

Research and Development.

An opportunity to reduce tax on qualifying expenditure.

“The technical environment in which our company operates continues to be one where innovation is at the forefront of continuing viability. This is even more relevant in the face of recent difficult trading conditions.

A significant part of our expenditure has been incurred in seeking out new innovations and whilst they may not generate immediate financial returns, it gives some comfort to know that by encouragement through additional tax relief, the authorities recognise that investment in research and development is key to ensuring future competitiveness and success.

GB Financials Limited has worked with us for many years, supplying a variety of services and has been successful in analysing and providing the necessary information to our tax advisors to support research and development tax claims during this time. ”

- *Glynn Westbury. Director, Westbury Control Systems Limited.*

Background

We have been successful in helping in a number of Research & Development (R&D) tax credit claims, working with finance staff and external accountants.

This note sets out to give some general information, expose some myths that have developed around this area and to provoke questions as to whether or not companies, who felt in the past that they could not qualify, could actually qualify.

What is Research & Development tax credit?

R&D tax credit is the biggest single funding mechanism provided by Government for investment in business R&D.

R&D tax relief was introduced in the Finance Act in 2000 and has been reviewed and revised consistently ever since.

In 2006/07 nearly 6,600 claims were made that totaled £670m. The bulk of the claims (5,200, or nearly 80 per cent) were made under the SME scheme. These included over 1,000 claims for payable credits. More of the total amount claimed (nearly 70 per cent) was however claimed under the large company scheme. *(Source; BIS web site).*

The credit is made available in one of two ways: either as a tax deduction based on R&D spending, or it may be possible for certain loss making small or medium sized companies (SMEs) to surrender their losses in return for a cash payment from the tax authorities (HMRC).

On the face of it this is a significant take-up of the relief. However in our experience, many advisors treat it with caution for a number of reasons. These reasons vary and include:

- There is a mistaken belief that unless the R&D is unique, it will not qualify for tax relief.
- The regulations have been tinkered around with and advisors may not be up to date with the latest qualification requirements.
- There is a belief that only research based companies will qualify.

What R&D relief schemes are available?

Companies can only claim R&D relief if liable for Corporation Tax.

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

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

What is a SME for R&D?

A SME is a company or organisation with fewer than 500 employees **and** either of the following:

- an annual turnover not exceeding €100 million
- a balance sheet not exceeding €86 million

This definition applies to spending on R&D from 1 August 2008. Before that date, a SME was a company with fewer than 250 employees, and either of the following:

- an annual turnover not exceeding €50 million
- a balance sheet not exceeding €43 million

A company may not be considered to be a SME if it's part of a larger enterprise that, taken as a whole, would fail these tests. This includes investments in, or by, associate companies.

If a company is claiming relief under the SME scheme, then it must own any intellectual property that might arise from the project.

This definition of a SME for R&D Relief purposes is not necessarily the same as that used by HMRC in relation to other areas of Corporation Tax or other tax areas such as PAYE, or by other government agencies.

Subcontractors cannot claim R&D Relief under the SME Scheme - that is, a company that has been subcontracted to do the work on behalf of somebody else. However, even if a company is small or medium-sized, it may still be able to claim, as a subcontractor, under the Large Company Scheme.

SME scheme – key points

- 150 per cent rate of enhanced deduction, increasing to 175 per cent for expenditure incurred on or after 1 August 2008.
- Payable credit equivalent to about £24 for every £100 of qualifying expenditure on R&D
- Company can claim for expenditure on R&D it sub-contracts to others
- Company cannot claim for contributions to independent research
- Claim can be reduced if the R&D project is subsidised or a grant is received in respect of it
- Company must own the intellectual property arising out of the R&D
- A cap of €7.5 million on the amount of relief per R&D project was introduced from 1 August 2008
- From 1 August 2008 companies whose most recent accounts are not produced on a going concern basis are unable to claim relief

Large company scheme – key points

- 125 per cent rate of enhanced deduction, increasing to 130 per cent for expenditure incurred on or after 1 April 2008
- No payable credit
- Company can claim for contributions to independent research carried out by charities, universities and scientific research organisations
- Company can only claim for expenditure on R&D it carries out itself, unless it sub-contracts R&D to universities, charities or public sector research establishments
- No reduction for grant or subsidy
- Company need not own the intellectual property arising out of the R&D
- There is no upper limit on the amount of a claim

For further information or an initial chat, please contact Gary Beesley, director of GB Financials Limited, Chartered Management Accountants on 01530 519500 or 07973 815213.