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Research and Development Tax Credits

Research and development tax credits were introduced for companies from 1 April 2000 and are designed to encourage investment in innovation. Companies can obtain enhanced tax relief and in some cases a cash repayment from the Exchequer.

Basic features

Enhanced R&D tax relief can provide generous tax reliefs for small and large companies and in some cases can generate a tax repayment of up to 24.5% from the Exchequer. There are two different schemes of relief and many qualifying conditions.

Overview of the relief

Research and development tax credits can only be claimed by companies. There are two different schemes, referred to as "the large company scheme" and "the SME scheme". The SME scheme is more generous but there are more conditions to be met. In cases where a small or medium entity cannot claim under the SME scheme it may be able to claim instead under the large company scheme.

The schemes are compared below.

The Schemes

SME Scheme	Large company scheme
<ul style="list-style-type: none"> A 75% enhancement of the amount spent on qualifying R&D can be claimed against taxable profit. (50% before 1 August 2008) If loss making, a payable tax credit can be received in cash up to a maximum of 14% of the surrendered amount. (16% before 1 August 2008) * 	<ul style="list-style-type: none"> A 30% enhancement of the amount spent on qualifying R&D can be claimed against taxable profit. (25% before 1 April 2008) No payable tax credit.

- Can claim for expenditure on R&D it sub-contracts to others.
- Cannot claim for contributions to independent research.
- Claim can be reduced if the project is subsidised or grant received, see below.
- Company must own the intellectual property arising out of R&D.
- Can claim for expenditure sub-contracted to others in limited circumstances.
- Can claim for contributions to independent research.
- No reduction for grant or subsidy.
- Company need not own the intellectual property.

*The payable tax credit is calculated at 14% (16%) of the lower of the enhanced R&D spend or as much of the trading loss that is unrelieved, or if less, the total amount of the company's PAYE and NIC liabilities for the period.

Size limits for the SME scheme

The size limits which determine whether or not a company qualifies were doubled from 1 August 2008. From that date onwards a company is a SME if the following conditions are met:

- Fewer than 500 employees, **and either**
- Annual turnover of less than Euro 100 million, **or**
- Balance Sheet total of less than Euro 86 million.

Large companies are those that do not fall within the size limits of a SME as detailed above.

Definition of R & D

R&D does not simply take its accounting or commercial meaning, and guidelines have been issued by the DTI

which are used to determine if a project is sufficiently innovative to qualify for the relief.

Generally speaking, a project will qualify as R&D if its aim is to advance the overall knowledge or capability in a field of science or technology where there is scientific or technological uncertainty.

A qualifying project could create or significantly improve a process, material, device or product which increases knowledge or capability in a field of science or technology.

An advance in science or technology may have tangible consequences, such as a new or more efficient product. It may also have intangible outcomes, for example new knowledge or cost improvements.

Even if the intended outcomes of the project are not fully achieved, R & D still takes place and expenditure can qualify.

The routine analysis and/or adaptation of an existing product, process or material will not be an advance in technology and will not qualify as R & D.

Qualifying expenditure

To qualify for the tax credit, expenditure must meet the following conditions:

- The expenditure must be revenue expenditure used directly in carrying out R & D.
- Expenditure must total at least £10,000 in an accounting period. There is no upper limit on the amount of the claim.

Expenditure must be on

- staff costs (including Employers' pension and Employers NI but not Benefits In kind)
- externally provided workers eg agency staff (65% allowable) **
- consumables used directly in R&D process
- power, water, fuel used directly in R&D process
- computer software
- subcontracted R&D costs can be claimed under the SME scheme only (65% allowable) **

**different rules apply where there are connected parties

Grants and subsidies

Care is needed where R&D claims are made in respect of expenditure covered by, or partly covered by grants or subsidies.

Under the large company scheme any expenditure against which the company has received a subsidy, is still eligible for R&D relief in the normal way i.e. 30% enhancement.

This however is not the case for the SME scheme.

State aid

Where a project undertaken by a SME receives a notified State aid (eg government grants), no expenditure on the project will qualify for relief under the SME scheme.

SME's can however claim relief under the large company scheme, providing that:

- the expenditure would be allowed under the large company scheme, and
- the expenditure was incurred after 27 September 2003, and,
- the expenditure does not qualify for relief under the SME scheme only because it was subsidised.

If these conditions are satisfied, an enhancement of 30% of the expenditure will be deductible from profits as detailed in the large company scheme rules above.

Non State aid

Companies receiving non State Aid funding (eg donations from charities) can still receive a 50% enhancement of the net expenditure incurred on the project (after deducting the non state aid funding). The expenditure covered by the non State aid funding receives a 30% enhancement. Payable tax credits are also receivable on the net amount of expenditure.

Claims

R&D claims are made within the company's CT600 for the accounting period. HMRC deal with these claims in specialist units and usually require detailed analysis of the projects and qualifying expenditure.

'Payable tax credits' will be received by the company after the return has been processed by HMRC, unless an enquiry is to be opened into the return.

The time limit for claims is two years from the end of the relevant accounting period.

What's next

This summary is intended to be illustrative only of the Research & Development Tax Credits so you should seek specific advice if you think you may be able to make a claim.

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