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R&D Tax incentives

Brief introduction



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Background

R&D Tax Reliefs are aimed at incentivising UK companies to innovate, through increased spending in research and development. Where companies can demonstrate they are developing new, or appreciably improved products, processes, materials, devices, or services, through *science* or *technology*, they are eligible to claim a refund on related costs, [subject to certain criteria](#).

As the schemes are administered through the tax system, to make a claim, the claimant must be within the scope of UK corporation tax.

There are currently two schemes under which companies can claim R&D Tax reliefs:

- (i) the R&D Tax Relief Scheme for Small & Medium sized Entities (SMEs)
- (ii) the R&D Expenditure Credits (RDEC) Scheme for non-SMEs.

From 1 April 2024, the government plans to merge both the above schemes to simplify their administration.

There is a separate scheme for Capital expenditure.

Benefits available

For **SMEs**, the R&D Tax Relief scheme provides a [super-deduction](#) of 130% (86% from 1 April 2023) on eligible costs. This translates to a benefit of 24.7% for a company paying tax at 19% (16.34% from 1 April 2023 or 21.5% for a company paying tax at 25%). For loss-making companies, there is an option to surrender up to 14.5% (10% from 1 April 2023) of the R&D expenditure and related super-deduction to HMRC, in return for cash (subject to a cap).

The **RDEC scheme** for non-SMEs provides a taxable credit of 13% on qualifying R&D expenditure (increasing to 20% from 1 April 2023).

For **capital expenditure** incurred on assets used in R&D or for providing facilities for undertaking R&D, accelerated R&D Allowances (RDAs) at the rate of 100% are claimable.



SME or non-SME?

SME criteria

The company should meet the following two-part test. It should have:

- (i) fewer than 500 employees AND
- (ii) EITHER:
 - a turnover of less than €100m or;
 - a balance sheet total of less than €86m

There are other complexities around ownership and control which must be considered. An understanding of the entire group and related shareholdings is thus essential for the purposes of this test.

Where a company does not meet the SME test, it is considered a non-SME or a 'Large Company'.

The R&D Definition

The definition of R&D for the purposes of the Tax incentives schemes is set out in detail within the DSIT (Department for Science, Innovation & Technology) guidelines (updated 7th March 2023). These guidelines are an important read and provide useful information on R&D-eligible activities for the purposes of the tax incentive. Briefly, for an activity/project to be eligible, it must:

- (i) **seek** to achieve an **advance** in **science or technology**; and,
- (ii) **seek** to resolve the associated **scientific or technological uncertainty**.

Note that success is not a criterion for claiming.



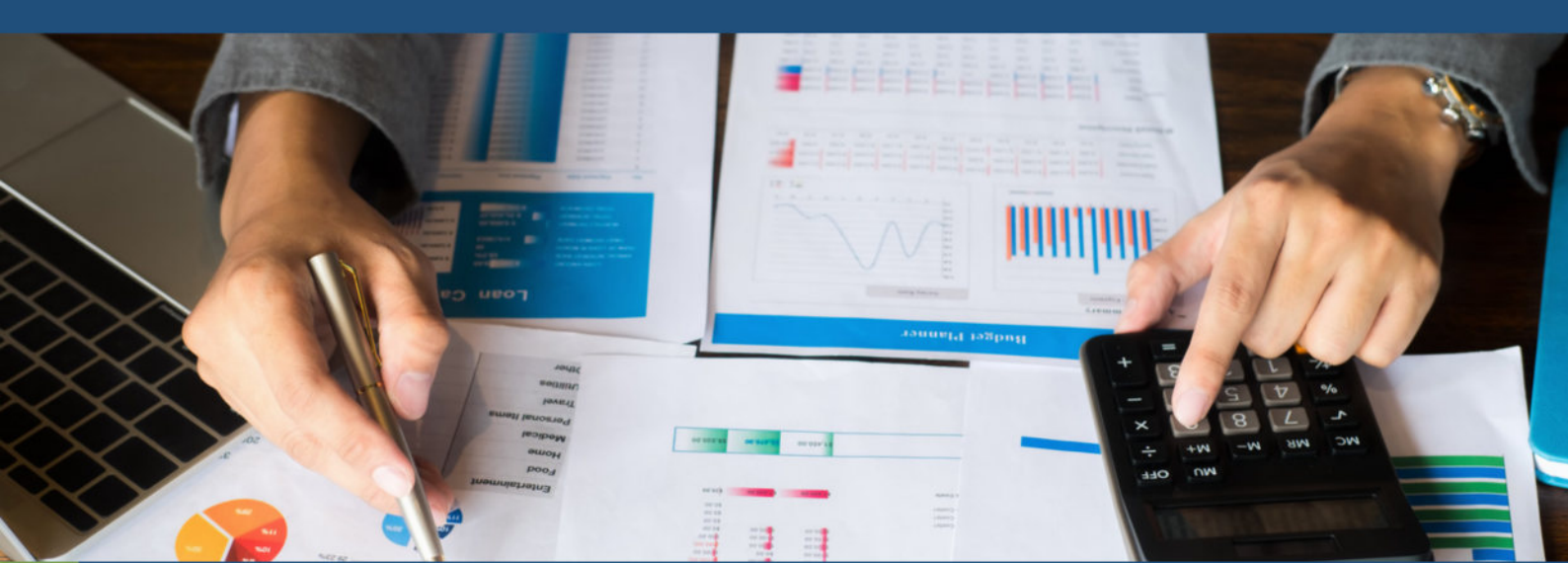
The R&D Definition

With the R&D definition being so broad, companies are tasked with trying to understand how it applies to their specific industry and business. Determining whether an activity meets the 'Advance' criteria requires careful consideration of the state of industry knowledge and how the company has sought to further this. In seeking this advance, the company may face scientific or technological uncertainties or in other words, challenges. How these are overcome or attempted to be resolved, determines whether the eligibility criteria have been met. Many companies find it difficult to identify these activities within their business as usual activities or from what they deem as normal problem-solving within their day job.

It is also important to bear in mind that to be eligible, activities are not restricted to developing a new product, process, material, device or service. They can relate to appreciable improvements made, or attempted, to an existing product, process, material, device or service. This can also include using science or technology to duplicate the effect of an existing product/process, material/device but by achieving it in a fundamentally different way (e.g automating a manual process). From 1 April 2023, mathematical advances are included as science for the purposes of these Guidelines.

Note that the straightforward application of information available in the public domain does not constitute eligible activities. However, if a competitor is undertaking similar development activities as you, but where this information is guarded/patented and thus not available in the public domain, these may be R&D eligible.

Broadly speaking, if your company is engaged in challenging developmental activities that **go beyond routine industry practice and publicly available information**, there is a good chance these activities will be eligible for R&D tax relief/credits.



Qualifying costs

Once the eligible activities have been identified, the next stage is to gather the related costs.

Only costs relating to specific cost categories may be claimed. These costs must be revenue in nature and deductible for the purposes of UK Corporation tax, in the year in which the claim is made.

These cost categories are set out below:

- **Staffing costs**
- **Externally Provided Workers (EPWs)** – payments for 3rd party contractor personnel or to group personnel working under the claimant's supervision, direction and control.
- **Software and consumable items**
- **Payments for subcontracted activities (for SMEs only)** – payments for R&D contracted to 3rd parties or to group companies.
- **Payments made to qualifying bodies (large companies only)** - qualifying bodies include charities, universities etc.
- **Payments made to the subjects of clinical trials.**
- **Cloud services and data licensing** - these are claimable for accounting periods starting on or after 1 April 2023.



Claim submission

The R&D Tax Credits claim is made in the company's corporation tax return (or amended return) for each accounting period.

From 8th August 2023, claimants must complete the digital **Additional Information Form** prior to submission of the R&D claim within the company tax return. A link to the online form is provided below:

<https://www.gov.uk/guidance/submit-detailed-information-before-you-claim-research-and-development-rd-tax-relief>

Claim notification

For accounting periods starting on or after 1 April 2023, new claimants or claimants who have not made a claim in the previous 3 years will be mandated to inform HMRC of their intention to make a claim for R&D tax relief using a new digital form. This form will have to be completed within the claim notification period, which begins at the start of the accounting period and ends 6 months after the end of the accounting period for which the company intends to make a claim.

Detailed guidance and a link to the online form can be found here:

<https://www.gov.uk/guidance/tell-hmrc-that-youre-planning-to-claim-research-and-development-rd-tax-relief>



CURRENT R&D LANDSCAPE

- **HMRC ENQUIRIES**

HMRC has heavily increased scrutiny of R&D claims. It is estimated that around 80% of submitted claims are currently being enquired into by HMRC. In almost all these instances, this has resulted in a (downward) claim adjustment, or claim rejection.

- **LACK OF AWARENESS OF LATEST GUIDANCE AND REQUIREMENTS**

From 8 August 2023, the completion of the Additional Information Form (AIF) is mandatory. The form must be completed PRIOR to submitting the claim within the company's tax return. HMRC has found that the vast majority of R&D claims submitted after 8 August were done so without the prior completion of the AIF, resulting in claims rejection.

- **WHAT DOES HMRC LOOK FOR IN SUBMITTED R&D CLAIMS?**

- Demonstration that the right people have been involved in the claim preparation. For this purpose, HMRC expects the 'competent professionals' to make judgments on R&D eligibility. These are persons who are experts in their field, who have been involved in undertaking the company's R&D eligible activities. They may be internal staff or external personnel.
- The people involved (i.e the competent professionals mentioned above) have understood the guidelines and definition of R&D for Tax, to enable them to make informed judgments on R&D eligible versus ineligible activities.
- There is a clear articulation in the AIF of why a project is deemed eligible.
- Demonstration that only the correct costs have been included in the claim.



Questions?

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Over 16 years experience of working with companies to
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