determining the amount of any claim pursuant to s766(4B)(a)[1] , the excess referred to in that section shall be calculated as if this chapter does not apply".*

[1] The excess repayable R&D tax credit

The calculation of the excess repayable R&D tax credit can be a very complex matter, and we suggest that illustrative examples in accompanying Guidance would be important to provide certainty on the interaction of the repayable credit with the KDB regime.

b) Order of offset

On page 13 of the Statement, attention is drawn to the order of offset provision on page 8,

> *"whereby the payable R&D tax credit could be calculated before the application of the KDB rate".*

Again, given the complexities involved, practical examples on the calculation of the offset would be important and the Institute would be happy to provide feedback on any examples being considered.

c) Loss relief

The Statement notes that relief should be given for losses and charges on a value basis, to take into account the differing tax rates applied to profits. This is discussed only in the context of relief for losses and charges relating to the "specified trade".

It is not clear whether current year losses and charges relating to the "non-specified trade" may be available for offset against profits arising to the "specified trade". If such an offset is permitted, clarity would be needed as to whether the available losses of the "non-specified trade" would have to take into account the difference between the 12.5% rate and the KDB rate.

d) Relief for foreign taxes

Ireland is already competing with jurisdictions that have attractive regimes for the relief of foreign taxes. Therefore, consideration should be given to ensuring that relief in Ireland for foreign taxes on income and gains of a KDB claimant company (Schedule 24 TCA 1997), is not inadvertently impacted or restricted by the "separate trade" provisions in the KDB legislation.

Relief for foreign taxes on income or gains should continue to be calculated in the normal manner as outlined in the relevant provisions of the Taxes Acts.

Interaction with other provisions – page 13

It is noted on page 13 of the Statement, that the KDB, the R&D tax credit and S291A TCA, although all aimed at incentivising R&D, are targeted at different stages of a company's business model. It is further noted, that it is not intended that relief under both the KDB and Section 291A would be available in respect of the same intangible assets.

While it is clear from the Statement that the R&D tax credit and KDB relief may be available in respect of the same asset, the business model outlined above where expenditure is incurred on an asset and income is subsequently generated is not fully reflective of a modern business model. It can often be the case that R&D will be incurred on an ongoing basis to improve an asset while income is generated from that asset at the same time.

There will also be instances when a KDB and a S291A claim will properly arise on the same intangible asset, for example at different stages of the business cycle or on different portions of the asset. It is important that the relevant reliefs are available in these circumstances, notwithstanding that they relate to the same intangible asset.

Tracking and tracing

A company is obliged to maintain records of qualifying income and expenditure, showing how:

> *"overall income from the qualifying asset, qualifying expenditure on the qualifying asset and overall expenditure on the qualifying asset are tracked".*

On request, the company must provide documentation to Revenue to show that the expenditures and income are linked.

Page 12 of the Statement notes that the requirement to track and link expenditure to income shall not apply to expenditures incurred prior to 1 January 2016.

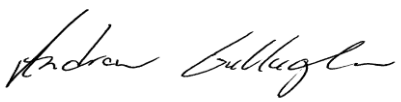
Clarity will be needed on the evidence required to support a claim, in cases where the qualifying income arises after 1 January 2016, but the qualifying expenditure was incurred before this date.

Furthermore, early engagement with businesses will be critical to ensure that the Guidance developed in relation to tracking and tracing and the administration of the regime by the claimant companies is practicable and will not result in disproportionate compliance costs. Excessively burdensome information requirements will limit the attractiveness of the regime, particularly for smaller businesses.

Different businesses and industries currently have different "norms" regarding the documentation they produce and retain to support their R&D expenditure claims. This is also going to be the case for the KDB regime. The Guidance must be flexible to reflect these different business norms and we would expect Revenue to take a fair and reasonable approach to evidence sought on tracking and tracing and other administrative matters.

If the Institute can be of further assistance in this consultation process, please do not hesitate to contact us.

Yours truly



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