PKF FRANCISCLARK

Chartered accountants & business advisers

Research and development tax relief for small to medium sized enterprises

Profitable tax paying SME companies conducting qualifying development work can claim government backed tax relief worth over a quarter of their R&D costs. Companies with losses in the year can claim a payable credit from HMRC worth up to a third of their R&D costs.

Recent statistics show that more than 25,000 companies are claiming enhanced tax relief using the R&D tax schemes. This is a very small fraction of the companies registered at Companies House. So why do so few companies take up this generous relief? Is it because R&D tax relief is too difficult to obtain? Maybe R&D is undertaken by only a very small percentage of companies? Or, perhaps a lot of companies are just missing out?

What tax relief is available to SME's investing in R&D?

If a company (or group) has fewer than 500 employees and either a turnover of less than €100m or a balance sheet total of less than €86m then, subject to certain other conditions, it is eligible for R&D tax relief under the SME scheme which can:

- Provide an additional 130% deduction, over and above the amount actually spent, when calculating a company's taxable profits (the 'super-deduction'). At the prevailing rate of corporation tax this can be worth up to 26% of the costs attributable to the R&D.
- Allow loss-making companies to 'cash-in' the loss relating to the R&D spend - resulting in a cash repayment from HMRC worth up to 33% of the costs attributable to the R&D. A particularly valuable mechanism for small start-up companies that may be in a pre-profit phase of their lifecycle.

It should also be noted that where a company fails to meet any of the conditions of the SME scheme because for example it has received grants or subsidies towards its R&D projects, then it may instead claim under the less generous large company regime.

What is qualifying R&D?

R&D has a wide meaning - broadly covering any project that 'seeks an advance in science or technology through the resolution of scientific or technological uncertainties'. Whether or not a project achieves its objective is irrelevant here; the costs of an abortive project are as allowable as those relating to a successful endeavour. Any field of science or technology may be the focus of a R&D project; from 'softer' technology projects such as developing improved food packaging through to software engineering and on to 'hard' science topics like micro-electronics and engineering problems. It is always worth considering whether any part of a business' activity comes within the definition of R&D.

What expenditure can be included in a R&D claim?

To qualify for relief costs must be 'revenue' in nature and not capital expenditure (there is a special capital allowances regime for R&D-related capital expenditure). Only specific types of expenditure can qualify for R&D tax relief:

- Staffing costs (including secondary Class 1 NIC and employers' pension contributions) of directors and employees directly associated with the R&D activity. This will not usually include the costs of purely administrative - and similar - support staff, and in some cases an apportionment of costs will be appropriate.
- Consumable items that are used up or transformed as part of the R&D so that they are no longer usable in their original form. This can include a 'just and reasonable' proportion of overhead consumables such as water, fuel and power but must not include any production costs for materials that ultimately end up as part of a sold product.

PKF Francis Clark has eight offices in the South West: Exeter, New Forest, Plymouth, Poole, Salisbury, Taunton, Torquay and Truro. Please visit www.pkf-francisclark.co.uk for contact details of your nearest office.

- Software that is used in the R&D projects.
- Subcontracted R&D payments to another person for work to be carried out on behalf of the company. The claimable cost is based on 65% of the payment made unless the claimant and the sub-contractor are connected (or elect to be treated as connected) where 100% of the relevant costs may be claimed.
- Externally provided workers - payments to an agency or other 'staff provider' for temporary workers who are directly and actively engaged on R&D. Normally the claimable cost is based on 65% of the payment actually made, unless the claimant and the staff provider are connected companies (or elect to be treated as connected companies) when 100% of the relevant costs may be claimed.

Subsidies and grants

If a subsidy is received for some or all of the costs of a R&D project only the unsubsidised expenditure may be claimed as R&D tax relief. This rule is stricter if the subsidy comprises any form of notified state aid, as defined by the EU, where a partial subsidy paid to an SME may disqualify the whole of otherwise qualifying expenditure from SME R&D tax relief. Importantly a claim should not be ruled out solely on the basis that a grant has been claimed. Although SME relief may not be available, the entire project costs may still be eligible for relief under the large company regime - see Research & development expenditure credit factsheet.

Making a claim

A R&D claim must be included in a company's corporation tax return and has to be made within two years of the end of the relevant accounting period. If a company has already filed its return for the period in question, an amended return can be submitted within the same two year period, to include a new or revised R&D claim. HMRC has several specialist R&D units set up specifically to deal with all company tax returns that include a claim for relief. It is generally recommended that an overview of the R&D claim is provided with a company's CT return/ amended return. HMRC aims to respond to or approve 95% of R&D tax relief credit claims within 28 days of submission.

How can PKF Francis Clark help?

PKF Francis Clark has a specialist team dealing with the tax aspects of business innovation and intellectual property - the Innovation and Technology Tax Group (ITTG). If you would like to discuss research & development relief/tax credits; research & development capital allowances; the patent box; the corporate intangibles regime; or any related issues please contact any member of the ITTG:

Stuart Rogers
Tax Partner

01823 275925
stuart.rogers@pkf-francisclark.co.uk

Katie Farley
Tax Consultant

01803 320100
katie.farley@pkf-francisclark.co.uk

Ian Pring
Tax Director

01752 301010
ian.pring@pkf-francisclark.co.uk

Lisa Whitbread
Tax Senior Manager

01202 663669
lisa.whitbread@pkf-francisclark.co.uk

28.02.2018