

## Research & Development Tax Credits and Enhanced Expenditure Relief

*The Ryecroft Glenton Technology Team highlights important changes that improve the R&D Tax Reliefs for companies.*

Research and Development (R&D) by UK companies is being actively encouraged by Government through a range of tax incentives. The government views investment in research and development (R&D) as a key to economic success. It is therefore committed to encouraging more smaller and medium sized (SMEs) companies to claim R&D tax relief which can either reduce a company's tax bill or provide a cash sum (tax credits) for companies not in profit.

The government's commitment to improving access to R&D highlights the need for more SME companies to understand what relief is available and how the process of claiming tax relief works. Recent changes to R&D scheme rates have increased the relief available so a clear understanding is needed to ensure that companies are aware of how the tax rules work.

In the Autumn Statement 2016 the Chancellor highlighted that research and development is a key driver for economic growth and has committed to an extra £2 billion a year of additional funding by 2020/21. The government will also review ways to build on the 'above the line' tax credit which is covered in the section on Research and Development Expenditure Credit scheme below.

### What are the tax reliefs available for SME companies?

The R&D tax relief works by allowing eligible companies to deduct up to 230% (from 1 April 2015, previously 225%) of qualifying expenditure on R&D activities when calculating their profit for tax purposes. If losses are made under the SME Scheme the tax relief can be surrendered to claim payable tax credits in cash from HM Revenue & Customs (HMRC) instead of loss relief. This is 14.5% for expenditure incurred on or after April 2014. A surrendered loss could therefore give a repayment of up to 33.35% of the expenditure.

Where the company incurs qualifying R&D expenditure before it starts to trade, it can elect to treat 230% of that expenditure as a trading loss for that pre-trading period. The pre-trading loss created by the R&D relief can then be surrendered, as above, which could provide much needed cash flow for new companies.

Qualifying R&D capital expenditure incurred by a company is eligible for 100% research and development allowance. If you think you have qualifying capital expenditure, then please discuss this with us.

### Example of an R&D claim and tax credit

A company has adjusted net profits of £50,000 before an R&D claim and allowable R&D expenditure of £70,000.

The enhanced claim is therefore an additional £70,000 x 130% = £91,000.

Deducting this from the adjusted profits gives a loss of £41,000. The company can decide to surrender this loss for a cash repayment. The amount they would receive is £41,000 x 14.5% = £5,945.

### Research and Development Expenditure Credit scheme (RDEC)

R&D relief under the SME scheme is not available if the R&D project has had the benefit of a grant or subsidy. There may, however, be an alternative claim available to the company. This is known as the Research and Development Expenditure Credit scheme (RDEC). RDEC allows the SME to claim a taxable credit of 11% of eligible expenditure. As this amount is taxable it is known as an 'above the line' credit. This 11% rate is for expenditure incurred on or after 1 April 2015. Prior to that date the rate was 10%.

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The credit received is used to settle corporation tax liabilities of the current, future or prior periods subject to certain limitations and calculations. Where there is no corporation tax due the amount can be used to settle other tax debts or can be repaid net of tax.

The RDEC relief is also available to an SME for expenditure incurred on R&D that is contracted to it by a large company.

## What is R&D for tax purposes

R&D relief can only be claimed by companies that have incurred expenditure on qualifying R&D projects that are relevant to the company's trade. A project should attempt to address an area of scientific or technological uncertainty and be innovative. The innovation needs to be an improvement in the overall knowledge in the relevant field of research, not just an advancement for the company.

An important point to appreciate is that the activity does not have to create something completely new from scratch.

We have successfully made claims on behalf of clients who were developing:

- improved database computer software;
- new processes to manufacture colour chemicals;
- new printing processes;
- algorithms to model industrial bio-processes and rheology sensors;
- remote medication dispensation systems;
- storage of foods to achieve increased shelf life;
- development of gluten free recipes;
- technological improvements to precision tools;
- among many others.

Companies should document the uncertainties and planned innovation at the start of a project to provide evidence to support an R&D claim.

Once the company is comfortable that R&D is taking place, then the next step is to identify the activities of the business that relate to the R&D activity.

## Relevant activities on R&D

There are essentially two types of activities:

- those that contribute directly to achieving the advancement
- certain activities that indirectly contribute to achieving the advancement.

Examples of direct activities are:

- scientific or technological planning;
- scientific or technological design, testing, and analysis;
- activities which design or adapt software, materials or equipment.

Examples of indirect activities are:

- information services eg preparation of R&D reports;
- indirect supporting services eg maintenance, security, clerical;
- ancillary services eg paying staff, leasing laboratories and equipment.

Indirect activities would have to be undertaken for the R&D project.

Once the project begins to be involved in the production process, any R&D activities are treated as having stopped as development has finished. It is therefore beneficial for companies to keep a timeline of activities and their purposes to detail when the business starts to move into the production phase and therefore optimise their claims prior to that point.

## What costs qualify for the R&D Tax Enhancement?

Companies can claim R&D tax expenditure enhancement for their revenue expenditure on:

- employing staff who are directly and actively engaged in carrying out R&D;
- paying a staff provider for staff provided to the company who are directly and actively engaged in carrying out R&D;

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- consumable or transformable materials used directly in carrying out R&D (broadly, physical materials which are consumed in the R&D); and
- power, water, fuel and computer software used directly and exclusively in carrying out R&D.

For expenditure on or after 1 April 2015, any consumables or transformable materials that are included in a product that is sold, transferred or hired out will no longer be qualifying expenditure for R&D relief.

## *Costs of work subcontracted out and externally provided workers*

Where the SME subcontracts qualifying R&D work to a subcontractor, the SME can claim a deduction for the cost of the subcontractor work. The amount that can be claimed depends on whether the SME is connected to the subcontractor but generally it is 65% of qualifying costs. Similar rules apply to externally provided workers.

## Helping smaller companies

The government introduced a voluntary Advanced Assurance scheme for small businesses making their first claim. Successful applicants will receive assurance that HMRC will allow their first three years of R&D tax relief claims without further enquiry.

In addition, there will be new bespoke guidance aimed at smaller companies and more direct communication between HMRC and companies that are already claiming, or thinking about claiming, R&D tax relief.

## We can help

- R&D tax credit computations are necessarily more complex than normal corporation tax computations.
- We have the appropriate software to help.
- We have experts who regularly complete these claims for clients and are often able to increase the claims above the client's initial expectation.
- We have experience of re-opening previous years' corporation tax computations for new clients in order to make retrospective claims for R&D tax credits.
- We prepare R&D expenditure enhancement and tax credit claims for many of our clients, but also for clients who retain other accountants.

**If you think your company may be eligible to claim R&D expenditure enhancements or tax credits, please do contact Detlev Anderson on 0191 281 1292 or by e-mail at [detlevanderson@ryecroft-glenton.co.uk](mailto:detlevanderson@ryecroft-glenton.co.uk)**

**ANY INITIAL DISCUSSION WITH US IS FREE**

*If you would like to discuss R&D relief and how this may be of benefit your business please contact one of our team:*



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Is it worth reading any further?

This chart indicates whether a company undertaking one R&D project is likely to be eligible for R&D tax reliefs or R&D tax credits.

