

Tax Relief for Research & Development

Overview

The government is keen to encourage UK businesses to undertake research and development (R&D), so the tax legislation provides generous tax reliefs for R&D expenditure. These reliefs have become progressively more generous over the years.

The amounts of relief and the rules for claiming it depend on whether the company concerned (and note the reliefs only apply to limited companies, not partnerships or sole traders) is a 'small or medium sized enterprise' (SME) or not.

An SME is a company that has fewer than 500 employees, and either an annual turnover below 100 million euros, or assets in its balance sheet with a value of under 86 million euros.

This briefing note concentrates on the R&D reliefs for SMEs.

What is the relief worth?

An SME can claim a deduction for 230% of its expenditure on R&D. If it spends £10,000 on the appropriate R&D costs, it can claim a tax deduction of £23,000, thus reducing its corporation tax by £4,370 instead of £1,900.

Alternatively, if the company is making losses and has no corporation tax to pay, it can surrender any losses resulting from R&D expenditure to HMRC for a cash payment equivalent to 14.5% of the loss attributable to the claim for R&D tax relief. Although this rate is less than the rate of tax relief the entity could relieve the expenditure at by way of the deduction of losses carried forward, the cash-flow benefit can be more attractive.

Example – surrendering an R&D loss

Brightco Ltd has a taxable profit for the year of £5,000, before taking into account the extra relief for expenditure on R&D. It spent £20,000 on R&D, so after the 230% uplift, the deduction becomes £46,000 instead of £20,000, converting the taxable profit of £5,000 into a loss of £21,000. Brightco can carry this loss forward to future years, or it can be paid £3,045 cash to surrender the loss.

What expenses can be claimed?

Not all expenditure on R&D qualifies for the 230% uplift. The expenses that do are:

- Staff costs – apportioned to exclude work not on R&D
- Materials – which are “consumed or transformed” during the R&D process
- Utilities – power, water, and fuel used in the R&D process
- Software – if directly used in the R&D programme
- Payments to staff providers (agencies) and subcontractors – restricted to 65% of the amounts paid

This list is exhaustive – if the expense does not fit into one of these categories, it cannot be claimed.

Note that the expenditure must be revenue expenditure (i.e. allowable as a deduction in calculating the taxable profits of the trade), and not capital expenditure. Enhanced capital allowances may be available for any qualifying capital expenditure.

What is R&D?

Too many companies miss out on the possibility of claiming tax relief on R&D because they do not realise they are doing it! HM Revenue & Customs and the profession have identified that lack of awareness is a significant issue with regard to claims not being made in respect of qualifying expenditure.

The basic definition of R&D can be quite simply stated; the trick is to recognise it in the work your company does.

R&D involves:

- A **project** which seeks to achieve;
- An **advance**, or an **appreciable improvement**;
- In **science** or **technology**.

In order to show an advance or appreciable improvement, the project must attempt to solve **an area of scientific or technical uncertainty**. This means that the answer to the problem the project seeks to solve must not, before the project begins, be 'readily deducible from the available knowledge by a competent professional working in the field'.

The word 'project' tends to cause the problem. It suggests that R&D can only take place in a laboratory, with men in white coats with clipboards, whereas much of the R&D that can be claimed for takes place in factories, or in a shed at the back of the business premises.

The test is not whether you have qualified for the Nobel Prize – it is whether you were confronted with a problem that required you to invent or adapt existing technology to arrive at a new solution.

Specialists

If you think your company may be involved in R&D – and your associated expenditure is sufficiently high to make it worthwhile, it is worth considering seeking specialist professional advice.

We have significant experience in assisting companies with R&D relief claims at all stages of the process.

If you would like to find out more about R&D tax relief and how we at RRL can assist, please contact our Tax Partner, Steve Maggs, on 01872 276116 or steve.maggs@rrlcornwall.co.uk

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