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CHARTERED ACCOUNTANTS



The Lowdown on Research & Development Tax Reliefs

The 2022 Autumn Statement and earlier reforms will see new rules introduced that will affect how businesses apply for Research & Development (R&D) Tax Relief.

Our factsheet outlines the new changes coming into place from April this year and how they may affect businesses considering a claim.



What is R&D Tax Relief?

The R&D Tax Relief Scheme was introduced to support, reward and encourage companies undertaking R&D.

It offers Tax Relief that reduces your company's Corporation Tax bill, or in some cases, will result in a payable tax credit.



What businesses are eligible?

Small to medium-sized enterprises (SMEs) can claim R&D Tax Credits through the SME scheme.

It is open to solvent registered companies with fewer than 500 staff, and a turnover of under €100 million or a balance sheet total of under €86 million.

Prior to April 2023, the small or medium-sized enterprise (SME) R&D Tax Relief allowed companies to either:

- Deduct an extra 130 per cent of their qualifying costs from their yearly profit, as well as the normal 100 per cent deduction, to make a total 230 per cent deduction; or
- Receive a cash tax credit where a loss is incurred equal to 14.5 per cent of the surrenderable loss.

From 1 April 2023, the rates of relief offered by this initiative will have changed as follows:

- The additional deduction rate for the SME scheme has been reduced to 86 per cent, to make a new total deduction rate of just 186 per cent
- The SME credit rate has decreased to 10 per cent for most claims
- The RDEC rate has increased to 20 per cent

If you are a loss-making company using the SME scheme, in many instances, you can now only receive £18.60 for every £100 - compared to £33.35 per £100 pre-April 2023.

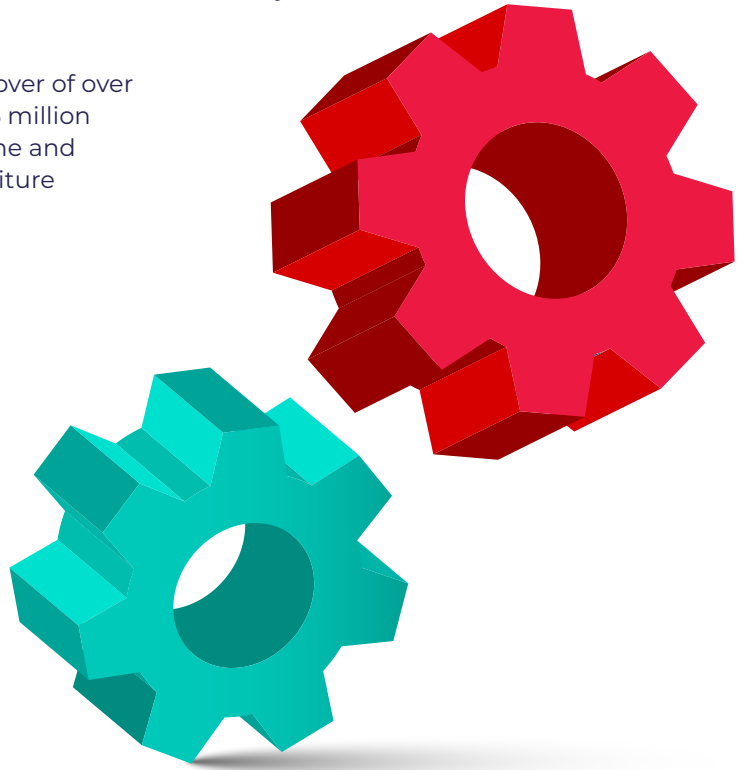
However, companies applying to the SME scheme can only claim a tax credit worth up to 300 per cent of their combined PAYE and NIC liability, plus a £20,000 grace amount.

Companies with more than 500 staff and a turnover of over €100 million or a balance sheet total of over €86 million are classed as a large company under the scheme and can claim a Research and Development Expenditure Credit (RDEC) instead.

The RDEC is calculated at 13 per cent of your company's qualifying R&D expenditure and is taxable.

Smaller businesses can also make use of the RDEC scheme where they have been subcontracted to do work by a large company.

Depending on if your company is profitable or loss-making the credit may be used to discharge Corporation Tax.



What R&D projects are eligible?

A business must first determine whether their R&D project is eligible before they consider claiming for their eligible expenditure.

This can sometimes be the hardest part of an R&D claim as it depends on several important criteria.



For your project to qualify you will need to show that it:

- Aimed to make an advance in an area of science and technology
- Involved technological uncertainty
- Made efforts to overcome this uncertainty
- Couldn't have been easily worked out by a qualified professional in the field.

You may be asking, “What is an advance?” or “What is a technological uncertainty?”

HM Revenue & Custom's (HMRC's) definitions of these are:

- **Technical or Scientific Advance:**
A project outcome that creates an advance in an overall field of science or technology, not just for your business or sector.
- **Technological Uncertainty:**
Something that isn't known to be scientifically or technologically feasible at the beginning of the project.

The rules around eligibility are complex, and many businesses do not realise that their projects may be suitable for a claim.

Often assumptions are made that this relief only applies to the most innovative businesses in highly technical sectors, such as engineering, manufacturing or IT, but this relief is open to all businesses as long as they meet the eligibility criteria.

Successful claims have been made by:

	Private healthcare clinics
	Dentist practices
	Agricultural businesses
	Education
	Finance and insurance
	Construction
	Real estate
	Hospitality
	And many more

If you are unsure whether a project might be eligible it is best to seek professional advice.

What is eligible R&D expenditure?

Once you've worked out which projects are eligible for R&D Tax Relief, you will need to identify what the eligible costs associated with the work are.

These fall into five main categories:

- Staff costs, including pensions and bonuses
- Subcontracted costs
- Raw material costs
- Utility costs
- Software costs.

When collating costs, you should make sure that these align with your company's profit and loss for the year so that HMRC can see how these costs link in with your financial statements.

HMRC will also expect any apportionments applied to R&D costs to be fair and reasonable.

In some cases, HMRC applies more advanced criteria around what costs are eligible, including caps on certain expenditure.



Recent reforms to R&D Tax Relief

Going Digital

From 1 April 2023, some new rules for R&D Tax Relief claims require businesses to submit a pre-notification of their claim to HMRC digitally.

This applies if a business:

- is a new claimant; or
- has not claimed in the last three financial periods.

HMRC will need to be informed within 6 months of the end of the period of account to which the claim relates. This is for claims made on or after 1 August 2023.

The changes predominantly affect SMEs, as they are more likely to be first-time claimants of R&D Tax Relief.

This is part of a wider package of reforms which also include:

- R&D reliefs will be focused on the UK from 1 April 2024 and all subcontracted R&D work and the cost of externally provided workers (EPWs) will be limited to work undertaken in the UK.
- Businesses are now able to include the costs of purchasing data for R&D projects or using cloud computing services within a claim.

The new rates of relief

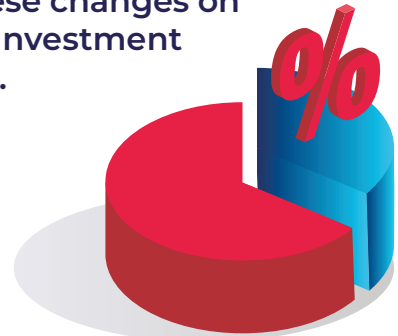
As mentioned, from 1 April 2023, the rates of relief offered by this initiative have changed as follows:

- The additional deduction rate for the SME scheme has been reduced from 130 per cent to 86 per cent– to make a new total deduction rate of just 86 per cent
- The SME credit rate has fallen from 14.5 per cent to 10 per cent
- The RDEC rate has increased from 13 per cent to 20 per cent

For those R&D intensive businesses, whose annual eligible R&D expenditure exceeds 40, the higher 14.5 per cent SME credit rate will remain available.

The reductions to the rates of relief available under the SME scheme come at a time when Corporation Tax rates are rising for more profitable businesses.

It is, therefore, important to calculate the impact of these changes on your investment plans.



How can you claim R&D Tax Credits?

Making an R&D claim allows you to do one of the following:

- Reduce your Corporation Tax liability for the period
- Get a refund of Corporation Tax that has already been paid
- Receive a tax credit (in the case of loss-making companies).

To claim R&D Tax Relief, you will need your accountant to enter the claim on your Corporation Tax return.

In addition, HMRC expects a clear R&D report to be submitted alongside the worked calculations for the R&D claim.

This report is what HMRC reviews to determine if you meet all their criteria for R&D eligibility, so it is important to produce a robust report for a claim to be successful.

The timelines for claiming R&D Tax Credits are strict – you must submit any R&D claim within two years of the end of the accounting period in which the work took place.

HMRC will not process any claims submitted after this deadline, which could lead to you missing out on huge tax benefits.



Get in touch

If you have questions regarding your business's eligibility for the scheme or the upcoming changes to R&D, then please **call us today**.

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