Saffery Champness

CHARTERED ACCOUNTANTS

Research and Development Tax Credits

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Introduction

Research and Development Tax Credits

Research and development (R&D) tax credits can be a valuable tax relief for companies investing in innovation, whether they are developing new products, services and processes or enhancing existing ones.

Whilst R&D credits are not restricted to particular industries - they are potentially available wherever a company is seeking to resolve a scientific or technological uncertainty, regardless of the field - clearly the potential for companies operating in the healthcare technology sector to obtain relief for qualifying R&D costs can be substantial.

Companies should therefore ensure they consider whether R&D credits might be available whenever they undertake significant development projects, to ensure that they benefit from relief where it is available.

What is eligible R&D?

For eligible expenditure to qualify for the relief, the project on which the expenditure is incurred must be seeking to achieve an advance in the overall knowledge or capability in the field of science or technology. It cannot simply be seeking to achieve an advance in the company's own knowledge or capability. This advance should be through the resolution of scientific or technological uncertainty.

Scientific or technological uncertainty exists when the knowledge of whether something is possible or feasible, or how to achieve it in practice, is not readily available or can be easily deduced by a professional in the field. That uncertainty can also arise from how to turn something that is established as scientifically feasible into a cost-effective product or service.

Even if a particular advance in science or technology has already been achieved or attempted by someone else, if the details of that advance are not readily available (for example it may be a trade secret), work to achieve that same advance can still be eligible R&D work for this purpose.

A project which seeks to make an appreciable improvement to an existing process, material, device, product or service through scientific or technological changes can be eligible R&D. If the scientific or technological advance sought by the project is not achieved or not fully realised, this can still be eligible R&D.

In contrast, improvements, optimisations and fine tuning which do not materially affect the underlying technology will not be eligible R&D. Similarly, routine analysis, copying or adapting an existing product, process or material will not be eligible R&D.

Revenue v capital spend

The rules described in this guide apply to revenue expenditure – either expensed or classified as an intangible fixed asset. Expenditure on capital assets used in qualifying R&D work may be eligible for a capital allowance at 100%, so that the expenditure is fully relieved in the year it is incurred.

Whilst R&D relief for revenue expenses is available only to companies, there is no restriction on the type of business that can claim the 100% capital allowance on qualifying capital R&D assets.

Eligible expenditure

Eligible expenditure

The main costs which are eligible for the R&D tax relief are:

- The costs of employing staff who are actively engaged in carrying out the R&D.
- Materials that are used directly in carrying out the R&D and are consumed or transformed as part of the R&D process. Note that expenditure incurred on items which are later sold or transferred as part of the company's ordinary business are excluded from qualification.
- Power, water and fuel costs used directly in carrying out the R&D, but not other costs such as telecommunications, rent and data costs.
- Computer software used directly in the R&D.
- Sub-contracted R&D expenditure, for example, where an SME sub-contracts certain activities within an R&D project to an external provider. Under the SME scheme, eligible expenditure is usually restricted to 65% of the payment to the sub-contractor, unless the subcontractor is connected. Large companies can claim subcontractor costs in full but only in limited situations.
- Expenditure on externally provided workers (ie those workers who are not employees of the company, but are instead paid through an intermediary, such as an agency), provided to work directly and actively in a company's R&D project. Usually these costs are restricted to 65% of the staff provision payment.

SMEs

An SME, for R&D purposes, is a company with fewer than 500 employees and either turnover not exceeding €100 million or gross assets not exceeding €86 million. The consolidated worldwide group is considered when determining the size of the business, as well as any linked or partner enterprises (for example joint ventures). Detailed rules need to be considered in this area.

Care must be taken in any claim where an SME has received a grant, subsidy or customer contribution, as relief can be reduced or even denied in those cases. In particular, if all or some of the costs of a project are met by a grant or subsidy that is notified State Aid, the expenditure on the project will not qualify for the SME R&D relief. However, SMEs that are unable to claim the SME relief in these circumstances may still be able to claim the relief that is available to large companies.

Relief is not available under the SME scheme if the company is itself undertaking R&D as a sub-contractor. However, an SME undertaking R&D as a sub-contractor may, under certain circumstances, be able to make a claim under the large company scheme.

Tax relief for SMEs

Tax relief on eligible R&D expenditure for SMEs is 230% from 1 April 2015. In other words, for every £100,000 of eligible expenditure, an SME can claim a deduction for corporation tax purposes of £230,000.

For loss-making SMEs, a cash repayment is available, providing the SME is a going concern. This repayment is currently equal to 14.5% of the loss arising from the R&D tax deduction (ie up to 33.35% of the actual R&D expenditure).

For accounting periods beginning on or after 1 April 2021, the SME R&D repayable credit is restricted to three times the PAYE and National Insurance paid by the company and any PAYE and National Insurance costs incurred by connected companies on R&D related externally provided workers and/or subcontracted R&D in the accounting period.

There is also a cap on the amount that an SME can claim in R&D relief on any one particular project, of €7.5 million in total. Where an extensive project could exceed this cap, it is worth considering whether the project could qualify as multiple separate projects. It's worth noting that any qualifying expenditure exceeding the €7.5 million cap could still qualify for relief under the large company scheme.

Tax relief

Tax relief for large companies

Large companies (ie those which do not qualify as SMEs) can also claim tax relief on qualifying R&D expenditure. However, relief is available under a different regime – the R&D Expenditure Credit (RDEC). Unlike the SME scheme, RDEC is usually accounted for 'above the line' (ie as part of EBITDA) for accounting purposes. This may impact cost-based contracts, staff bonuses, the reported tax rate and other financial ratios. The full impact of accounting for the RDEC should therefore be explored before a claim is made.

Under RDEC, a company can claim a 13% tax credit (12% for R&D expenditure incurred between 1 January 2018 and 31 March 2020 and 11% before 1 January 2018) on R&D spend. The RDEC is itself taxable and so there is an effective tax saving of up to 10.53% of the qualifying expenditure (9.7% and 8.8% before April 2020 and January 2018 respectively). A feature of RDEC is that the credit can be claimed as a cash repayment. However, there are detailed offset provisions against corporation tax and other taxes, before the credit can be converted into a cash payment.

Key consideration

A key issue for companies is how to ensure qualifying R&D projects undertaken, and the associated costs, are identified and recorded by the finance team.

This may mean a need for better communication between the finance and project teams, particularly in the early stages of a project, to ensure that there is an understanding of whether the key criteria around seeking an advance in scientific or technical knowledge is likely to be met.

This will enable the company to take more specific advice where required and ensure that a claim is made – and the tax benefits realised – as early as possible.

About Saffery Champness

How can Saffery Champness help

Having prepared many claims for companies of all sizes across many sectors, including the healthcare technology sector, we ensure that claims are maximised, whilst being robust and defendable under scrutiny. We can undertake a review to help you to identify whether any of your activities might constitute R&D, which projects qualify as eligible R&D, and the specific costs which are eligible expenditure.

Equally, if HM Revenue & Customs (HMRC) have raised an enquiry into an already submitted R&D tax credit claim, we can work with you and manage the enquiry process to help achieve the optimum conclusion.

To find out how we can help you, please get in touch with:

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About Saffery Champness

We are a firm of chartered accountants providing accountancy, audit, tax and other advisory services. We currently have more than 80 partners and over 720 staff in nine offices in the UK and further offices in Dubai, Dublin, Guernsey, Geneva and Zurich. All of our offices share the same professional approach and commitment to a genuinely partner-led service, supported by the knowledge of experts drawn from throughout the firm.

We are a firm with a deliberate focus; we do not try to be all things to all people. Instead we choose to specialise in specific sectors and areas of business where we have real in-depth expertise and experience.

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