

[15.1.40] Relief for key employees engaged in Research and Development activities

Section 472D Taxes Consolidation Act 1997 [as inserted by Section 8 of Finance Act 2012]

Reviewed March 2016

1. Introduction

Section 8 of Finance Act 2012 inserted a new section, Section 472D, into the Taxes Consolidation Act 1997 which applies for the tax year 2012 and subsequent tax years.

Section 472D allows key employees engaged in research and development (“R&D”) activities avail of the R&D tax credit (or part thereof) to which their employer company is entitled (under section 766 of the Taxes Consolidation Act 1997) and which is surrendered by the company in favour of such key employees. Where the R&D tax credit is to be used by key employees, the key employees can use it only as a credit against income tax charged on their income from the employment with that employer.

A key employee cannot avail of Section 472D credit if the effective rate of income tax on his or her total income (including the income of his or her spouse or civil partner) for the tax year of claim is 23% or less. However, where, before claiming the credit, the employees effective rate of income tax is more than 23%, he or she can claim the credit to the extent that it reduces the effective rate of tax on his or her total income to not less than 23%.

The relief under section 472D does not impact on an employee’s liability to the Universal Social Charge or to PRSI.

The definitions used in Section 472D are reproduced in *Appendix 1*.

Note: While Section 472D applies for 2012 and subsequent years, the first tax year for which individuals can claim the credit provided for by the section is 2013 (see examples at 3 below).

2. To whom does the relief apply?

Section 472D applies to ‘key employees’ engaged in R&D activities with their employer company.

A key employee means an individual who –

- is not, and has not been, a director of the relevant employer or an associated company of the relevant employer and is not connected to such a director;

- does not, and did not, have a material interest in the relevant employer or an associated company of the relevant employer and is not connected to a person who has such a material interest; and
- in the accounting period for which his or her relevant employer was entitled to claim relief for R&D expenditure under section 766(2), performed 50% per cent or more (75% or more in 2012) of the duties of his or her employment in the conception or creation of new knowledge, products, processes, methods or systems.

For this purpose, a material interest in relation to a company means the beneficial ownership of or ability to control, directly or through the medium of a connected company or connected companies or by any other indirect means, more than 5% of the ordinary share capital of the company.

In addition, in order for an individual to be a key employee, 50% or more (75% or more in 2012) of the cost of his or her emoluments from the relevant employer must qualify as expenditure on research and development under Section 766(1)(a) in the accounting period for which the relevant employer would be entitled to claim the R&D credit under Section 766.

A relevant employer means a company that employs a key employee and which is entitled to relief under section 766(2).

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3. The credit against tax charged

Where, in accordance with Section 766(2A), a company surrenders R&D tax credit (to which it is entitled) to a key employee, that employee can, subject to the restrictions set out in paragraph 4, claim to have the income tax charged on his or her relevant emoluments from that company for a tax year reduced by the amount surrendered.

As a company will not be in a position to determine the amount of credit available for surrender before the end of their accounting period, the claim for the credit can be made by an employee for the tax year after the tax year during which the accounting period in respect of which the company surrenders the credit ends.

Note: Only companies with an accounting period beginning and ending after 1 January 2012 can surrender credit to key employees.

Example 1.

Research Ltd has an accounting period that ends on 30 June 2013. Research Ltd surrenders credit of €20,000 from that period to Mary, a key employee. Mary is entitled to use the credit against the income tax charged on her salary from Research Ltd in 2014 (provided the effective rate of tax on her total income does not fall below 23%). Mary can make the claim in 2015 in respect of the 2014 credit – see section 7 below re making a claim.

Example 2.

BETA Ltd. has a 12-month accounting period ending on 31 December 2012. BETA Ltd. surrenders credit of €30,000 to key employee John. John is entitled to use the credit against the income tax charged on his salary from Beta Ltd in 2013 (provided the effective rate of tax on his total income does not fall below 23%).

Where for a tax year an employee is no longer a *key* employee of the company that surrendered the credit, but remains an employee of that company, he or she will still be entitled to claim the credit for that tax year provided that he or she was a key employee in the accounting period in respect of which the credit was surrendered.

Example 3

Taking example 2 above, if in 2013 John, while remaining an employee of Beta Ltd, is no longer a key employee (for example he performed less than 50% of the duties of his employment in the conception or creation of new knowledge etc.) he will still be entitled to use the credit in 2013 as he was a key employee in the accounting period in respect of which the credit was surrendered (i.e. 2012). This is provided the effective rate of tax on his total income does not fall below 23% in 2013.

4. Limit on relief

The amount of relief that an employee can claim in any tax year is limited by reference to his or her effective rate of tax for that year.

Before and after claiming the relief, the employee must have an effective rate of tax on his or her total income (including the income of his or her spouse or civil partner where joint assessment applies) of not less than 23%. In addition, the credit can only be offset against income tax on the income from the employer who surrendered the credit. It cannot be offset against income tax due on other sources of income that the employee may have.

Example 4

Ben (single) is a key employee of Develop Co that has an accounting year-end of 31 December 2012. Develop Co decided to surrender €10,000 of its R&D credit for 2012 to Ben.

Ben seeks to claim this as a credit against the tax on his income from Develop Co in 2013 as follows:

Salary		€120,000
Tax	€32,800 @ 20% =	€ 6,560
	€87,200 @ 41% =	<u>€35,752</u>
		€42,312
Less Credits		<u>€ 3,300</u>
Tax		€39,012

The tax attributable to Ben's salary from Develop Co is €39,012. This is sufficient to absorb the full credit surrendered by Develop Co of €10,000. However, Ben's effective rate of income tax must be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate before the credit = **32.51%** (€39,012/€120,000).

Tax	€39,012
R&D credit	<u>€10,000</u>
Tax after credit	€29,012

Effective rate after the full credit = 24.18% (€29,012/€120,000). Ben can therefore use the full credit against the income tax on his salary in 2013.

Example 5

Maria (single) is also a key employee of Develop Co. The company decided to surrender €10,000 of its R&D credit for 2012 to Maria. Maria seeks to claim this as a credit against the tax on her income from Develop Co in 2013 as follows:

Salary	€75,000
Tax	€32,800 @ 20% = € 6,560
	€42,200 @ 41% = <u>€17,302</u>
	€23,862
Less Credits	<u>€ 3,300</u>
Tax	€20,562

The tax attributable to Maria's salary from Develop Co is €20,562. This is sufficient to absorb the full credit surrendered by Develop Co of €10,000. However, Maria's effective rate of income tax must be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate before the credit = 27.42% (€20,562/€75,000).

Tax	€20,562
R&D credit	<u>€10,000</u>
Tax if full credit used	€10,562

Effective rate if full credit used = 14.08% (€10,562/€75,000).

Therefore Maria cannot use the full R&D tax credit in 2013. She can only use so much of the R&D credit (€3,312) as to give a minimum effective rate of 23% i.e.

Tax	€20,562
R&D credit	<u>€ 3,312</u>
Tax after credit	€17,250

Effective rate after using restricted R&D credit of €3,312 = 23% (€17,250/€75,000).

The credit balance (€6,688) can be carried forward for use against income tax on her income from Develop Co in subsequent years. See section 5 below.

Example 6

Sean (married) is a key employee of Beta Co, which has an accounting year-end of 31 December 2012. Beta Co decided to surrender €15,000 of its R&D credit for 2012 to Sean.

Sean seeks to claim this as a credit against the income tax on his income from Beta Co in 2013. Sean and his wife Joan are jointly assessed for tax purposes. Their joint income/liability for 2013 is as follows:

Income	Salary Beta Co. (Sean)	€130,000
	Salary Wings Ltd. (Joan)	€ 80,000
	Rental income	€ 15,000
	Case 111 income	€ 5,000
	Total	€230,000
Tax	€ 65,600 @ 20% =	€13,120
	€164,400 @ 41% =	<u>€67,404</u>
		€80,524
Less Credits		<u>€ 6,600</u>
Tax		€73,924

In order to determine whether any restriction of the credit is required, the tax attributable to Sean's income from Beta Co must be calculated together with his effective rate of income tax.

Tax attributable to Sean's income with Beta Co.

$$\frac{€73,924 \times €130,000}{€230,000} = \mathbf{€41,783}$$

The tax attributable to Sean's salary from Beta Co is €41,783. This is sufficient to absorb the full credit surrendered by Beta Co of €15,000. However, Sean's effective rate of income tax must also be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate of tax before the R&D credit = 32.14% (€73,924/€230,000).

Tax	€73,924
R&D credit	<u>€15,000</u>
Tax after full credit	€58,924
Effective rate after full R&D credit = 25.62% (€58,924/€230,000)	

As the tax attributable to Sean's income from Beta Co exceeds the credit surrendered, and as Sean passes the 23% effective rate test, Sean is entitled to use the full credit against his 2013 income tax liability.

If Beta Co had surrendered an R&D credit of €40,000, the position would be as follows:

Tax	€73,924
R&D credit	<u>€40,000</u>
Tax after credit	€33,924

Effective rate if full R&D credit used = 14.75% (€33,924/€230,000).

Sean must have a minimum effective rate of 23%. Therefore, the R&D credit is restricted as follows:

Tax	€73,924
R&D credit (restricted)	<u>€21,024</u>
Tax after restricted credit	€52,900

Effective rate after restricted R&D credit = 23% (€52,900/€230,000).

In this case, Sean may carry forward €18,976 (€40,000-€21,024) of unused R&D credit to use in subsequent years – see section 5 below.

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5. Carry forward of unused credit

Where, as a result of the restriction mentioned in section 4 above, a key employee cannot use the full amount of the credit surrendered by his or her employer in a tax year, the amount not used can be carried forward to reduce the income tax charged on the employment income of the next tax year and each succeeding tax year until the full credit has been used. This will apply provided that:

- (i) the individual remains an employee of the company (but not necessarily a *key* employee), and
- (ii) the individual passes the 23% effective rate test in each subsequent year in which credit is used, and
- (iii) the individual pays sufficient tax, on his or her income from the employment with the company that surrendered the credit, to absorb the credit.

Example 7

Greg (single) is a key employee of XYZ Co., which has an accounting year-end of 31 December 2012. XYZ Co decided to surrender €15,000 of its R&D credit from its 2012 accounting period to Greg. Greg seeks to claim this as a credit against the tax on his income from XYZ Co in 2013 as follows:

2013

Salary		€115,000
Tax	€32,800 @ 20% =	€ 6,560
	€82,200 @ 41% =	<u>€33,702</u>
		€40,262
Less Credits		<u>€ 3,300</u>
Tax		€36,962

The tax attributable to Greg's salary from XYZ Co is €36,962. This is sufficient to absorb the full credit surrendered by XYZ Co of €15,000. However, Greg's effective rate of income tax must be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate before the credit = **32.14%** (€36,962/€115,000).

Tax	€36,962
R&D credit	<u>€15,000</u>
Tax after credit	€21,962

Effective rate if full credit used = **19.09%** (€21,962/€115,000).

As Greg must have a minimum effective rate of 23%, he cannot use the full R&D tax credit in 2013. He can only use so much of the R&D credit (€10,512) as to give a minimum effective rate of 23% i.e.:

Tax	€36,962
R&D credit (restricted)	<u>€10,512</u>
Tax after restricted credit	€26,450

Effective rate after R&D credit = 23% (€26,450/€115,000). Greg may carry forward the balance of the R&D credit (€4,488) to 2014.

2014

In 2013 XYZ Co decide to surrender a further €6,000 of its R&D credit to Greg who is still a key employee of the company. Greg can use this as a credit against the tax on his income from XYZ Co in 2014. He also has R&D credit carried forward to 2014 of €4,488. His tax liability is as follows:

Salary		€119,000
Tax	€32,800 @ 20% =	€ 6,560
	€86,200 @ 41% =	<u>€35,342</u>
		€41,902
Less Credits		<u>€ 3,300</u>
Tax		€38,602

The tax attributable to Greg's salary from XYZ Co is €38,602. This is sufficient to absorb the full credit surrendered by XYZ Co of €6,000 and the credit carried forward of €4,488. However, Greg's effective rate of income tax must be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate before the credit = **32.44%** (€38,602/€119,000)

Tax	€38,602
R&D credit carried forward	€ 4,488
R&D credit 2014	<u>€ 6,000</u>
Tax after credit	€28,114

Effective rate if full credit used = **23.62%** (€28,115/€119,000)

Greg may use the full R&D credit (including the amount carried forward) in 2014 as his effective rate of income tax is 23.62% and the tax on his income (€38,602) can absorb the credit.

Example 8

Leo (married) is a key employee of XYZ Co., which has an accounting year-end of 31 December 2013. Leo has R&D credit from 2013 (surrendered in 2012) for carry forward to 2014 of €21,500. XYZ Co. decided to surrender a further €25,500 of its R&D credit for 2013 to Leo. This gives a combined credit of €47,000.

Leo seeks to claim this credit against the tax on his income from XYZ Co in 2014. Leo and his wife Mary are jointly assessed for tax purposes. Their joint income/liability for 2014 is as follows:

Salary	XYZ Co (Leo)	€135,000
	ABC Co (Mary)	€ 85,000
	Rental income	€ 14,000
	Case 111	<u>€ 2,000</u>
		€236,000

Tax	€ 65,600 @ 20% = €13,120
	€170,400 @ 41% = <u>€69,864</u>
	€82,984
Less Credits	<u>€ 6,600</u>
Tax	€76,384

In order to determine whether any restriction of the credit is required, the tax attributable to Leo's income from XYZ Co must be determined together with his effective rate of tax.

Tax attributable to Leo's income with XYZ Co:

$$€76,384 \times \frac{€135,000}{€236,000} = €43,694$$

The tax attributable to Leo's salary from XYZ Co is €43,694. This is not sufficient to absorb the combined credit surrendered by XYZ Co of €25,500 and the amount carried forward of €21,500. Therefore, the maximum credit that Leo can claim is restricted to €43,694 (first restriction).

However, in addition Leo's effective rate of income tax must be determined to ensure that the minimum threshold of 23% is not breached.

Tax	€76,384
R&D restricted as above	<u>€ 43,694</u>
Tax after restricted credit	€ 32,690

Effective rate after restricted credit (first restriction) = **13.85%**
(€32,690/€236,000).

Therefore, Leo cannot use the full credit remaining after the first restriction (i.e. €43,694) in 2014. He can only use so much of the R&D credit (i.e. €22,104) as to give a minimum effective tax rate of 23%.

Tax	€76,384
R&D credit (restricted)	<u>€22,104</u>
Tax after credit (restricted)	€54,280

Effective rate after using R&D credit of €22,104 = 23% (€54,280/€236,000).

The remaining credit balance of €24,896 (€47,000-€22,104) can be carried forward to 2015 provided Leo remains an employee of XYZ Ltd.

6. PAYE must be paid

A key employee cannot have the tax charged on his or her emoluments reduced where all tax deductible under the PAYE system by the relevant company from the employee's emoluments for a tax year is not remitted by the company to the Collector General.

This condition applies not just to a tax year in which an employee makes a claim but also to any tax year in which credit is carried forward from a previous tax year and used in the later year.

7. Making a claim and submitting a tax return

An employee making a claim under section 472D or seeking to avail of a tax credit under the section where unused credit is carried forward is a "chargeable person" for self-assessment Pay & File purposes. Such an employee must, therefore, file a tax return for all years in which he or she avails of a tax credit under the section, and not just the first year of claim. This is particularly relevant to cases where an employee carries forward unused credit from one tax year to the next.

Claims are subject to the 4-year time limit. For example, where an individual is first entitled to make a claim for the tax year 2013 (in relation to amounts surrendered by a company in 2012), then the latest time that the claim can be made is 31 December 2017.

8. Withdrawal of Relief

For the tax year 2013, any relief granted must be withdrawn from an employee if for any reason the employee was not entitled to the credit or part of the credit given under Section 472D. Reasons for withdrawal of the relief would include:

- (i) an employee was not a key employee during the accounting period in respect of which the company surrendered the credit,
- (ii) the amount surrendered by the relevant company exceeded that which the company was entitled to surrender (see section 9 below).

Where an employee is not entitled to relief (or part of the relief), he/she must pay to the Revenue Commissioners an amount equal to the excess relief claimed.

In addition, where it is found that a surrender claim by a company is not authorised by section 766, the company may be liable to tax at the 25% rate of Corporation Tax (under Case IV of Schedule D) on an amount equal to 4 times the incorrect amount.

In the first instance, recovery of the relief should be sought from the employee. Only in situations where this proves impractical will the employer be pursued.

For the tax year 2014 and subsequent years, any tax foregone as a consequence of an employee not being entitled to an R&D credit (or part thereof) can, depending on the circumstances, be pursued with the company (under the terms of section 766 of the Taxes Consolidation Act 1997) and/or with the employee (under self assessment rules).

Where it is found that a surrender claim by a company (under section 766(2A)) is deliberately false or overstated and that the amount surrendered is not as authorised by section 766, the company shall be liable to tax (under Case IV of Schedule D) on an amount equal to 8 times the unauthorised amount surrendered.

In circumstances where it is found that a surrender claim by a company is not deliberately false or overstated but is not authorised by section 766, the company may be liable to tax at the 25% rate of Corporation Tax (under Case IV of Schedule D) on an amount equal to 4 times the incorrect amount.

In the circumstances referred to in the previous paragraph, recovery of the relief should be sought from the employee where the employee ought to have known that no valid claim could be made under section 472D e.g. the employee is a director of the employing company or a connected company or has a material interest in the employing company or connected company. Where relief is withdrawn from an employee, there should be no need to pursue the company.

9. Changes to amount surrendered

It may happen that, on review, it is found that a company surrendered more credit than it was entitled to surrender. Where this happens for the tax year 2013, the company is obliged to inform the employee of the change to the amount.

Where the employer company fails to give details of the revised amount (known as the “relevant authorised amount”) to the key employee, such failure does not exempt the employee from having to pay to the Revenue Commissioners an amount equal to any excess relief claimed.

The above does not apply for the tax year 2014 and subsequent years. In those years, the tax foregone can be pursued with the company or the employee, as outlined in section 8 above.

10. Interaction with high earner’s restriction

In the legislation dealing with the high earners’ restriction, Section 485G(4) of the Taxes Consolidation Act 1997 provides that:

- the calculation of a credit, which requires total income, taxable income, tax payable or tax chargeable for a year to be taken into account, must take place before the application of the restriction, but
- the benefit of such a credit is to be given against tax chargeable following the application of the restriction.

Therefore, calculation of R&D relief under section 472D should be carried out before the high earners’ restriction is applied but the benefit of the allowable amount of the R&D credit (as calculated before applying the restriction) should be given against the tax chargeable following application of the restriction.

Example 9

Jack is a key employee of Q.I Ltd, which has an accounting year-end of 31 December 2012. The company surrendered R&D credit of €15,000 to Jack from its 2012 accounting period. Jack had a salary from Q.I in 2013 of €115,000. He also had rental income in that year of €100,000, which he covered with rental losses carried forward. These losses arose from “section 23-type” relief, which is a specified relief for the purposes of the high earners’ restriction.

Jack seeks to claim the surrendered R&D amount (€15,000) as a credit against the tax on his income from Q.I Ltd in 2013 as follows:

2013

Salary		€115,000
Case V	€100,000	
Losses forward (specified reliefs)	<u>(€100,000)</u>	<u>€NIL</u>
Total income/taxable income		€115,000
Tax	€32,800 @ 20% =	€ 6,560
	€82,200 @ 41% =	<u>€33,702</u>

	€40,262
Less Credits	<u>€ 3,300</u>
Tax	€36,962

The tax attributable to Jack's salary from Q.I Ltd is €36,962. This is sufficient to absorb the full credit surrendered by Q.I Ltd of €15,000. However, Jack's effective tax rate must be determined to ensure that the minimum threshold of 23% is not breached.

Effective rate before the credit = **32.14%** (€36,962/€115,000).

	Tax	€36,962
R&D credit		<u>€15,000</u>
Tax after credit		€21,962

Effective rate if full credit used = **19.09%** (€21,962/€115,000).

As Jack must have a minimum effective rate of 23%, he cannot use the full R&D tax credit in 2013. He can only use so much of the R&D credit (€10,512) as to give a minimum effective rate of 23% i.e.

Tax	€36,962
R&D credit (restricted)	<u>€10,512</u>
Tax after restricted credit	€26,450

Effective rate after R&D credit = 23% (€26,450/€115,000). Jack may carry forward the balance of the R&D credit (€4,488) to 2014.

Application of high earners' restriction

Jack is subject to the high earners' restriction for 2013 as his adjusted income¹ for the year is greater than €125,000 and his use of specified reliefs is greater than the relief threshold amount of €80,000 (i.e. "section 23 type" rental losses of €100,000).

His recalculated taxable income for 2013, using the formula $T + (S - Y^2)$ in section 485E TCA 1997, is:

$$T (\text{€}115,000) + S (\text{€}100,000) - Y (\text{€}80,000) = \text{€}135,000$$

Therefore, Jack's taxable income for 2013 is increased from €115,000 to €135,000.

¹ Adjusted income = taxable income (T) + specified reliefs (S) – ring fenced income (R) (see section 485C)

² Y is the greater of €80,000 and 20% of an individual's adjusted income

His revised income tax position for 2013 is as follows, after application of the high earners' restriction:

Recalculated Taxable Income	€135,000
Tax	€ 32,800 @ 20% = € 6,560
	€102,200 @ 41% = <u>€41,902</u>
	€48,462
<i>Less</i>	
Personal tax credits	€ 3,300
R&D credit (restricted)	<u>€10,512</u>
Net tax payable	€34,650

*Appendix 1***Definitions**

“associated company”, in relation to a relevant employer, means a company which is that employer’s associated company within the meaning of section 432 TCA 1997.

“control” has the same meaning as in section 432 TCA 1997.

“emoluments” has the same meaning as in Chapter 4 of Part 42.

“key employee” means an individual who –

- is not, and has not been, a director of the relevant employer or an associated company of the relevant employer and is not connected to such a director;
- does not, and did not, have a material interest in the relevant employer or an associated company of the relevant employer and is not connected to a person who has such a material interest, and
- in the accounting period for which his or her relevant employer was entitled to claim relief under section 766(2) TCA 1997, performed 50% or more (75 per cent or more in 2012) of the duties of his or her employment in the conception or creation of new knowledge, products, processes, methods or systems.

In addition, in order for an individual to be a key employee, 50% or more (75% or more in 2012) of the cost of his or her emoluments from the relevant employer must qualify as expenditure on research and development under section 766(1)(a) in the accounting period for which the relevant employer would be entitled to claim relief under section 766.

“material interest”, in relation to a company, means the beneficial ownership of or ability to control, directly or through the medium of a connected company or connected companies or by any other indirect means, more than 5 per cent of the ordinary share capital of the company.

“ordinary share capital”, in relation to a company, means all the issued share capital (by whatever name called) of the company.

“relevant authorised amount” has the same meaning given to it in section 766(2C).

“relevant emoluments” means emoluments paid by a relevant employer to a key employee.

“relevant employer” means a company that employs a key employee and who is entitled to relief under section 766(2).

“tax year” means a year of assessment for income tax purposes.