Research & Development Tax Relief

Enhanced tax relief is available to companies for qualifying Research & Development (R&D) costs

R&D tax relief has been around for approximately 20 years and is one of the few government accredited tax relief schemes available for companies.

In recent years the number of claimants has increased significantly. However there are still many companies who have yet to take advantage of the scheme.

To benefit the conditions and definitions described below need to be met.

Definition of R&D

The definition of "R&D" for tax purposes is based on the generally accepted accounting treatment of R&D, which was further modified and adapted by the former DTI in 2004 into detailed guidelines for tax purposes.

In summary, an activity can qualify as R&D if it is characterised by work that contains an appreciable element of innovation and technological advancement in a field of science and technology that leads to the creation of a new or "appreciably improved" product or process.

For an activity to qualify it must also:-

- seek to resolve a scientific or technological uncertainty
- be by way of systematic investigation

Routine modifications or adaptations that are easily achieved are therefore excluded and it needs to be demonstrated that the technological objective of a project created a challenge to the team of technical staff in the company. An indicator of R&D is that a project needed a number of iterations to succeed - in fact if a project fails by reason of technological problems, this is a strong R&D candidate!

The scheme is open to a diverse range of industries, such as agriculture, medicine, software, green technology, and manufacturing. The only areas which are not considered R&D as "science and technology" are in the "social sciences" such as in the arts, humanities and economics. However even these can form part of an R&D claim if other technologies are brought in (e.g. a software package built to an interactive economic model could qualify as an advance in software).

Two kinds of relief

The tax relief given for qualifying R&D depends in part upon the size of the company as two separate schemes operate.

Small and Medium-Sized Enterprise ("SME") Scheme

To qualify for SME treatment the company must pass a test of having less than 500 employees and either a turnover of up to €100m or a balance sheet value of less than €86m.

Certain upstream investors such as investment funds/corporate shareholders or linked enterprises need to be taken into account in certain circumstances. Therefore care needs to be taken to examine the impact of these rules as the size test may not apply to the company in isolation.

The RDEC Scheme - Large Company Scheme ("Above The Line" rules)

If a company does not fall to be an SME, it is dealt with under the large company R&D Expenditure Credit (RDEC) scheme.

Comparison of R&D Schemes

SME scheme	RDEC / Large company scheme
Enhanced deduction of **130% of qualifying expenditure** against taxable profits/losses for Corporation Tax from 1 April 2015 onwards. Where the relief is offset against taxable profits the effective rate of tax relief is 24.7%. Where the relief creates or enhances a tax loss, there is an option to cash in an R&D tax credit for **14.5%** of the "surrenderable loss" (rather than carry the loss forward at a future rate of 19%). The "surrenderable loss" is the lower of 230% of expenditure or the overall tax loss after R&D. The R&D tax credit is equivalent to 33.35% where a full surrender is possible. From April 2021 the repayment will be capped at 3 times the company's total PAYE & NIC bill (including all staff and employer's NIC costs).	Instead of the enhanced deduction a taxable "above the line" credit is available: - 11% from 1 April 2015 - 12% from 1 January 2018 - **13%** from 1 April 2020 Although this forms part of the company's taxable profits/losses, a credit for the same amount is claimed later on in the tax computation. Therefore the overall net savings are typically 10.5% from 1 April 2020. The relief acts to reduce tax payable or provide a repayable tax credit (known as an RDEC) if losses arise and there is no tax liability. The payment of the RDEC credit is subject to a cap based on PAYE and NIC paid that relates to the employees in the RDEC claim.

SME scheme	RDEC / Large company scheme
HMRC have a target of 30 days to pay out R&D tax credits.	There is no set time limit for HMRC to pay out RDEC – however expect 2 to 3 months.
Company can claim for expenditure on R&D it subcontracts to others	Company can generally only claim for expenditure on R&D it carries out itself
Company cannot claim for contributions to independent research (e.g. universities).	Company can claim for contributions to independent research (e.g. universities).
Claim can be reduced or blocked if the R&D project is subsidised or grant funded (however it can claim under the RDEC scheme for any costs affected in this way).	No reduction for grant supported or subsidised expenditure.

Time Limits

R&D tax relief is not given automatically. It must be claimed in the company's Corporation Tax Return (Form CT600).

As a result the claim for the enhanced relief must be made within the time limit for any amendments to the Company Tax Return, namely within two years of the end of the company's accounting period.

To provide a robust claim it is necessary to provide HMRC with a computation of the enhanced relief, together with a description of the projects undertaken.

Qualifying R&D Expenditure - SME Scheme

To qualify for the more valuable enhanced relief available for Small and Medium-sized Enterprises, only expenditure meeting the following criteria is eligible:-

- Attributable to relevant research & development projects
- It is incurred on staffing costs, consumable items, utilities, software, payments to clinical trial volunteers, agency staff or qualifying subcontracted work
- Not capital expenditure (but this may qualify for a separate allowance), unless it would have been revenue expenditure apart from a decision to capitalise in the accounts
- The company does not act as a subcontractor to its customer (although if the customer is "large" it can claim under the RDEC scheme)
- The expenditure is not subsidised or covered by a grant. However where this occurs it can claim under the RDEC scheme

Definition of staffing costs

Staffing costs are all amounts paid to directors, employees and externally provided employees (agency workers, etc.) including:-

- Gross pay, bonuses and fees paid, but not the cost of providing benefits in kind, such as company cars
- Employer's NIC paid in respect of these payments (i.e. not Class 1A or 1B NIC on benefits)
- Employer's pension payments (e.g. such as those made under auto enrolment).
- Reimbursed travel and subsistence incurred while carrying out R&D.

The employees must be either:

- Directly connected with the R&D project (meaning that they are undertaking the R&D or providing technical support, or are managers who plan and organise the programme of research), or
- Provide specific logistical support to those carrying on R&D (e.g. maintenance of labs, HR duties).

Definition of subcontractor costs

If an SME subcontracts all or part of its R&D work to another person it may be able to claim R&D tax relief on its payments to the subcontractors.

The rules for claiming relief on this type of expenditure are complex and the rules differ depending on whether the subcontractor is a "connected person".

If the subcontractor is connected, the company can claim relief on the lower of the amount brought into the subcontractor's accounts in respect of costs related to R&D work and the amount of the company's payment to the subcontractor.

If the subcontractor is not connected, the company can claim relief in two ways, either by making a joint election with the subcontractor to be treated as connected (as above), or, by claiming 65% of the payment made to the subcontractor.

Large companies can only claim for research sub-contracted to individuals or certain qualifying organisations (charities, universities, health service bodies, etc.).

Definition of consumable items

Expenditure on consumable items is expenditure on materials (such as chemicals, electronic components, etc.) that are used up or transformed in the R&D activity. These items must not be useable in their original form after the research project and cannot be incorporated into products that are subsequently sold.

There is specific relief for utilities (water and power), but not for services such as telecoms, server hosting, hire of equipment or lab hire.

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