



R&D tax relief update

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What we'll be covering

- / Background to the reliefs
- / Definition of R&D
- / The two regimes (for now!)
- / Qualifying Expenditure
- / Changes from 1 April 2024
- / How to claim and the new digital submission
- / HMRC enquiries

R&D tax reliefs: background

- / R&D tax credits introduced in 2000, originally for small and medium-sized enterprises (SMEs)
- / Many similar regimes around the world
- / Idea was to reward innovation but arguably poorly targeted & policed and open to abuse
- / The definition of R&D has always been subjective and remains so!
- / Significant tinkering of the regime of late with HMRC now taking a much tougher line on claims
- / New, combined regime to apply from 1 April 2024

What do we mean by R&D?

- / DSIT Guidelines 2023 (CIRD81910)
- / R&D for tax purposes takes place when an overall **project** seeks to achieve an **advance in science or technology** through the resolution of scientific or technological **uncertainty**
- / Must be an advance to the industry/field as a whole not just to the company's own state of knowledge

In other words...

- / Work carried out in the field of science & technology which:
 - Creates a process, material, device, product or service through a technological advancement
 - Appreciably improves something which already exists
 - Duplicates existing product, process, etc but in a fundamentally new way
- / Being **unique** or commercially innovative is not enough!
- / Nor can the project just be large and complex; it must push the technological boundaries

So what sort of industries qualify?

- / You don't have to be sat in a lab coat!
- / Any company developing new products, technology or processes
- / Includes telecoms, defence, financial services, manufacturing and software development
- / But HMRC are policing far more closely!**
- / 300 new inspectors**
- / Software in particular being targeted**
- / Beware your SIC code!**

Previous successful claims

- / Robotic double glazing sealing unit
- / Fingerprint recognition technology
- / Bio-diesel production
- / 3D television live systems
- / Lithium-ion batteries
- / Software!

Is there just one R&D tax regime?

- / There are in fact two:
 - SMEs
 - Large companies
- / SME regime used to be far more beneficial
- / As we will see, the gap is narrowing and the intention is to merge the two from next year

What do we mean by an SME?

- / Based on Annex of 2003/361/EC
- / Company/group (worldwide):
 - Less than 500 employees; and
 - Turnover less than €100 million; or
 - Balance sheet total less €86 million
- / Care needed if investors have more than a 25% interest (partnership enterprises) but some relief for non-controlling institutional investors
- / Corporate members of LLPs can claim (but see CIRD81220)

What are the reliefs? (SMEs)

/ R&D Tax Relief:

- 86% uplift on “qualifying expenditure”
- For expenditure incurred prior to **1 April 2023**, the rate was 130%
- Profitable companies stop there

What are the reliefs? (SMEs)

/ R&D Tax Credit:

- Loss-making companies can surrender gross R&D losses
- Credit was 33.35% of R&D (230% @ 14.5%) qualifying expenditure, reducing to 18.6% (186% @ 10%) for expenditure after **1 April 2023**
- R&D-intensive SMEs are entitled to a higher rate of relief where the 'R&D intensity' condition is met; broadly, where the company's relevant R&D expenditure is at least 40% of the company's total expenditure
- This measure applies from 1 April 2023, allowing eligible claimants to access the SME payable credit at an increased rate of 14.5% (rather than 10%)
- Credit subject to cap: 3 x PAYE costs plus £20,000 (for AP beginning after 1 April 2021)
- Cap doesn't apply if company creating IP wholly or mainly by employees and less than 15% of R&D subcontracted to connected parties

What about subsidised expenditure?

- / You can only claim relief for net expenditure under the SME regime, with balance claimable as a large company
- / However, if you receive even a penny of a notified State Aid (for example Smart Award), the entire project is precluded from the SME regime
- / SMEs can also claim under the large company regime for work subcontracted R&D to it from a large company

What other qualifying conditions are there?

- / Company must be trading (although relief available for pre-trading expenditure by election)
- / Expenditure must be revenue in nature:
 - May however capitalise as an intangible asset and claim full relief in year of expenditure (although remember to add-back amortisation)
 - Are in-house software projects capital?
 - 100% capital allowances available for capital expenditure
- / Company must be a going concern
- / SME aid limit per project of €7.5 million

What is qualifying expenditure?

- / Gross deductible staff costs:
 - Pro-rate time (record-keeping is important!)
 - Excludes benefits in kind
- / Subcontracted costs (generally @65% but special rules if connected)
- / Externally provided workers
- / Consumable items:
 - Materials and utilities used up in R&D activity plus software
- / For AP beginning after **1 April 2023**, cloud computing and data costs

But what about consultancy costs?

- / Strictly do not fall within any of the qualifying heads of costs.
- / May be possible to contend that they are acting as subcontractor...

How does the large company regime work?

- / Rules similar (in particular definition of R&D) but some important differences, e.g. can't generally claim for subcontracted R&D
- / Relief less generous:
 - A **20%** tax credit in respect of their qualifying R&D costs (whether profitable or not)
 - Credit was 13% for pre 1 April 2023 expenditure
- / The credit is itself taxable and so should be included “above the line” in the P&L
- / Part of credit withheld for off-set against future CT if loss-making

Comparing the regimes

SME loss benefit

	Previous rates	Post 1 April 2023 rates
Qualifying expenditure	£100	£100
Maximum losses to surrender for tax credit	£230	£186
R&D tax credit	£33.35	£18.60

SME profit benefit

	Previous rates	Post 1 April 2023 rates
Qualifying expenditure	£100	£100
Enhanced R&D deduction	£130	£86
Corporation tax refund	£ 24.70	£ 21.50

RDEC benefit

	Previous rates	Post 1 April 2023 rates
Qualifying expenditure	£100	£100
Gross RDEC	£13	£20
RDEC net of corporation tax	£10.53	£15

Source: GovGrant

The new regime from 1 April 2024

- / To apply to expenditure incurred after **1 April 2024**
- / Modelled on the existing large company regime
- / However, relief will be available for contracted-out R&D
- / Subcontractors and EPWs must do the work in the UK (subject to narrow exemptions where work can't be done here)

How do I claim?

- / Quantify costs and include claim in tax return within two years of period end but for AP beginning after **1 April 2023**, companies must notify HMRC within six months of year-end of the intention to claim if:
 - Claiming for the first time; or
 - The last claim was submitted more than three years ago.
- / Best practice is to include a breakdown of qualifying costs and a synopsis, setting out the project and why it qualifies. But...
- / From **8 August 2023**, the claim must be supported by a digital form submitted in advance through HMRC portal
- / Claim will normally be reviewed by specialist R&D unit and HMRC promise repayment within 40 days (under SME regime)
- / Check progress online

The digital submission

- / Provide background information such as UTR, VAT number, internal R&D contact, agent details and qualifying costs
- / Answer the following questions:
 - What is the main field of science or technology?
 - What was the baseline level of science or technology that the company planned to advance?
 - What advance in that scientific or technological knowledge did the company aim to achieve?
 - What scientific or technological uncertainties did the company face?
 - How did your project seek to overcome these uncertainties?
- / If 1-3 projects, complete for all; otherwise, describe those projects that account for at least 50% of total expenditure

HMRC enquiries

- / HMRC are launching far more enquiries, particularly for R&D claims submitted close to the deadline
- / Enquiries being made long after cash repayments when company may have assumed they were safe
- / Questions focusing on digital submission points
- / Chaotic, aggressive approach with lack of engagement: see CIOT representations
- / Not only looking for reasons to reject claims but also raising **penalties** for carelessness (“Has the company ever sought advice from HMRC?”!!!)
- / Push back and seek help where necessary

How can I maximise the claim?

- / Ensure that the accounts are consistent and helpful!
- / Define the project
- / Know when the project starts and ends
- / Get everything in the right company
- / Keep proper records, e.g. timesheets, patent applications, subcontract agreements
- / Get the company's tax affairs up to date
- / Don't forget notification and digital submission requirements
- / Consider using external experts to benchmark claim!

When does a project start and end?

- / A project begins when work to resolve the scientific or technological uncertainty starts. This includes the planning stage
- / The project ends when the uncertainties have been resolved
- / So cosmetic effects, routine bug fixing and production activities are not R&D
- / However, if new uncertainties arise, a second R&D phase may begin
- / HMRC have been known to argue that an ongoing project without a defined end cannot be R&D!

Can I claim for abortive projects?

- / Absolutely!
- / If the project fails due to inability to resolve technological issues, it only highlights that the project was qualifying in the first place!

How can I get help?

- / See CIRD80000
- / Seek external, specialist help where necessary
- / Contact us to discuss how BKL can help you or your client
- / Check your tax investigation insurance!



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