# 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 over 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.

### 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.

HMRC have in 2023 provided a further updated definition for R&D relief and the criteria that will need to be met in order to make a qualifying claim. We would strongly recommend the below link is read before pursuing a R&D claim in order to ensure the work being done by your company meets the qualifying criteria.

https://www.gov.uk/government/publications/guidelines-on-the-meaning-of-research-and-development-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. From April 2023, this will also incorporate work undertaken on 'pure mathematics.'

For an activity to qualify it must also:-

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

HMRC state that 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 to 31 March 2023. | Instead of the enhanced deduction a taxable "above the line" credit is available:<br>- **13%** from 1 April 2020<br>- **20%** from 1 April 2023 |
| This deduction is in addition to relief for the expenditure under normal rules, making the total deduction 230%. | Although this forms part of the company's taxable profits/losses, a credit for the same amount is claimed in the tax computation. |
| Where the relief is offset against taxable profits the effective rate of the additional tax saving is **24.7%**. | Therefore, after tax, the net savings are typically **10.5%** up until 31 March 2023. |
| For expenditure incurred from 1 April 2023 onwards, the additional deduction decreased to **86%** making the total deduction **186%.**<br><br>Where the relief is offset against taxable profits the effective rate of the additional tax saving is **21.5%** for large companies and **16.3%** for small companies. | From 1 April 2023 for a company paying corporation tax at the lower rates the effective saving will be **16.2%.** For companies paying corporation tax at the higher rate the effective net saving will be **15%.** |

| SME scheme | RDEC / Large company scheme |
|---|---|
| **Prior to April 2023** 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 to save future Corporation Tax at a rate of 19%).<br><br>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.<br><br>**Post April 2023** the tax credit described above will decrease from 14.5% to **10%**. This change though will not impact a loss-making SME that is deemed to be R&D intensive.<br><br>An organisation is deemed to be R&D intensive if 40% or more of their expenditure relates to qualifying R&D expenditure. | The relief acts to reduce tax payable or provide a repayable tax credit (known as an R&D Expenditure Credit or RDEC) if losses arise and there is no tax liability to offset the RDEC against. |
| Any **repayment** will be capped at £20,000 plus 3 times the company's total PAYE & NIC bill (including all staff and employer's NIC costs). This does not restrict the enhanced R&D expenditure. Any loss that is capped from repayment will be relieved in the usual way.<br><br>The cap does not apply to work on creating patents and similar rights where no more than 15% of the R&D spend relates to connected party costs. | **Repayment claims** are capped based on the company's PAYE & NIC bill for workers engaged in R&D.<br><br>Restricted RDEC amounts are carried forward to the next accounting period. |
| 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, capped at 65% unless a connected party election is made. | 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 with page CT600L), with outline details submitted via an electronic portal before the Corporation Tax Return is submitted.

It is necessary to provide HMRC with a computation of the enhanced relief, together with a full description of the projects undertaken.

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.

## Notification of New Claims

For accounting periods starting on or after **1 April 2023**, companies that have not previously made a claim for R&D relief, or companies that have not made a R&D claim in the prior three accounting periods, will be required to submit to HMRC a pre-notification form.

This notification must be submitted to HMRC within **6 months of the end of the relevant accounting period.**

In addition to the above the actual enhanced relief claim must also 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.