

RESEARCH & DEVELOPMENT (R&D) TAX RELIEF

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Overview

R&D tax relief is designed to give companies (and other entities within the scope of corporation tax) an extra tax boost if they carry out innovative Research and Development. This is an incentive to encourage businesses to do R&D and a way of giving them extra funds to help with the costs involved.

There are two distinct schemes:

- The SME (small and medium enterprises) scheme
- The Large Company scheme

The 'size' criteria for the two schemes are liable to variation, so the situation should always be checked if there is any doubt. Currently, companies with an annual turnover exceeding 100m Euros or an annual Balance Sheet total exceeding 86m Euros and which have over 500 employees must use the Large Company scheme and are not eligible for the SME scheme. There is also an independence test for the SME scheme.

Although the two schemes have much in common, there are also various differences between them in terms of what is allowable and the amount of tax relief available. The main reliefs offered by the two schemes are as follows:

SME scheme

From 1 April 2015 the company is entitled to a 230% rate of enhanced deduction (the usual P&L account deduction, plus an extra 130% deduction in the computation).

A loss-making company can choose, instead of carrying losses forward or surrendering them as group relief, to claim a **payable R&D tax** credit for an accounting period in which it has a surrenderable R&D loss. The tax credit is given at 14.5% of the surrenderable loss. Alternatively, the enhanced loss may be carried forward against future profits for tax relief at 19%. (It is proposed to restrict the cash payment to three times the company's PAYE plus NIC for the period from 2020)

Large Company scheme

The large company scheme operates as a credit in the P&L account, with a corresponding deduction, this is known as "Above the Line"(ATL) relief.

The ATL is a taxable credit being 12% of qualifying R&D expenditure. It will be paid in full, net of tax, to companies with no corporation tax liability.

Other Differences

There are also various other differences between the two schemes:

SMEs can claim for expenditure on R&D they subcontract to others, but Large Companies can only claim for R&D they carry out themselves (or subcontract to qualifying bodies).

SMEs cannot claim for contributions to independent research, whereas Large Companies can claim for this.

For SMEs, if the R&D project is subsidised or a grant is received in respect of it, the R&D claim is reduced. Large Companies do not suffer a reduction.

In some cases SMEs can claim for expenditure under the Large Company scheme if the expenditure qualifies for that but not for the SME scheme.

Other points to note are:

In most cases, expenditure has to be paid, not just accrued, before the claim is made. Expenditure has to be allowable revenue expenditure appearing in the company's profit and loss account and cannot be capital expenditure.

Just because expenditure is shown as R&D in a company's accounts does not mean that it will qualify for R&D tax relief. The definition of R&D for tax relief purposes is very exact and, while the reliefs are generous, the definition is quite restricted.

The time-limit for making R&D claims is usually two years after the end of the accounting period. The claim is included in the tax computation and tax return for the accounting period and does not need to be submitted separately, but should include a full explanation of the R&D projects being undertaken and a breakdown of qualifying expenditure.

As this is a specialist area with specific qualification criteria, R&D tax relief claims are dealt with by designated tax offices. It is usual for clients to confirm to us, based on detailed knowledge of their own situation, that their R&D work is qualifying R&D. They then provide us with full information as to the costs relating to the R&D projects, so that we can prepare the claim. In some cases, we become more involved with the specific project details, for instance if the qualification criteria are queried by HMRC.

The R&D projects

In order to qualify for relief, projects need to fulfil various criteria. In broad terms, this means:

- Projects seeking an advance in science or technology through the resolution of scientific or technological uncertainty; and
- Leading to an advance in the overall knowledge or capability in the field, not just the company's own knowledge or capability

Costs of planning, design, testing and analysis (say up to prototype) do qualify but costs of actual production, distribution and marketing do not.

Ideally, it is good for computations to include a thumbnail sketch of the R&D projects and how they are cutting-edge in words a layman can understand. The progress of the projects should be identified, in order to demonstrate that costs are being claimed only up to prototype stage.

Type of expenditure

As regards the type of expenditure allowable for R&D claims, this falls into the following categories and, as mentioned above, there are some differences between the SME scheme and the Large company scheme, so we recommend clients discuss the specifics with us:

- **Staffing costs**, ie salaries, overtime, bonuses (not benefits), employer's NI and the company's pension contributions. These costs often constitute the largest element of the R&D claim. We need to have an analysis showing the breakdown of the above costs for each employee and the percentage being claimed for that person. HMRC would be very unlikely to accept 100% for a director for instance. It is useful to have a note of the name, job-title or role of each individual and confirmation whether he/she is a director
- **Any expenditure on consumable or transformable materials** (for instance raw materials used up in the R&D and the relevant proportion of related 'water, fuel and power' costs) can be included in the R&D claim
- **Cost of software employed directly in R&D** (not computer maintenance costs)
- **Externally provided workers** (only 65% allowed if agency and not a connected person)
- **Subcontracted activities** (only 65% allowed if subcontractor is not a connected person)
- **Other expenditure** on R&D projects, such as travel and subsistence costs, car hire and motor vehicle costs, telephone costs etc, is not allowable for the purposes of the R&D claim, as these costs do not fall into the specific categories mentioned above

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