

A guide to Research and Development (R&D) Tax Relief for Small and Medium-Size Enterprises



ACCA

A SIMPLE GUIDE TO RESEARCH AND DEVELOPMENT TAX RELIEF

This is a basic guide prepared by the Technical Advisory Service for members and their clients. It is an introduction only and should not be used as a definitive guide, since individual circumstances may vary. Specific advice should be obtained, where necessary.

The Government wants to send out the signal loud and clear that Britain is open for business.

Central to the government's plans is to provide 'the most competitive corporate tax system in the G20, in order to support strong and sustainable growth'. In recent years numerous businesses have left the UK amid concerns over tax competitiveness and the government is keen to stem and indeed reverse this trend. The government has undertaken a staged program of cuts in corporation tax rates and has also been consulting on the modernisation the taxation of foreign subsidiaries, as well as looking at targeted measures in certain areas.

Creativity and innovation will be crucial to the future of the UK economy and it is therefore crucial that 'the most competitive corporate tax system in the G20' includes sufficient tax breaks for expenditure on innovation.

One of the key features of the proposed corporation tax reforms is to create a more favourable tax regime for expenditure on innovation and intellectual property. The government has been consulting on the future of the research and development tax system. The current system of R&D tax credits is quite generous up to a point but the consultation will look at extending tax breaks further into the life-cycle of innovative products.

Below we look at the Research and Development tax regime as it currently stands following the 2014 Autumn Statement.

Research And Development (R&D) Tax Regime

Tax relief for expenditure on R&D is provided for in Part 13 of Corporation Tax Act 2009 and offers a system of enhanced tax deductions/credits for qualifying expenditure

What Qualifies as R&D Expenditure

R&D is defined as activities falling to be treated as research and development in accordance with generally accepted accounting practice, but the Treasury have powers to modify the definition by specific regulations. The relevant standards for this are SSAP 13 under UK GAAP and IAS 38 under International GAAP.

For the purpose of the tax reliefs available, research and development (R&D) has the meaning given by section 1138 of the Corporation Tax Act 2010. This means activities which fall to be so treated in accordance with generally accepted accounting practice, but not including oil and gas exploration and appraisal. The BIS website contains Guidelines on the Meaning of Research and Development for Tax Purposes at <http://www.bis.gov.uk/assets/biscore/corporate/docs/r/rd-tax-purposes>

The current definition is:

'R&D for tax purposes takes place when a project seeks to achieve an advance in science or technology. The activities which directly contribute to achieving this advance in science or technology through the resolution of scientific or technological uncertainty are R&D. Certain qualifying indirect activities related to the project are also R&D. Activities other than qualifying indirect activities which do not directly contribute to the resolution of the project's scientific or technological uncertainty are not R&D.'

Related to the trade

There is a requirement that the R&D carried on by the company is either related a trade carried on by the company or from which it is intended that such a trade will be derived. R&D related to a trade includes any R&D which may lead to or facilitate an extension of the trade and medical research that has a special relation to the welfare of workers employed in that trade.

There are two schemes for claiming relief, depending of the size of the company:

- The Small or Medium-sized Enterprise (SME) Scheme
- The Large Company Scheme

This guide looks at the reliefs available for SMEs. We have produced a separate Guide to the large company scheme.

Definition of Small and Medium-sized Enterprise

Although Commission Recommendation 2003/361/EC sets limits defining a micro, small or medium-sized enterprise, these limits are extended for the purposes of R&D relief in relation to expenditure incurred on or after 1 August 2008 by limits set by Treasury regulations.

For the purposes of R&D relief from 1 August 2008, an SME is a company meeting the EU SME definition but with the following wider limits:

Number of employees	< 250	< 500
And either of the following:		
Annual turnover	≤ EUR 50 million	≤ EUR 100 million
Balance sheet total	≤ EUR 43 million	≤ EUR 86 million

An entity's employee, turnover and balance sheet figures must be aggregated with figures for certain 'linked enterprises' and 'partner enterprises'.

The Small or Medium-sized Enterprise (SME) Scheme

From 1 April 2012, the £10,000 minimum spend requirement is removed for SMEs. Prior to that, an SME was entitled to R&D tax relief for an accounting period in which it has total qualifying R&D expenditure of not less than £10,000.

Some conditions are specific to the SME scheme. These are:

- The company must not be in receipt of a notified state aid in respect of the project
- Expenditure must not be subsidised
- The company must not have been contracted to carry out the R&D
- The company must be a going concern (see below)
- The R&D project must not receive total aid of more than €7.5million

Method of Relief

- Small and medium-sized companies as defined can claim R&D tax relief for 230% incurred from 1 April 2015. For expenditure incurred between 1 April 2012 and 31 March 2015, companies could claim 225%. Prior to that, they could claim relief of 200%. The relief would normally be claimed by deducting from taxable profits in the company's corporation tax computation, an additional amount equal to 130%, 125% or 100% of the R&D expenditure, depending on when it was incurred.
- Relief at 230% of the expenditure gives companies liable to pay the small profits rate of 20% a tax saving equal to 46% of the R&D expenditure.

Example:

Cork Ltd makes a profit of £300,000 during the year ended 31 March 2016. It has incurred qualifying R&D during the year of £100,000 (already reflected in net profit).

The R&D tax relief is given in the corporation tax computation would be as follows:

Profit per accounts	£300,000
Less: R&D relief (£100,000 x 130%)	<u>-130,000</u>
Profit chargeable to corporation tax	<u>£170,000</u>

Corporation tax thereon @ 20% = £ 34,000

- Companies carrying on R&D before they start to trade may treat the R&D relief as a trading loss.
- Where a company has a surrenderable trading loss, it may surrender the R&D tax relief (or the unrelieved loss if lower) in exchange for a tax credit equal to 14.5% of the surrendered amount, equal to 29% of the qualifying expenditure (different rates applied before 1 April 2014). Prior to 1 April 2012, the repayable tax credit could not exceed the company's PAYE tax and NIC liabilities for payment periods ending in the relevant accounting period. The tax credit will be paid to the company, or used to discharge outstanding corporation tax liabilities.

Example:

Chunky Ltd has the following results for the year ending 31 March 2015:

Trading loss	£200,000
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Qualifying R&D expenditure £ 60,000

The surrenderable loss is the lower of:

£200,000 and

$£60,000 \times 225\% = £135,000$.

The repayable tax credit is therefore $£135,000 \times 14.5\% = £19,575$.

The trading loss of the company to carry forward is £200,000 -£135,000.

- Where a large company subcontracts work to a small or medium-sized company, the small/medium-sized company may claim R&D relief of 130% of the qualifying expenditure.

What Expenditure Qualifies for Relief?

If the company and the project meet the necessary conditions, then tax relief can be claimed on the following items of revenue expenditure:

- **Staff Costs** - This means the cost of employing staff directly who are actively engaged in carrying out R&D itself.
- **Externally provided workers and sub-contractors** - This covers the cost of paying a staff provider for staff provided to the company, or a sub-contractor who are directly and actively engaged in carrying out R&D.
- **Consumable Items** - These include consumable or transformable materials used directly in carrying out R&D. **NOTE:** Finance Bill 2015 introduces a new restriction which changes the definition of qualifying expenditure for R&D purposes with effect from 1 April 2015. Where the R&D activity results in goods or services sold in the normal course of a company's business, the cost of consumable items reflected in those goods or services will not attract tax relief from 1 April 2015. In other words, relief will only be available on the cost of those items fully used up or expended by the R&D activity itself and which do not go on to be sold as part of a commercial product.
- **Software** - Revenue expenditure incurred on computer software employed directly in R&D.
- **Utility Costs** - Power, water, fuel used directly in carrying out R&D, but not for instance telecommunication costs and data costs.

Research & Development - Capital Expenditure

Enhanced capital allowances are available for capital expenditure on research and development. Allowances are only due if the research and development is related to the trade of the business. The allowance is known as the Research & Development Allowance (RDA) and qualifying expenditure will be eligible for capital allowances of 100%. For further details, see <http://www.hmrc.gov.uk/manuals/camanual/CA60000.htm>.

Specialist HMRC R&D Units

HMRC have set up specialist R&D units for examining claims to R & D tax relief. These offices deal specifically with R&D claims and will give a ruling on whether certain expenditure qualifies for R&D tax relief.

For a list of these specialist offices, see <http://www.hmrc.gov.uk/manuals/cirdmanual/CIRD80350.htm>

For details of which office deals with which postcode, see <http://www.hmrc.gov.uk/manuals/cirdmanual/CIRD80360.htm>

Useful Links

We have assembled a collection of useful links on ACCA UK's Technical Advisory website at http://uk.accaglobal.com/uk/members/technical/advice_support/tax/corporation_tax/2011/rdlinks, including a link to the relevant section of HMRC's Manuals which contains a treasure trove of information relating to R&D claims.



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