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# Tax Reliefs for Research and Development Expenditure in UK

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successive Governments have recognised that encouraging businesses to undertake Research and Development (R&D) activities in the UK is vital for the health of the UK economy and the tax benefits on offer have become steadily more attractive - Le agevolazioni fiscali per le spese di ricerca & sviluppo nel Regno Unito

## Introduction



Successive Governments have recognised that encouraging businesses to undertake Research and Development (R&D) activities in the UK is vital for the health of the UK economy and the tax benefits on offer have become steadily more attractive. In 2014/15, 22,445 claims were made and, based on qualifying expenditure of £21.8 billion, the value of the enhanced relief given was £2.45 billion. Despite this, there are many eligible companies that are not claiming the benefit of these very generous reliefs.

There are separate reliefs depending on whether the company is an SME (small or medium-sized enterprise) or a large company. Under the SME scheme, a company can claim a deduction of 230% of the qualifying R&D expenditure in calculating its taxable profits. Additionally, if the R&D claim results in a tax loss, the loss can be surrendered in exchange for a cash payment from HM Revenue & Customs (HMRC).

Large companies can claim an R&D credit of 11% of qualifying expenditure. The credit is included as income in calculating taxable profits and an equal amount is deducted from the company's corporation tax liability giving (from 1 April 2017) a post tax benefit of 8.9% of the qualifying expenditure.

## What is the definition of research & development?

Research and development is defined as creative or innovative work in the field of science or technology with a view to extending scientific or technological knowledge and producing new or substantially

improved materials, devices, products, processes, systems or services before commercial production starts.

The definition distinguishes research and development activity from non-research activity by the presence of an appreciable element of innovation.

Additionally, any development work carried out by a company on well established products and processes which does not extend the knowledge base in the relevant industry sector would not be R&D, even if it improves the company's understanding of them.

#### **Activities that would normally be included in R&D**

- Experimental, theoretical or other work aimed at the discovery of new knowledge, or the advancement of existing knowledge
- Searching for applications of that knowledge
- Formulation and design of possible applications for such work
- Testing in search for, or evaluation of, product, service or process alternatives
- Design, construction and testing of prototypes and models and development batches primarily to test R&D hypotheses
- Design of products, processes, services or systems involving new technology or substantially improving those already produced or installed
- Construction and operation of prototypes and pilot plants
- Indirect supporting activities such as maintenance, security, administration and clerical activities and finance and personal services insofar as undertaken for R&D

#### **Activities that would normally be excluded from R&D**

- Testing or analysis of equipment or product for the purposes of quality or quantity control

- Periodic alterations to existing products, services or processes even though these may represent some improvement
- Operational research not tied to specific research and development activity
- Cost of corrective action in connection with break-downs during commercial production
- Legal and administrative work in connection with patent applications, records and litigation and the sale or licensing of patents
- Activity, including design and construction engineering, relating to the construction, relocation, rearrangement or start-up of facilities or equipment other than those whose sole use is for a particular research and development project
- Market research

### **What relief is available for small and medium-sized companies (SMEs)?**

Small and medium-sized companies can claim relief equal to 230% of qualifying research and development expenditure.

Therefore, if the company charges to the Profit and Loss Account qualifying R&D expenditure of £30,000 it can deduct an amount of £69,000 (£30,000 x 230%) in calculating its taxable profits. From 1 April 2017, the tax saved as a result of the enhanced deduction is £7,410.

### **Conditions required for 230% relief**

To be able to claim relief the company must be a going concern.

The expenditure must satisfy the following four conditions:

1. It must be of a revenue nature
2. It must relate to the company's trade, an extension of that trade, or a trade that will be derived from that expenditure

3. It must relate to staffing costs (including employers' NIC and pension contributions), consumable items, externally provided workers, certain computer software, power, water or fuel employed directly in relevant R&D

4. The expenditure cannot relate to activities which have been contracted out to the company by another person

### **What is an SME for R&D purposes?**

To qualify as a small or medium-sized company, it must have during the period in question:

- fewer than 500 employees; and
- annual turnover not exceeding €100m and/or
- gross assets not exceeding €86m

Where a company has interests of 25% or more in other enterprises or where itself is owned 25% or more by other enterprises, it may be necessary to take account of employment, turnover and assets of those other enterprises when deciding if it is an SME. In addition, no more than 25% of the claimant company's capital or voting rights can be held by enterprises that are not small or medium-sized.

### **Payment for R&D surrenderable loss**

If the SME's R&D tax relief gives rise to a trading loss there are two methods available for claiming relief:

- 1) The loss can be used in the normal way (set sideways against other income from that period, carried back to the preceding accounting period, carried forward against future profits from the same trade or surrendered as group relief).
- 2) A cash payment can be claimed from HMRC based on any loss still unrelieved after taking into account loss relief claimed (or which could have been claimed) as set out in 1 above up to a maximum of the 230% R&D deduction.

The amount of the cash payment that can be claimed is 14.5%. This is equivalent to 33.35 pence for every £1 spent. This compares with the tax which might be saved under the normal loss relief rules (at

the current rate of corporation tax) of 43.70 pence for every £1 spent.

### **R&D contracted out by or to an SME**

If an SME contracts out R&D, the SME can generally claim enhanced relief at the rate of 230% on 65% of the payments it makes to the sub-contractor.

If, however, the sub-contractor is connected with the SME, the R&D claim is based on the allowable R&D costs incurred by the sub-contractor.

If an SME undertakes R&D as a sub-contractor for a large company, it can claim the tax credit available to large companies discussed overleaf.

### **Advance Assurance**

Small companies, with annual turnover of £2 million or less and less than 50 employees, making their first claim can request advance assurance from HMRC that a project qualifies for relief. An advantage of obtaining advance assurance is that HMRC will allow R&D claims for the first 3 accounting periods without further enquiries.

### **What reliefs are available for “large” companies?**

Large companies (i.e. those not classified as SMEs), can claim a credit in respect of qualifying expenditure. A claim can only be made in respect of costs on work contracted in if the contractor is another large company or a person who is not eligible for R&D relief.

Generally if a large company subcontracts work to others it will not be able to claim relief unless the subcontractor is:

- A university or other higher education institute
- A charity
- A scientific research organisation
- An NHS body

- An individual or partnership of individuals

A large company can also claim relief on contributions towards the cost of relevant independent R&D carried out by the above persons.

### **Tax credit for large companies**

Large companies can claim a credit equal to 11% of qualifying R&D expenditure. This is also available to an SME in respect of qualifying expenditure on R&D subcontracted to it by a large company.

An amount equal to the credit is added to taxable profits and deducted from the company's corporation tax liability. The effective rate of tax relief from 1 April 2017 is 8.9%.

If the company, or the group of which it is a member, has insufficient tax capacity, provided it is a going concern, the company can claim a payment from HMRC equal to the amount of the unused credit, subject to a cap based on PAYE/NIC paid.

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## Frequently asked questions

What if the company is an SME and it has not started to trade?

If the company can claim relief on the expenditure at the enhanced rate of 230%, it can elect to have the loss treated as if it were a trading loss which can be:

- set against other profits of the period (such as interest)
- surrendered as group relief
- surrendered for a cash payment from HMRC

Any unused losses can be carried forward and used against future profits of the trade.

What if some of the qualifying expenditure has been funded by a grant or subsidy?

An SME cannot claim enhanced relief at the rate of 230% on:

- any expenditure related to a project which benefits from notified State aid (i.e. State aid approved by the EU); this does not prevent expenditure incurred on other projects from qualifying
- expenditure which is funded by other grants or subsidies

Such expenditure is eligible for the R&D tax credit.

## Relief for capital expenditure

Where a company incurs qualifying capital expenditure, it can claim a Research and Development Allowance (R&DA) of 100%.

Qualifying expenditure includes all expenditure on plant, buildings etc incurred for carrying out R&D and providing R&D facilities, but no relief is available for the cost of the land.

## Frequently asked questions

What if expenditure qualifies for more than one capital allowance?

If expenditure qualifies for more than one capital allowance, e.g. R&DAs and plant and machinery allowances, it is possible to claim for only one allowance. Any of the qualifying allowances can be chosen but once a choice has been made it is not possible to claim another allowance.

What if the asset is only partly used for qualifying research and development?

If the asset is only partly used in research and development then only that part of the asset qualifies for R&DAs.

If no part of the asset is used exclusively for one purpose then the cost of the asset should be apportioned to reflect the use for the purposes of research & development.

What if the cost includes an element of land or a dwelling?

In the case of land a portion of the expenditure reflecting the value of the land should be excluded from the amount on which the R&DAs are claimed.

If a dwelling is included in the expenditure this should also be excluded.

However, if the dwelling is part of a larger building, and that building is used for R&D, then the element of expenditure associated with the dwelling, if it is not more

than a quarter of the whole cost of the building, can be ignored. In this case the whole amount can be treated as allowable.

Can R&DAs be claimed on qualifying research and development expenditure that has been funded by a grant or subsidy?

In general no allowances will be available on expenditure funded by grants or subsidies from third parties.

Where these grants or subsidies fund only a portion of the qualifying research and development expenditure then it should be deducted from the total in order to arrive at the amount eligible for R&DAs.



The following grants are exceptions and thus do not affect the amount which qualifies:

- a regional development grant made under part II of the Industrial Development Act 1982
- a regional development grant made under part I of the Industrial Development Act 1972

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