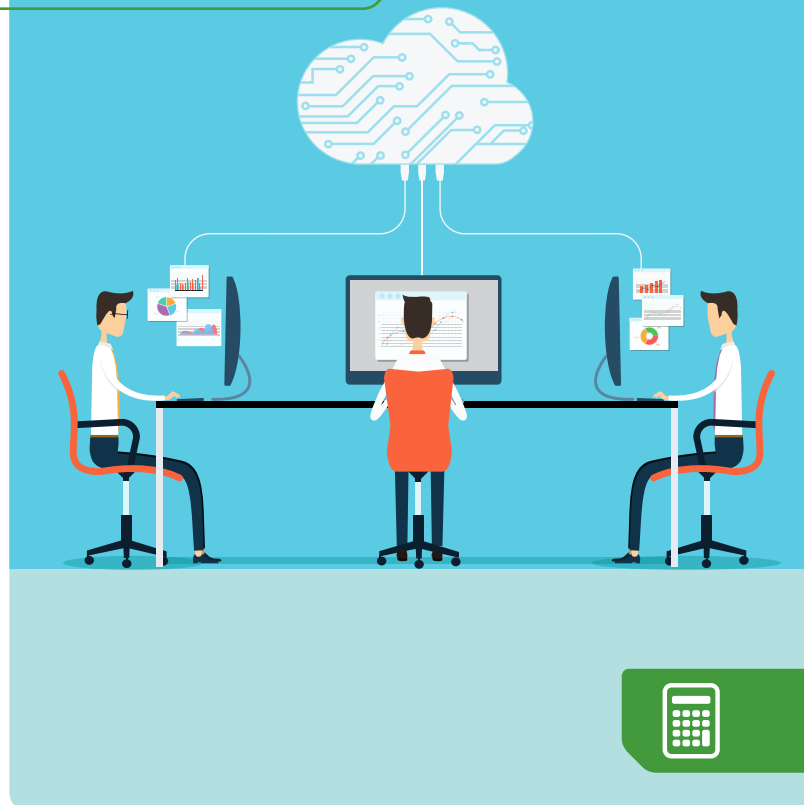




THE MCCAY PARTNERSHIP
Chartered Accountants



R&D tax credits

A guide to the tax relief available to innovative SMEs.

Research and development (R&D) tax relief for small companies provides an enhanced deduction for the costs of qualifying R&D projects.

R&D tax relief for large companies is given as an expenditure credit in the company's profit and loss account before the tax charge is deducted. This 'above the line' mechanism for providing R&D relief is not discussed further in this article, which is concerned only with the scheme for SMEs.

Relief available

R&D tax relief currently provides an enhanced deduction of 230% of qualifying R&D revenue costs.

This is made up of:

- 100% of the costs which would normally be deducted without R&D tax relief; and
- 130% of those tax deductible costs.

This means that for every £100 of qualifying R&D costs, £230 is deducted from the company's profits, or added to the company's trading losses for tax purposes.

For expenditure incurred between 1 April 2012 and 31 March 2015 the deduction rate was 225% of qualifying costs. Relief at this lower rate can still be claimed if it is less than 2 years after the end of the relevant accounting period.

If the company makes a loss in the period for which an R&D claim is made, after deducting

the R&D enhanced relief, part or all of that loss can be surrendered to HMRC for a payable tax credit. This is a cash sum paid to the company to use how it wishes.

Talk to us about the tax reliefs available to your business.

Calculating tax credits

The payable tax credit is calculated as 14.5% of the surrendered loss, which must be the lesser of:

- unrelieved trading loss; or
- 230% of the qualifying R&D costs.

Example

Whizz Ltd has made a loss of £5,000, after deducting qualifying R&D costs of £50,000. Its R&D tax credit is calculated as:

	£	£
Trading loss after costs deducted:		5,000
R&D relief: 130% x £50,000		65,000
Total loss after R&D relief		70,000
Loss available to surrender is lesser of:		
R&D relief: 230% x 50,000	115,000	
Unrelieved trading loss	70,000	
Loss surrendered		70,000
Loss available to carry forward:		Nil
R&D tax credit: 14.5% x 70,000	10,150	

After submitting a claim for R&D tax relief and a claim for the R&D tax credit Whizz Ltd should receive a cash sum payment from HMRC for £10,150.



R&D tax credits

Who can claim?

Only companies can claim R&D tax relief; it is not available to unincorporated businesses.

The company must have no more than 500 employees and satisfy one or both of the following conditions in the current accounting year or the previous year:

- annual turnover of no more than €100 million
- balance sheet total of no more than €86 million.

The company must also be a going concern at the time the R&D claim is made. If its last published accounts were prepared on a going concern basis, and nothing in the accounts suggests that its trading status depends on its receiving R&D relief or tax credits, HMRC will accept that this condition is met.

A company in administration or liquidation cannot make a claim to R&D relief.

The company does not have to spend a minimum amount on R&D projects in the accounting period in order to claim R&D relief.

R&D project

The key to a successful R&D tax relief claim is being able to prove to HMRC that the particular project falls within the definition of R&D established by the BSI guidelines (which came into effect on 1 April 2004).

This definition can be summarised as: activities which directly contribute to achieving an advance in science or technology through the resolution of technological or scientific uncertainty.

This can include the adaptation of knowledge or capability from another field of science or technology in order to make such an advance where this adaptation was not readily deducible.

The aim of the R&D project can be to create a new product, a material, or change or improve an existing process. For example, finding a way of speeding up a production line.

Many innovative ideas don't actually work. That doesn't matter; a failed R&D project still qualifies for tax relief.

As long as the company can show it was pushing the boundaries of knowledge or capability in the fields of science or technology (not just for the particular company), the project should qualify for R&D tax relief.

Computer programming projects can qualify as R&D, especially where the company is striving to make previously unrelated computer systems work together.

The key to qualifying as R&D is that no one else has done it yet or if they have attempted to solve the same problem, their work hasn't been made public.

If your company has not made an R&D claim before, make sure to apply for advance assurance from HMRC to check whether the R&D project and the company will both meet the conditions for the relief.

Costs

Not all costs incurred during an R&D project will qualify for relief. The qualifying costs are broadly those which fall into the following categories:

- direct staff costs (but not employment related benefits)
- consumables
- software
- payments to clinical trial volunteers.

In addition, 65% of the costs can be claimed on subcontracted R&D work or externally provided staff.

Capital expenditure, and rent for premises do not qualify for relief.

Advance assurance

HMRC is keen to encourage more companies to apply for R&D tax relief by providing them with an advance assurance that their company will qualify. This procedure can be used by small companies which haven't claimed R&D tax relief before, and which have:

- fewer than 50 employees; and
- annual turnover of no more than £2 million.

However, where the company is part of a group the tax history for the group must be examined. Where another member of the group has claimed R&D tax relief in the past the advance assurance won't be given. This doesn't bar the company from claiming R&D tax relief, it just blocks access to the advance assurance procedure.

The main benefit of advance assurance is that the company has a guarantee that HMRC won't raise further questions about the initial R&D claim, and for R&D claims submitted for the next 2 accounting periods. It is effectively a guarantee that R&D claims will be accepted for 3 consecutive accounting periods.

Making a claim

The R&D tax relief claim should be included on the company's corporation tax return. There is detailed guidance on which boxes of the return to complete for this claim within HMRC's guide: research and development tax relief.

Deadline for claims

The deadline for submitting a claim for R&D tax relief is 2 years from the end of the accounting period in which the costs were incurred.

Before submitting an R&D tax relief claim for an earlier year, calculate whether that claim will create a trading loss for the year. If a loss is expected, the company should consider disclaiming capital allowances for that year or for a later year, in order to use the loss created by the R&D tax relief claim.

A capital allowance claim can be made or amended within 2 years of the end of the relevant accounting period, the same period during which the R&D tax relief claim can be made.

Contact us about becoming more tax-efficient today.