

## RESEARCH AND DEVELOPMENT

Research and Development (R&D) tax relief were introduced in 2000. They provide tax incentives for companies to invest in innovation. It is a common misconception that this relief is restricted to scientific research or technology companies. Relief is potentially available to any company which carries out activities which seek to resolve technological or scientific uncertainties or make advancements. Claimants obtain enhanced tax relief for qualifying expenditure and can sometimes claim tax repayments from HMRC.

### Overview of the Relief

A company can claim on R&D tax reliefs' expenditure incurred on a R&D project provided it meets the qualifying criteria.

The reliefs can only be claimed by companies. There are two different schemes: the large company scheme and the small/medium sized enterprise (SME) scheme.

The SME scheme is more generous, but has more qualifying criteria that must be met. There may be occasions where a small or medium entity cannot claim under the SME scheme in which case it may be able to claim under the large company scheme instead.

### Qualifying company

For a company to be regarded as an SME it must have fewer than 500 employees, and either an annual turnover of less than €100m, gross assets of less than €86m. Large companies are those that fall above these size limits. Where the claimant company is in a group or has connections to other companies these limits will apply to the group. A company must not be a going concern at the time of claiming.

### Qualifying expenditure

To qualify for tax reliefs, expenditure must meet the conditions set out below:

- The expenditure must be revenue expenditure, used directly in carrying out R&D.
- Expenditure must total at least £10,000 in an accounting period. There is not upper limit on the amount of the claim.

Expenditure must be on:

- Staff costs (including employers pension and employers NI, but not benefits in kind)
- Externally provided workers, e.g. agency staff (65% allowable) \*
- Consumables used directly in the R&D process
- Power, water, fuel used directly in the R&D process
- Computer software
- Subcontracted R&D costs can be claimed (65% allowable) \*

\* Different rules apply were there are connected parties.

### Qualifying R&D Project

Generally speaking, a project will qualify as R&D if it aims to advance the overall knowledge or capability in a field of science or technology where there is scientific or technological uncertainty. A qualifying project could create or significantly improve a process, material, device or product which increases knowledge or capability in a field of science or technology.

An advance in science may have tangible consequences, such as a new more efficient product. It may also have intangible outcomes, for example new knowledge or cost improvements.

Even if the intended outcomes of the project are not fully achieved but R&D still takes place then expenditure can qualify.

The routine analysis and/or adaptation of an existing product, process or material will not be an advance in technology and will not qualify as R&D.

There is a common misconception that qualifying activities are limited to pure research by technicians in laboratories; this is not the case. Any kind of innovation may constitute qualifying activities. If the answer to any of the following questions is yes, then a claim may be possible:

- Have you automated previously manual processes?
- Have you modified manufacturing processes, maybe for specific customer requirements?
- Have you developed new products or upgraded/refined existing products?
- Have you devised bespoke software for a particular purpose?
- Do any of your technical staff undertake research/problem solving?
- Are you market leaders in your field?
- Have you created patents over any of your products?

### Research and development allowances

Capital expenditure (such as plant and machinery) incurred for R&D purposes is eligible for 100% tax relief by way of capital allowances in the year of acquisition rather than the standard 20% allowances available under the normal capital allowances regime. This accelerates the tax relief given on such expenditure.

### Summary of the Reliefs Available

#### SME Scheme

An additional 125% of qualifying expenditure incurred can be claimed against taxable profits. The company therefore obtains 225% tax relief on qualifying expenditure. As from 1 April 2015 this has increased to 230%

Losses arising from the enhanced deduction can be sacrificed to HMRC in return for a cash repayment of up to 32.63% of qualifying expenditure.

The company can claim for expenditure on R&D that it sub-contracts to others.

Claims can be reduced if the project is subsidised or grant funded.

#### Large Company Scheme

An additional 30% of qualifying expenditure incurred can be claimed against taxable profits. The company therefore obtains 130% tax relief on qualifying expenditure.

Losses cannot be sacrificed.

The company can claim for expenditure sub-contracted to others in only limited circumstances.

There is no reduction for grants or subsidies.

### Claims

R&D claims are made through the companies corporation tax computations. HMRC deal with these claims in specialist units and usually require detailed analysis of the projects and qualifying expenditure.

The time limit for claims is two years from the end of the relevant accounting period.

#### Example – SME Scheme

- ABC Ltd incurs £1000,000 of qualifying R&D expenditure during the year. The company is eligible for relief under the SME scheme and the company pays corporation tax at 20%
- ABC Ltd will obtain an additional revenue deduction from its taxable profits of £125,000 as well as the usual £100,000 deduction for the cash actually spent.
- The additional tax saving to the company is therefore £25,000 (125,000 x 20%) minus fees incurred for obtaining the saving itself.