Tax facts

RoffeSwayne

R & D Update

Current update in relation to HMRC practice and claims.

HMRC's aim is to scrutinise all companies' R&D claims at least once every three years. This means that just because a research and development ("R&D") claim is initially accepted it does not mean HMRC will not later review/enquire into it.

We have experienced a higher level of scrutiny from HMRC on R&D claims; in particular on software claims.

HMRC have their own technical teams to review R&D claims from the perspective of a 'competent professional'. Therefore sufficient evidence needs to be provided with R&D claims to demonstrate the advances being undertaken.

Given this increased scrutiny it is important to ensure a record of claimed figures is robust and a technical report is drawn up with clear evidence to demonstrate R&D is taking place.

HMRC's focus

We have recently seen more questions in relation to the 'boundaries' of an R&D project i.e. the start and finish dates of actual R&D activity. HMRC are focused on discerning when R&D commences (e.g. once a specific project is decided upon).

The following would not qualify as R&D activity

- Deciding what projects to pursue; and
- Researching gaps in the market, or avenues for development.

This is because they do not relate to resolving any specific scientific or technological uncertainty.

It is equally important to determine when R&D finishes; R&D would end once any uncertainty in how to develop a product has been resolved.

Taxpayers should bear these boundaries in mind when calculating the costs associated with their R&D projects, those costs falling outside of the boundaries will not qualify.

HMRC are currently consulting on a change in their approach to software R&D claims, which may mean in future cloud computing/data hosting costs will qualify for R&D tax relief.

Timing of repayments

HMRC have continued to meet their aim for a 28 day turnaround of SME R&D claims during the ongoing COVID19 situation, with delays only arising as an exception rather than the rule.

However, we have seen delays for large company 'RDEC' claims which can take several months to be processed.

Technical report

So how can you mitigate the risk of increased scrutiny and delays?

If your SME business is reliant on a speedy turnaround of your R&D tax credit, any delay could cause significant cash-flow issues. An enquiry by HMRC into a claim could last months and incur additional fees to manage the dispute.

By submitting a technical report with the corporation tax return, a company can help reduce the chances of HMRC asking queries into the claim and thereby delaying it being approved.

Ideally, the report should:

- Outline for each project how it meets the criteria to be considered R&D, and the costs associated with it. HMRC are not looking for weighty volumes covering all aspects of the projects in question, or a detail incomprehensible to a layman, but the report should be sufficient to emphasise why the work was innovative.

- Be updated and improved on an annual basis. A sound approach is to develop a background that can be updated easily with work done during the relevant accounting period.

- Highlight developments in projects spanning multiple years; HMRC are looking for evidence of ongoing R&D activity.

Impact of Covid-19

Care will need to be taken when submitted R&D claims where a company been the recipient of the various government support schemes, including:

- Coronavirus Business Interruption Loan Scheme ('CBILS');
- Bounce-back Loans ('BBLS');
- Furlough Scheme; and
- Job Retention and Support Scheme ('JRSS').

HMRC have confirmed CBILs and BBls are considered 'state aid' and may therefore restrict a company's claim to R&D tax relief where they have been used to subsidise R&D projects. Where this is the case, a claim can still be made under the (less beneficial) large company 'RDEC' scheme.

This will need to be examined on a case by case basis and will vary depending on the loan agreement.

For the Furlough Scheme and JRSS, given the employees will not be working for the company while furloughed, they will not be contributing directly to R&D work. Therefore, only the employees time spent directly on R&D activity can claimed on, which means a claimant will need to take care to exclude any 'non-working' time from their calculations.

HMRC have confirmed, however, that annual leave is included in 'assessable time' when calculating an employee's time spent on R&D and should not prejudice how much of their time is spent on R&D activities.

HMRC are not looking to punish business for claiming these schemes and are likely to be lenient providing the taxpayer takes sufficient care in preparing their R&D claim.

Looking ahead CHANGE HERE

Currently, loss-making SMEs can surrender their R&D losses for a tax credit from HMRC. For many start-ups this has meant the difference between failure and success.

New legislation is set to come into force in April 2021 capping the repayable credit to a maximum of £20,000 plus three times a claimant company's total PAYE and NIC, we believe in order to combat perhaps more aggressive claims made by some companies claiming this repayment.

But what about those companies with minimal employee costs and genuine R&D activity?

A company is exempt from the cap if:

1. Its employees are creating, preparing to create or managing Intellectual Property (IP); and
2. It does not spend more than 15% of its qualifying R&D expenditure on subcontracting R&D to, or the provision of externally provided workers (EPWs) by, connected persons.

Impact of Brexit

It might seem an unusual step to open up the public purse in such uncertain times, and one could not be faulted for assuming the government might intend to limit some of the R&D provisions. However, it is felt that this is unlikely to be the case.

A key priority for the UK will be to encourage new start-ups and tech-leaders to set up shop here – and a way to achieve this is to offer incentives, which will include R&D. One could infer that the current UK offering may not be sufficient to attract big names, as evidenced by Tesla's choice in a new German factory, so given this we are unlikely to see R&D tax relief leave us anytime soon, and indeed might even expect some enhancement to the existing schemes to attract industry to the UK.

A greener future

We also ought not lose sight of the bigger picture, and could expect to see at least some incentives for 'greener' technologies.

A new uplift to R&D for projects revolving around new or more efficient renewable technologies would come as a welcome incentive to the Renewables sector.

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