

Research and Development (R&D) Tax Relief SME Scheme

Research and Development (R&D) tax relief can prove an extremely valuable tax relief and, for companies carrying out significant qualifying R&D projects, it may mean not having to pay any corporation tax for many years or even claiming a repayment from HMRC.

Despite the above it still remains a relatively under-claimed relief with companies believing the rules and qualifying criteria to be complex and prohibitive.

For SMEs, a deduction of 230% can be made from taxable profits, reducing the corporation tax due.

For loss making companies, the scheme allows up to 33.35% of a company's R&D spend to be recovered as a cash repayment.



However, HMRC are slightly relaxing their approach and with specialist advice from Dixcart, companies do not need to be developing ground breaking products. Indeed, to qualify for R&D tax relief a company could be developing their own version of an existing product to suit their needs for the marketplace or maybe because they do not have access to a competitor's knowledge.

The actual processes carried out by a business can also lead to an R&D claim. For example, if a business can show how they have improved their manufacturing processes using existing knowledge or equipment, there could be some element of R&D available.

WHAT IS THE QUALIFYING CRITERIA FOR COMPANIES?

Firstly, only incorporated companies can claim R&D Relief because it is linked to the payment of corporation tax. The company must also be a going concern; this means it must be able to continue operating and conducting its R&D projects whether it receives the tax relief or not.

The Government allows small to medium sized businesses who qualify for R&D tax relief to either reduce their corporation tax liabilities by claiming the relief or receive a tax credit instead, by way of a cash sum paid by HM Revenue & Customs (HMRC). The definition of a small to medium sized business (SME) in the case of R&D tax credits specifically, is currently a company or organisation with fewer than 500 employees and either an annual turnover not exceeding €100 million or a balance sheet not exceeding €86 million.

Schemes are available for large companies, but this note focuses on the SME scheme.

HOW MUCH TAX RELIEF CAN YOU CLAIM?

The tax relief has increased over the years, but SME's can now claim 230% of all allowable R&D costs for projects. For instance, for every £100 of costs incurred, the Government allows qualifying companies to reduce their taxable profits by £130 in addition to claiming for the £100 already paid as tax deductible expenses.

If the SME incurs an allowable trading loss as a result of R&D relief, then the company has the option of surrendering part or all of the loss relating to the R&D relief and claiming an R&D tax credit in the form of an immediate cash payment from HMRC. The SME can surrender to HMRC a loss up to the lower of:

- 230% of the qualifying R&D expenditure (i.e. all of the expenditure plus the relief); and
- the total loss of the trade, after deducting any claim made (or which could be made) to set the loss against other profits or gains of the company in the same accounting period and deducting any other relief claimed for the losses (including losses carried back to earlier accounting periods or surrendered to group companies as group relief).

The amount of payable tax credit that a company is entitled to for an accounting period is 14.5% of the surrenderable loss for that period. R&D tax relief applications can be backdated by up to two years and so companies who have not previously claimed can maximise their relief.

For accounting periods beginning on or after 1 April 2021, the payable R&D tax credit that a loss-making SME can receive will be capped at £20,000 plus 300% of its total Pay as you Earn (PAYE) and National Insurance Contributions (NICs) liability for the period. The cap therefore does not apply for companies whose payable credits is not more than £20,000. A company is exempt from the cap if: the claimant company's employees are creating, preparing to create or actively managing Intellectual Property (IP); it does not spend more than 15% of its qualifying R&D expenditure on subcontracting R&D to, or the provision of externally provided workers (EPWs) by, connected persons.

WHAT TYPES OF PROJECTS WILL QUALIFY FOR R&D TAX RELIEF?

R&D Tax Relief is only available for companies embarking on trade related projects that will achieve 'an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technological uncertainty'. This is different to just advancing an existing state of knowledge or capability and the condition of 'trade related' is important because the project must fall within the confines of the company's existing trade, or be in a new trade it intends to diversify into, subject to the results of the R&D activity.



Common examples of projects that may qualify include:

- Innovative methods of capturing, transmitting, manipulating, and protection data;
- State-of-the-art software for new projects, or new functionality for existing R&D projects;
- Improvements to programming language;
- Designing, constructing, and testing product prototypes;
- New methods of capturing, utilising or communicating data;
- Developing processes that would meet increasing regulatory requirements; or,
- Streamlining manufacturing processes through automation.

“A wide variety of business sectors can potentially qualify for R&D relief. It is not just ‘men in white coats.’”

- Paul Webb, Tax Director

There are currently two R&D schemes available to UK businesses: the SME regime and the Research and Development Expenditure Credit (RDEC) regime for larger organisations. Depending on which category your business falls under, the benefits available will differ.



WHAT IS HMRC LOOKING FOR IN AN APPLICATION FOR R&D TAX RELIEF?



1

EVIDENCE OF REAL SCIENTIFIC OR TECHNOLOGICAL ADVANCE

They will want to understand what scientific or technological advance is being sought by the activities and what the overall aims of the project are. A successful application must go beyond simply being commercially innovative and cannot include the development of products or services that are non-scientific or non-technological. For this reason, economic advances are not allowable.

2

EVIDENCE THAT REAL SCIENTIFIC OR TECHNOLOGICAL UNCERTAINTIES EXIST WHICH THE PROJECT SEEKS TO RESOLVE

The determining factor here is that prior to embarking upon the project, there was little or no knowledge available from professionals working in the same field to indicate whether the project is scientifically possible or technologically feasible and how it can be achieved.



3

EVIDENCE PROVING HOW AND WHEN THE UNCERTAINTIES WERE OVERCOME AND WHY THIS KNOWLEDGE WAS NOT READILY AVAILABLE

It is important to explain how the company or organisation intends to overcome the uncertainties and the investigations and analysis undertaken, to clearly demonstrate this was a complex matter. It is also important to include details of the individuals working on the project to demonstrate their professional competence in the area being researched and their suitability for the role.

WHICH COSTS QUALIFY FOR R&D RELIEF?

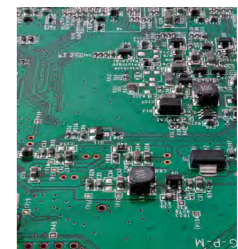
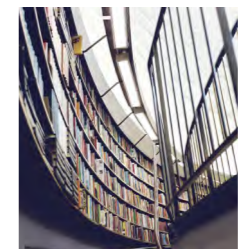
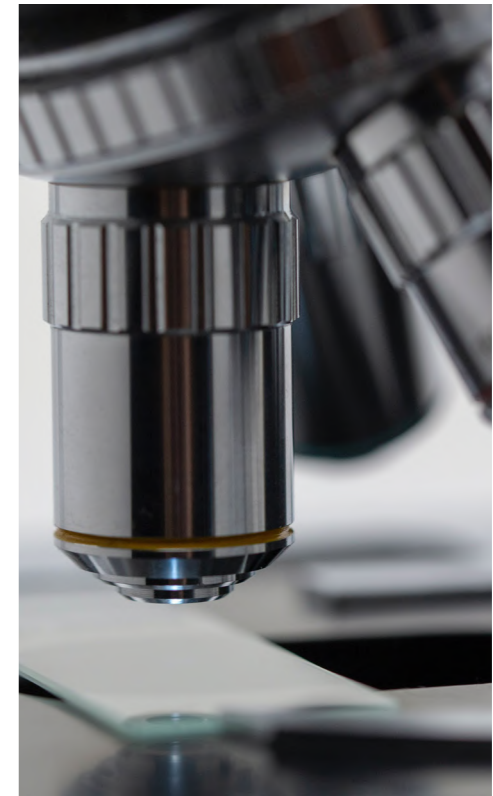
If your claim is successful, it is possible to obtain tax relief or credits for the running costs incurred in carrying out the R&D. This is a complex area because different rules apply according to whether you are using employees or sub contractors to complete the project, and if the latter, lower rates of tax relief apply.

The costs claimed must be apportioned in relation to how much of a 'resource' was used wholly and exclusively for the project. For example, for an employee spending 70% of his or her time on the project, 70% of their cost can be claimed, with the remaining 30% not being eligible for the additional relief.



In summary the following costs are usually allowable:

- Cost of specialist employees or subcontractors (special rules apply for the latter and tax relief at 65% of costs only can be claimed - see below)
- Purchase of certain specialised assets for use during the project (subject to certain rules)
- Purchase of raw materials and consumables utilised during the course of the project although new rules restricting claims for expenditure of this type are to be introduced from 1 April 2015.
- Cost of utilities, e.g. power, fuel, and water used during the project but not rent, telecommunications or data costs.



SUB CONTRACTED R&D

If you have subcontracted some or all of your R&D activities to another company e.g. testing at a 3rd party laboratory, the default position is that you can only include 65% of the amount charged by that subcontractor when calculating the enhanced relief available.

If, however, the subcontractor is a connected company (or willing to elect to be treated as such) then it may be possible to include more than 65%. For connected a connected company relief can be claimed on the lower of:

- the payment made to the connected party, and
- the relevant staff costs incurred by them.

An unconnected SME and staff provider can make an irrevocable election to be treated as connected parties to improve the SME's R&D claim, but this does require the staff provider to share what may be commercially sensitive expense details with the contracting SME.



OVERSEAS R&D

One interesting point to note is that the R&D activities do not need to be carried out in the UK to qualify for relief.

A UK company may for example subcontract R&D to a company in India (this may be a 3rd party or a connected company) and this would, providing all other conditions are met, be an eligible cost.



ADVANCE ASSURANCE

Small companies making their first R&D claim can apply to HMRC for Advance Assurance that their activities will qualify as R&D. To be eligible, the companies must also have an annual turnover of less than £2million and less than 50 employees.

Advance Assurance is not compulsory but, by doing so, applicants can ensure they comply with the R&D tax relief conditions.

In order to apply for Advance Assurance, the following information will be required to be sent to HMRC:

- company accounts
- company registration documents (from Companies House)
- HMRC correspondence
- previous company tax returns (not needed for new companies)
- the name of a main contact with a direct knowledge of the R&D process.
- basic company information
- detailed information on company's R&D activities.

A successful application means that HMRC will not open any enquiries into the claim for the first three accounting periods. HMRC will also write to the business to confirm what changes can be made to R&D credits as part of an existing agreement.



CASE STUDY

Our client is involved in the production of electronics and hardware systems for the defense sector.

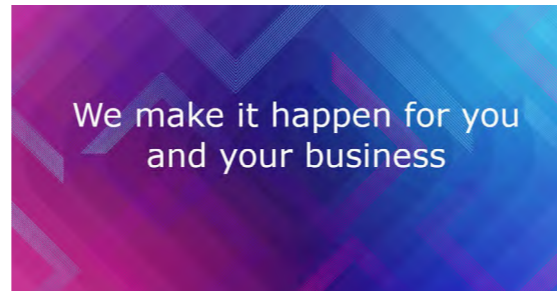
Through discussions with the company director, we identified a number of projects, both historical and ongoing, that would qualify as R&D.

Having carried out a detailed analysis of the costs including staff salaries, externally provided workers and other overheads, we were able to identify the appropriate allocation of these costs to the qualifying R&D activities.

A detailed claim document and related calculations were prepared and submitted to HMRC to support the claim.

To date, more than £7.8m of enhanced expenditure has been claimed, giving an additional tax saving of £850,000.

Next Steps



DIXCART UK

If you think your company may be carrying out qualifying R&D activities, or even if you are not sure then please get in touch.

Our specialist team will take all the hassle away from you and you can be confident that your claim will be handled quickly and efficiently to maximise the relief available.

Please contact [Paul Webb](mailto:Paul Webbs) on 0333 122 0000 or email hello@dixcartuk.com to arrange a free no obligation consultation.

1

COMPLIMENTARY MEETING

Find out if you qualify for R&D relief.

Our professional advisors are offering a complimentary phone call or meeting to help you determine if your business qualifies for R&D relief.

2

YOUR CLAIM

One team, one goal. We make it happen.

Our combined tax, legal and accounting professionals will build and evaluate your R&D claim to maximise the relief available.

3

WE TAKE AWAY THE HASSLE

We deal with everything from start to finish, including HMRC approval, the drafting of the claim and accompanying report, and submission of the finalised paperwork. No risk to you - we only charge a % of the tax saved on a successful outcome.