

The UK has a very attractive set of tax incentives intended to encourage Research and Development (R&D) activities within the UK. The schemes provide generous tax reliefs and can often result in significant cash repayments from HMRC. Despite this, many businesses are unaware of the reliefs that are available to them and therefore may miss out on these valuable incentives.

The Tax Reliefs Available

The UK has, broadly, two different R&D incentive schemes, applying to enterprises of different sizes.

SMALL & MEDIUM SIZED COMPANIES (SMEs)

For the purposes of the UK R&D tax incentives, an enterprise is an SME if it has:

- fewer than 500 employees; and either
 - an annual turnover <€100M; or
 - a gross balance sheet assets total <€86M

If the company is part of a group, the group as a whole must satisfy the above limits. Any company that exceeds these size criteria for SMEs is treated as a 'large' company and can qualify for tax reliefs under the Large Company Scheme.

Where an SME satisfies the qualifying conditions it will be entitled to a 'super deduction' in relation to allowable R&D costs of 130% i.e. for every £100 of qualifying expenditure the company can claim an additional tax deduction of £130. Thus, for every £100 of eligible expenditure spent the company's tax bill will reduce by £26 as a result of claiming the relief, in addition to the £20 tax relief that the original £100 generates, giving a total of £46. If the company is not paying taxes as it is loss-making then these additional losses can be carried forward against future profits.

This tax repayment from HMRC will be equivalent to 14.5% of the lower of the qualifying, enhanced R&D expenditure and the total of the company's trading

losses for the year. For every £100 spent on qualifying R&D costs it is possible to claim a refund of £33.35. The rate of relief has increased in recent years so the refunds in respect of historic claims may be lower.

The time limit for making such claims is 2 years from the end of the relevant accounting period (i.e. for an accounting period that ended on 30 June 2020 a claim must be made before 30 June 2022)

LARGE COMPANIES

Companies that do not qualify as SMEs can benefit from a different, less generous, R&D tax incentive called the R&D Expenditure Credit (RDEC). This scheme also applies to SMEs that receive subsidies for their R&D or where they undertake R&D as subcontractors for large companies.

The RDEC is effectively a grant equal to 13% of the qualifying R&D costs (12% prior to 31 March 2020). This grant is taxable income in the hands of the company and the overall effect is that £100 of qualifying cost will generate a payable credit of £10.53.

Where expenditure is capitalised as an intangible asset, the RDEC can still be claimed, and the amount of R&D capitalised can be treated as an expense in the year for tax purposes.

CAPITAL EXPENDITURE

The above reliefs apply only to expenditure which is revenue (not capital) in nature. Capital costs (for example, those relating to the purchase of equipment used in the R&D process) may qualify for 100% capital allowances (Research & Development Allowances) instead giving an immediate write off of this expenditure for tax purposes. There is no option to surrender any loss created by these allowances for a tax credit.

What Exactly is R&D?

The technical definition of R&D is somewhat complex, but in broad terms for a company to be carrying on qualifying R&D it must be undertaking a project seeking an advance in science or technology through the resolution of scientific or technological uncertainties. For example, in a software project, you may need to demonstrate that software relies on newly developed algorithms or architectures which break new ground in the industry sector as a whole.

R&D can include not only the design of products and services and software involving new technology but also substantially improving existing products and services. The definition also includes the construction of prototypes and certain indirect activities that, while not directly R&D, are necessary for the R&D process, for example recruitment of staff for R&D work or maintenance of R&D facilities. Successful R&D claims have been made in many sectors ranging from civil engineering to recruitment consultancies.

Qualifying Expenditure

Enhanced R&D reliefs can only be claimed in relation to certain categories of costs relating to R&D activities. Qualifying expenditure includes:

- Gross staff costs- this includes employer's national insurance costs and pension payments, but benefits in kind are generally excluded;
- Software used in the R&D process;
- Materials consumed or transformed in the R&D process;
- Utilities such as water, gas and electricity;
- The cost of engaging workers employed by another entity (e.g. an agency or group service company); and
- The cost of subcontracting parts of the R&D process to other companies (SME scheme only)

It should be noted that the last two categories of cost will not qualify in full and the qualifying cost will be limited to 65% of the actual cost in these cases. However externally provided workers from a group related

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R&D TAX RELIEF

Get in touch

If you would like to find out more, please feel free to contact our Tax specialists who are happy to help.



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