

## Research & Development Tax Relief

It is generally accepted that insufficient Research and Development (R&D) is undertaken in the UK than is 'optimal for the economy as a whole'. The government is committed to using R&D Tax Relief as part of its effort to promote increasing levels of R&D.

Since 2000/01, more than 20,000 companies have claimed enhanced tax relief using the R&D tax scheme. But this is less than 1% 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 – but the real issue is whether your company is missing out.

### What is R&D Relief – Outline

R&D Tax Relief is a specific corporation tax relief claimable, by trading companies of all sizes. Depending on the size of the company the R&D Tax Relief can:

- provide an additional deduction, over and above the amount actually spent, when calculating a company's taxable profits (the 'super-deduction'); or
- allow, in SME loss-making companies, the enhanced R&D deduction to be 'cashed-in' - resulting in a cash repayment from HMRC; or
- reduce a large company's profits by introducing an additional deduction into the profit & loss account (an 'Above the Line' deduction).

### What is R&D relief worth?

The R&D Tax Relief regime is constantly being improved. The rates of relief have generally been increased over the years and can be claimed by even more trading companies.

For many years, in order to claim R&D Tax Relief a company had to incur a 'minimum spend' on R&D activities – this is no longer the case, even small amounts can now qualify for relief.

For an SME, for every £1 of qualifying R&D expenditure shown in its profit and loss account, an *additional* £1.25 is allowed in its corporation tax computation as a 'super-deduction'. This means that total relief equal to 225% of the actual R&D expenditure is available.

### R&D Tax Credits

If an SME claimant company is loss making, and has no way to immediately relieve its loss, the availability of even more losses produced by a R&D Tax Relief claim may not seem too useful. However, it is possible to 'surrender' or 'cash-in' losses that derive from an R&D Tax Relief claim to HMRC and they will 'repay' the surrendered losses as a cash R&D Tax Credit. For accounting periods from 1 April 2012 onwards, the rate of payment for the R&D Tax Credit is 11% of any surrendered R&D-derived losses.

For large companies relief is less generous. There are two ways of claiming the R&D Tax Relief:

- as for SMEs: the provision of a 'super-deduction' in the larger company's corporation tax computation equal to 30% of the actual R&D expenditure, giving total relief equal to 130% of the actual expenditure; or
- for expenditure incurred after 31 March 2013: claiming an 'Above the Line' (ATL) deduction equal to 10% of the actual R&D expenditure – this ATL amount is intended to be shown in the company's statutory profit & loss account as an expense, alongside the actual expense.

From April 2013 use of the ATL method is optional, but from April 2016 it will become compulsory for all large companies. It is possible for some SMEs to opt into the ATL scheme if basic SME is unavailable, for example if grants have

been received to cover some of the R&D costs as this will prejudice SME relief but not large company R&D Tax Relief.

### What is an SME?

Whether a company is an SME or not is determined by European Union rules. To qualify, a company must have fewer than 500 full-time equivalent employees during the year; and must meet either one (or both) of the additional tests:

- Annual turnover: no more than €100 million (approx. £80 million)
- Balance sheet total: no more than €86 million (approx. £69 million)

These limits are applied to a company and all of its 'linked' and 'partner' enterprises. So a claimant company that is part of an association or group of companies will usually have the headcount, turnover and balance sheet totals of the whole of the association/group attributed to it when deciding if it meets the tests.

### What is 'Research & Development'?

For tax purposes 'Research and Development' has the same meaning given by Generally Accepted Accounting Practice, in conjunction with Guidelines issued by the Department for Business, Innovation and Skills. The result is that 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; so 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'



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science topics like micro-electronics and engineering problems. It is always worth considering whether any part of a businesses activities come within the definition of R&D

### What expenditure can be included in an R&D Claim?

To qualify for R&D Tax 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 NICs 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, in some cases an apportionment of costs will be appropriate.
- Software and/or consumable items (including water, fuel and power), apportioned where necessary.
- Payments to an agency or other 'staff provider' for workers who are 'externally provided' and 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 payment may be claimed.

- Payments by a company to another person for R&D work to be carried out on behalf of the company ('sub-contractor payments'). The claimable cost is based on relief is based on 65% of the payment made unless the claimant and the sub-contractor are connected (or elect to be treated as connected) when 100% of the payment may be claimed.

If a subsidy is received for some or all of the costs of an 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 State Aid, as defined by the EU, where a partial subsidy paid to an SME may disqualify the whole of otherwise qualifying expenditure from R&D Tax Relief.

### Making a claim

A R&D claim must be included in a company's Corporation Tax return and has to be made within 2 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 including a new or revised R&D claim can be submitted within the same 2 year period.

HMRC have 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 a R&D claim is provided with a company's CT return/amended return. HMRC aim to respond to or approve 95% of R&D Tax Relief claims within 28 days of submission.

### How can Francis Clark help?

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 and Development Capital Allowances; the Patent Box; the Corporate Intangibles Regime; or any related issues please contact any member of the ITTG:

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