

Research & Development Tax Relief

Since 31 March 2000, the UK tax system has offered a level of tax relief for small and medium sized UK companies that have done internal research and development (R&D). From 1 April 2002, that enhanced tax relief became available for some R&D work subcontracted to a business, for some R&D work subcontracted out, and for larger companies. As criteria for claiming such relief is ever evolving, current rules for claim must always be reviewed.

Meaning of Research and Development

Typically, the prominent criteria stipulates that a company must be spending a minimum amount per year on qualifying R&D activities.

The definition of R&D activities is generally what one might expect, but boundaries can be blurred. Consequently, the DTI has published guidelines on the subject, and it should be noted that the definition for these purposes has changed between those for accounting periods that ended before 1 April 2004, and those that ended on that date and beyond.

One of the main guidelines indicates that work must be pushing the boundaries of what is currently public knowledge. As this is not going to be common knowledge, specialists performing the work will be those who know or who can prove whether this is the case or not.

Documenting whether or not there was any element of uncertainty, and if so how it was overcome, is another key guideline in this area. This will demonstrate how there was some element of R&D performed.

Research & Development Tax Credits

Tax relief in this area is primarily split between two schemes: the Small & Medium sized Enterprises (SME) company scheme, and the large company scheme. The SME scheme is open to companies that meet certain size requirements and can that can result in a refund through an R&D tax credit claim. Unfortunately, the entire system has been deemed "R&D tax credits", and has therefore led people to incorrectly believe that any company can obtain a tax refund where that company performs R&D.

SME Scheme

In the event that a company meets the size and expenditure requirements outlined, it can claim an enhanced deduction of 50% (150% in total) of the qualifying costs in its corporation tax return. From 1 August, 2008 this has been increased to 75% (or 175% in total).

Where the company made a loss for tax purposes, the loss that relates to the enhanced expenditure can be surrendered in return for a repayable tax credit as mentioned above. The repayable tax credit is limited, however, to the lower of

a) 16% (14% from 1 August 2008) of the loss relating to enhanced expenditure [e.g. maximum is 16% of 150% (or from 1 August 2008 14% of 175%) of R&D costs].

or

b) The amount of tax and national insurance paid to employees through the company's PAYE scheme.

Where not all of the loss can be claimed or the company does not want to claim the tax credit, the (remaining) loss is carried forward and automatically offset against any future trading profits from the same trade.

Large Company Scheme

The large company scheme is actually open to all companies, including SME companies. Although the same expenditure under the SME scheme qualifies under the large scheme, there are additional items which qualify under the large scheme. This includes where SME companies may want to claim using the large scheme, as this does not stop them using the SME scheme as well (though the same expenditure cannot be claimed under both).

The large company scheme does not allow a surrender of any loss for a repayable tax credit. It does, however, allow an enhanced deduction of 25% (30% from 1 August 2008) of the qualifying expenditure.

Qualifying costs

All costs must arise from one of the qualifying R&D activities. The main current qualifying costs are outlined below.

a) Staffing costs

This covers all emoluments such as gross salary and pension payments, but not benefits in kinds provided like healthcare.

b) Consumable or transformable materials

This covers the costs of general overheads such as water, heat, power and light, but also materials that are directly used by the R&D process such as chemicals and parts. Note that smaller items such as test tubes and flasks, which might not be "used", are also included in this.

c) Software

Software required for the R&D and used by the R&D staff is allowable here, including bespoke software to word and excel.

d) External staff expenditure

Expenditure on externally provided staff, on clinical trial volunteers and on subcontracted out costs may all qualify, but these have more stringent criteria and special conditions on the amount that may be claimed.

Obviously most of the above is not going to be easily quantifiable, and it is important that records are kept to help identify the qualifying amounts. Again, the basis for claiming all of the above has changed over the years so care needs to be taken over knowing the particular rules for any given period.

Please contact us now if you need any advice or assistance in respect of this fact sheet, or if you would like us to deal with your tax affairs on your behalf.

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