

# R&D tax credits

## A quick guide



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**R&D Tax Relief is a corporation tax relief on research and development expenditure that can reduce your company's tax bill or even lead to a cash payment from HMRC; if your company is small or medium-sized (i.e. an SME), and you have made a tax loss, then you can claim the tax credit by way of a cash sum paid direct to you by HMRC.**

### What companies qualify?

A company can only claim R&D Relief if it's liable for corporation tax. Note that there is a separate regime for 'large' companies, i.e. non-SMEs, but we only have only shown information for the SME regime below. An 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

From 1 April 2012, the tax relief on allowable R&D costs is 225 per cent - that is, for each £100 of qualifying costs, your company could have its taxable income reduced by a notional extra £125 on top of the £100 spent.

### How we can help

We have worked with a lot of SMEs to claim R&D tax relief and it's important to note that **'R&D' does not have to mean men in white coats wandering about the place.** A large number of software and hardware

companies have benefited from the tax credits but so too have clients involved in other sectors. A good example is a company that designed high performance eco houses, which required research into insulation efficiencies. Because they made losses in their first years of trading, they were able to claim back over £100k in *cash* from HMRC. Once profitable, R&D tax credits can significantly reduce your tax bill. See below for more on the definition of R&D, but if you think you may qualify, it's always worth checking. Basically, if the technology you are working on is innovative and there is no ready answer or solution out there already, then it's probably R&D for these purposes.

### Which R&D projects might qualify for Relief?

Your company can only claim for R&D Relief if an R&D project seeks *'to achieve an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technological uncertainty'* - and not simply an advance in its own state of knowledge or capability. The project must be related to your company's trade -

either an existing one, or one that you intend to start up based on the results of the R&D.

It's helpful to document the following questions, with your own answers, when filing your Company Tax Return, so HMRC can see your view of how the definition of R&D applies to your project(s).

#### 1 What is the scientific or technological advance?

Rather than stating the name of the product, process, functionality, etc, being developed you should consider what scientific or technological advance is being sought. This focuses attention on the project's aim for an advance, which is the key issue in judging whether R&D for tax purposes is being undertaken. It's not enough that a product is commercially innovative. You can't claim in respect of projects to develop innovative business products or services that don't incorporate any advance in science or technology.

## 2 What were the scientific or technological uncertainties involved in the project?

Scientific or technological uncertainty exists when knowledge of whether something is scientifically possible or technologically feasible, or how to achieve it in practice, is not readily available or deducible by a competent professional working in the field. But uncertainties that can be resolved through relatively brief discussions with peers are routine uncertainties rather than technological uncertainties. Technical problems that have been overcome in previous projects on similar systems are not likely to be technological uncertainties. You should set out at a high level, in a form understandable to the non-expert, what these uncertainties were and when they started and ended.

## 3 How and when were the uncertainties actually overcome?

Describe the methods adopted to overcome the uncertainties and the investigations and analysis undertaken. This should not be in great detail, simply sufficient to show that the matter was not straightforward. Describe the successes and failures and the impact of these on the overall project. If the uncertainties were not overcome, explain what happened.

## 4 Why was the knowledge being sought not readily deducible by a competent professional?

It might be publicly known that others have attempted to resolve the uncertainties and failed, or perhaps that others have resolved the uncertainties but that precisely how it was done is not in the public domain. In either case a valid technological uncertainty can still exist. Alternatively, if the project is one where there is little public information available, you'll need to show that the persons leading the R&D project are themselves competent professionals working in the relevant field. Outline their relevant background, professional qualifications and recent experience.

## Which costs qualify for R&D Relief?

To qualify as R&D, any activity must meet the definitions set out by the Department for Business, Innovation and Skills. The activity must contribute directly to seeking the advance in science or technology or must be a qualifying indirect activity. If your company and the project both meet the necessary conditions, then you can claim tax relief on revenue expenditure (generally, this means costs incurred in the day-to-day running of the business - not capital expenditure on assets) in the areas outlined below, if all necessary conditions are met. If you've spent money on something such as staff costs where the employee was only partly engaged on R&D activities, you can only claim for an appropriate proportion of the cost.

*Employee costs* - that is, employing staff directly who are actively engaged in carrying out R&D itself. The staff must be employed under a contract of employment directly with your company - not consultants, agency workers, or staff/directors whose contracts of employment are with other companies. However, these others may qualify under either the rules for staff providers or subcontractors.

*Staff providers* - paying a staff provider for staff provided to the company who are directly and actively engaged in carrying out R&D. The staff provider needs to contract with the individual whose services they supply – not through another person.

*Materials* - consumable or transformable materials used directly in carrying out R&D. These are actual physical materials that are consumed in the R&D, and not things like telecommunication or data costs.

*Utilities* - power, water, fuel used directly in carrying out R&D, but not things like telecommunication costs and data costs.

*Software* - computer software used directly in the R&D.

*Subcontracted R&D expenditure* - if your company or organisation is claiming relief under the SME

Scheme, then you may be able to claim back 65% of what you spend on certain R&D activities carried out for you by a subcontractor.

## Capital expenditure

Although R&D Relief is only available for 'revenue expenditure' (generally, day-to-day running costs, as opposed to capital expenditure), if you are involved in R&D and you spend money on capital assets, you may be able to claim R&D capital allowances at 100%. This will be separate from the R&D tax credit procedure though.

## When to claim

You must make any claim for R&D Relief in your Company Tax Return. The normal time limit for making your claim is two years after the end of the relevant Corporation Tax accounting period, so you can claim for two years not just the last year.

## Record keeping for R&D Relief

There is no specific record-keeping requirement for R&D Relief claims. But the general Corporation Tax requirement to keep sufficient records to support the entries on your Company Tax Return still applies. HMRC doesn't expect you to create new primary business records just for an R&D Relief claim. But you may need to maintain your business records in a different way, to allow you access the information you need easily. Typically this may include a record of time spent on specific R&D projects by staff. Before you make your claim, you may want to involve your R&D staff in the process. This will help you identify qualifying activities and expenditure.

## How much R&D Relief SMEs can claim Amount of expenditure

Until April 2012 tax relief was only available if your company spent at a rate of at least £10,000 a year on qualifying R&D costs in an accounting period. This limit was removed for expenditure incurred on or after 1 April 2012. There's an upper limit of €7.5 million on

the total amount of aid you can receive on any one R&D project.

**Rate of tax relief or credit**

The tax relief on allowable R&D costs incurred after 1 April 2012 is 225 per cent (before 1 April 2011 it was 200 per cent) - that is, for each £100 of qualifying costs, your company could have its tax bill reduced by an additional £125 on top of the £100 spent. See example 1.

If instead there is an allowable trading loss for the period, this can be increased by 125 per cent of the qualifying R&D costs - so that's £125 for each £100 spent. This loss can be carried forward in the normal way, but only if you choose not to convert it to tax credits and get cash paid to you.

If you have made a loss, and you want 'cash back' from HMRC, you will receive 11% (for 2012/13) of the R&D expenditure – see example 2. This rate has increased to **14.5%** for 2014/15.

**To discuss your requirements please call or email Jerry Davison: 01392-432654 or [jerry@millconsultancy.co.uk](mailto:jerry@millconsultancy.co.uk)**

Example 1 - R&D Relief for expenditure of £20,000 where the company has made a profit of £25,000	
Calculation step	Amount
R&D expenditure	£20,000
R&D Relief	£20,000 × 125% = £25,000
Normal taxable profit	£25,000
Taxable profit less R&D Relief	£25,000 - £25,000 = 0
Revised taxable profit	Nil – therefore saves 20% tax on the normal profit of £20,000

In both examples, remember that the actual R&D expenditure of £20,000 has already been deducted as normal from the calculation of profit or loss. The R&D tax credit relief is then added to give the 'revised' taxable profit or loss.

Example 2 - Converting R&D Relief on expenditure of £20,000 to a tax credit payment	
Calculation step	Amount
R&D expenditure	£20,000
R&D enhancement	£20,000 × 125% = £25,000
Normal taxable loss	-£5,000
Trading loss (after R&D Relief)	-£30,000 (-£5,000 - £25,000)
R&D expenditure qualifying for conversion to credits	£20,000
Potential tax credit	£20,000 × 11% = £2,200
Payable tax credit	£2,200
Losses available to carry forward or back	Nil