

Do you qualify for R & D tax relief?

Are you undertaking innovations? Companies that push the boundaries of science and technology are potentially entitled to an attractive tax relief.

Typical industries with research & development (“R&D”) activities.

- Software applications;
- Equipment/machinery/electronics;
- Manufacturing;
- Technology systems;
- Recipes;
- Renewables & bio-energy;
- Construction (new methods);
- Engineering (new designs);
- Substances;
- Gadgets; and more...

Based on published information in 2017/18 73% of R&D claims made were by companies in the following sectors:

- Manufacturing;
- Professional, scientific, technical; and
- Information and communication.

However, the nature of the industry in which a company operates is irrelevant, provided the activities being carried out meet the definition of R&D for tax purposes.

What is qualifying R&D?

To qualify, the DTI guidelines state that the project must seek to achieve an advance in either physical sciences or technology by:

- Extending overall knowledge in a field;
- Creating a process, device, product or service which represents an increase in overall knowledge or capability within a field;
- Making an appreciable improvement to an existing process, material, device, product or service through scientific or technological changes; and
- Using science or technology to develop an existing process, material, product or service in a new and appreciably improved way.



Notably, a company need not necessarily succeed in achieving the advance, provided it had aimed to do so and the R&D project met all other criteria.

Qualifying R&D can include activities related to:

- Developing new or improved products or processes; or
- Investing in technology, including the development of new and improved software for sale or licensing.

What type of expenditure can be included in the claim?

Certain revenue expenditure incurred by a company in relation to carrying on qualifying R&D and resolving technological or scientific uncertainties, including:

- Staff costs (e.g. salaries, bonuses, employer’s pension contributions, and employer’s national insurance) of the employees involved in the R&D process, apportioned based on their time spent directly on qualifying activities;
- Items which are ‘used up’ in the R&D process (e.g. consumables, materials, light and heat);
- Software used in the R&D process, apportioned based on direct usage in R&D activities; and
- Costs of certain subcontractors or externally provided workers directly involved in the R&D process (normally restricted to 65% cost).

Small Medium Enterprise “SME” R&D claim

Allows companies to:

- Deduct an extra 130% of qualifying expenditure from your annual taxable profit.
Total = 230% deduction for tax purposes.
- If loss making before/after additional expenditure, you can claim a tax credit of up to 14.5% of the surrender-able loss.
- Costs of certain subcontractors or externally provided workers directly involved in the R&D process (normally restricted to 65% cost).

Example - a company with the following costs incurred in relation to qualifying R&D activities:

- R&D staffing costs of totalling £55,000; and
- Costs of software used directly for R&D purposes totalling £5,000.

Total R&D spend = £60,000 gives rise to an additional 130% enhanced deduction of £78,000.

If the company was profitable, this could be offset and reduce the tax liability by a combined total of £26,220 (including the tax relief on the base R&D spend).

If the company made sufficient taxable losses both the original R&D spend and the enhancement (combined for a total of £138,000) could be surrendered for a cash repayment of £20,010.

Who is eligible for the SME scheme?

Companies will normally qualify as a SME if they, including their linked or partner enterprises, have:

- Not more than 500 employees; and
- Less than €100m of turnover or €86m of total assets.

Meeting these criteria doesn't automatically mean a company is eligible for the SME scheme, if for example they have been funded, partly or in full, by State Aid. Companies not eligible under this scheme, may be eligible under the Large Scheme.

Care should be taken to carefully consider and identify any linked or partner enterprises and whether they should be brought into account when assessing the size thresholds for the SME scheme.

Large Scheme R&D Enhanced Credit (“RDEC”)

R&D claims for large companies can be more complex. Broadly, once qualifying R&D spend has been identified, 13% is taken as a 'credit' which is then added to the company's taxable profits.

The 13% credit is also deducted from any tax liability arising. Provided there is sufficient spend on employees involved in the R&D work, the company will be due a repayment equal to the credit (less any amount used to offset tax or charges due by the company to HMRC).

Example - a company with £60,000 identified R&D spend. Assume its pre-RDEC taxable profits are £50,000:

The credit is calculated as:	$£60,000 \times 13\% = £7,800$
This is added to taxable profits:	$£50,000 + £7,800 = £57,800$ taxable profits
The profits are taxed at the relevant rate:	$£57,200 \times 19\% = £10,982$ tax liability
Subtract the credit:	$£10,982 - £7,800 = £3,182$ net tax due

Making an R&D claim

Claims are made through the company's corporation tax return and computation. It is also best practice to provide to HMRC alongside the computation, a report detailing:

- The nature of the R&D project;
- The scientific or technological advances sought;
- Any scientific or technological uncertainties encountered and work done in the period to overcome them;
- Why the advances were not readily deductible by a competent professional working in the field (e.g. a lead developer); and
- Details of qualifying R&D expenditure.

In order to make a claim, companies should ensure they have carefully considered why they qualify for R&D and build their claim in accordance with legislation and best practice; HMRC are currently increasing their scrutiny of some R&D claims.

Whilst an R&D report does not have to be submitted for a claim to be successful, it does help reduce the chance of HMRC making queries into the claim and thereby delaying its agreement (and subsequent repayments if applicable).

Reports should be updated and improved over time, continually focusing on why projects meet the criteria for R&D.

Time limits

A claim for R&D tax relief must be made within two years following the end of the period within which the R&D expenditure arises.

Advanced Assurance

For companies yet to begin making a claim, but wanting to ensure their activity will meet the criteria, HMRC offer an Advanced Assurance service that reviews future projects and based on the information provided, will confirm whether that project would qualify as R&D activity.

Please note that this factsheet is for general information purposes only. Professional advice should be obtained before action is either taken or refrained from as a result of information contained herein. Date created: 25.11.2020