

Innovation & Technology

RESEARCH & DEVELOPMENT TAX INCENTIVES

2022/23



Research & Development (R&D) tax incentives have gathered some momentum over recent years and many companies are now aware of the existence of this valuable tax break. However, despite increased awareness of R&D tax incentives, we still encounter a fair degree of uncertainty by potential claimants regarding whether they are eligible and how to prepare a claim.

WHAT IS R&D AND WHO CAN CLAIM R&D TAX INCENTIVES?

R&D tax incentives are designed to encourage scientific and technological innovation by companies in the UK tax system.

Although the tax incentives refer to 'R&D', they are not just for R&D companies in the traditional sense, nor do they apply just to 'high tech' companies. Any company can claim R&D tax incentives if it is involved in the sort of innovative activities that this tax break seeks to encourage.

It is equally important to note that R&D tax incentives are not just for 'ground-breaking' new inventions or products. Projects can qualify for R&D tax incentives if they seek to achieve significant improvements by changing the underlying science or technology of something such that it is 'better than the original', provided that they also involve scientific or technological challenges.

HOW MUCH ARE R&D INCENTIVES WORTH?

The majority of companies that we encounter are small or medium-sized entities (SMEs) for these purposes; they have fewer than 500

employees and either annual turnover of less than €100 million or gross assets of less than €86 million.

In most situations where an SME bears the cost and commercial risk of a qualifying R&D project, it should be able to claim R&D tax relief and/or payable R&D tax credits on its qualifying R&D expenditure. These can be very valuable:

- For profitable companies, extra R&D tax relief can be claimed, which in cash terms is worth **24.7% of the qualifying R&D expenditure.**
- For companies reporting tax losses, the loss relating to the qualifying R&D expenditure can be 'cashed in' with HMRC for **payable R&D tax credits worth just over 33% of the qualifying R&D expenditure.**

Companies undertaking R&D on a subcontract basis for third parties, or receiving funding towards their R&D expenditure, cannot claim under the scheme mentioned above. However, they are often eligible for an **'R&D Expenditure Credit' worth 10.53%/9.72%* of the gross qualifying R&D expenditure, before deducting any funding received.**

*Rates applicable from 1 April 2020 and for the period 1 January 2018 to 31 March 2020 respectively.

OPPORTUNITIES OFTEN MISSED

In our experience, there are numerous areas of qualifying R&D activities for which companies can claim R&D tax incentives but which are frequently overlooked:

- **'Non product' and 'internal' R&D.** R&D tax credits are not exclusively aimed at new products; they apply equally to the development of substantially improved processes, materials, devices and services. Technical improvements to increase efficiencies or to reduce costs can potentially qualify, even though the end product/service delivered to the customer may effectively remain unchanged.
- **Projects undertaken for third parties.** There is a common misconception that companies cannot claim R&D tax incentives for projects that are undertaken for customers, clients and other third parties. This is not the case. In some circumstances it will be possible to claim R&D Expenditure Credits, even if the intellectual property arising from the project belongs to someone else.
- **Projects for which grants or other funding is received.** Another common misconception is that companies cannot claim R&D tax incentives if they have received funding towards the R&D project. R&D Expenditure Credits are often available in such circumstances in addition to the funding received.
- **Unsuccessful and aborted R&D projects.** The R&D tax credits rules do not require a project to succeed in order to qualify. It is not uncommon for technologically innovative projects to fail due to the complexities involved; review of such projects is often fertile ground for an R&D tax credits claim.

PARTICULAR REASONS TO USE A SPECIALIST ACCOUNTANT

In preparing an R&D tax credits claim, there are various benefits in involving a specialist accountant.

The involvement of a specialist can help speed your progress up the learning curve in understanding what falls within the definition of R&D for tax purposes and which costs may be claimed.

It is important to remember that these incentives are delivered through the corporation tax system and should be considered in the context of the company's overall tax planning. A specialist accountant can help you to ensure that the tax benefit is maximised.

There are also certain areas of particular complexity for which specialist accounting advice should be sought, including:

- **Groups of companies.** Contractual and accounting arrangements between the companies can affect the amount of R&D tax relief/credits available, as well as the overall tax position.
- **R&D Expenditure Credits.** These are reported differently in the company's accounts and can affect the timing as well as the amount of the company's tax liabilities.
- **Patent Box.** Companies considering claiming the Patent Box tax incentive (which effectively reduces the tax rate to 10% on certain profits derived from patents and patented goods) will need to track their R&D expenditure in an appropriate way. This needs to be considered when the R&D tax relief/credits claim is prepared.
- **'Capitalisation' of development costs.** In certain situations, R&D expenditure may be reported in the company's balance sheet. Accounting for the expenditure in this way can give rise to complexities affecting the general tax treatment of the costs and the R&D tax relief/credits position.

HOW ARE R&D TAX INCENTIVES CLAIMED?

R&D tax incentives must be claimed through the company's tax return, which is usually accompanied with a brief report setting out the details of the claim.

The claim is retrospective and must usually be made within two years after the end of the company's relevant period of account.

Companies are not required to keep specific records purely for R&D tax credits purposes, so it is possible for a new claimant to review expenditure already incurred in the previous two to three years with a view to claiming for eligible R&D expenditure in that period.

When the claim is filed with HM Revenue and Customs, it is dealt with by a specialist team. It is usually processed very quickly, often within a few weeks.

HOW CAN HAZLEWOODS HELP?

Hazlewoods Innovation and Technology Team has considerable experience in helping companies to claim R&D tax incentives.

We provide a complete 'end to end' service:

- Free initial discussion to help the company consider eligibility;
- Guidance in collating qualifying costs;
- Preparation of the claim document for the company;
- Filing the claim and amended return with HM Revenue and Customs;
- Advice on improvements to the company's systems for future claims; and
- Advice on planning and structuring to optimise future claims.

For help and advice that you can trust, please contact David Clift or Jemma Vaughan on 01242 680000 for a free initial consultation.



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