

BScale

Legal services for start-ups,
scale-ups, founders and investors

R&D claims for small and medium size enterprises – a good news tax story

The detail on this one can be complicated. But the headline messages are nearly always good for businesses overcoming technical challenges.

We can help your business, very cost effectively, with:

- A high level assessment of the likely value of an R&D claim
- Preparing claims for filing, together with supporting documents
- Implementing a process to capture the information required to support future claims on a real time basis.

We also regularly risk assess R&D claims in the context of M&A transactions, particularly for fast growth businesses, to ensure these are robust.

Overview of key points for R&D for small and medium size businesses

Small and medium sized enterprises (SMEs)

Small and medium size businesses which have incurred qualifying expenditure can get extra tax relief for this. Very broadly, to qualify an SME, the business and certain associated businesses must have:

- less than 250 members of staff and
- turnover which does not exceed €50m or a balance sheet size of less than €43m.

Care is needed where an entity is a joint venture or, for example, has institutional funding and the position should be reviewed to make sure it can still qualify.

Value of relief

Where R&D relief is available, the actual value of the relief is £43.70. Or, put a different way, £100 of qualifying spend can offset £230 of taxable profits.

If the business is loss making, a credit can be reclaimed of up to 14.5% of the amount that would be deductible against profits – so for every £100 of spend, cash of £33.35 can be reclaimed (subject to a restriction reflecting the total of the losses). This is very attractive in cashflow terms, but

needs to be balanced against the loss of value as compared with waiting for full relief where, for example, the business is about to move into profit. This is particularly significant given the expected rise in the corporation tax rate to 25% from 2023, although the impact of the small companies rate will also need to be considered. Modelling the value of the relief against business forecasts will help ensure the most appropriate choice is made. But for businesses still in development phase, this remain a way of deferring the need to raise cash from other sources and the discount may be worth it to improve immediate cashflow.

However, from April 2021 the amount of cash reclaims is also capped at the total of £20,000 and 300% of relevant PAYE and NIC costs, unless the company is exempt. Exemption applies where the company's employees are, broadly, engaged in preparing or creating IP and certain independence conditions are met. This is an anti-avoidance measure but may catch some UK businesses with genuine research activities.

What expenditure can qualify

For expenditure to qualify, cutting edge science and technology research will obviously be eligible. What is often less well understood is that the relief is also available for expenditure on resolution of scientific or technological uncertainties. The advances in question do not have to be the kind that are published in scientific papers, and may be very specific to the business concerned. They do have to involve an uncertainty that a competent professional can't readily resolve. But they can occur in many fields – from agriculture to construction. And they can involve new adaptations or applications of existing technology which involve uncertainty.

Spend on abortive projects can qualify as long as the criteria are met – the relief is not restricted to projects which succeed or turn out to be valuable to the business.

There are some red lines to bear in mind

- **Pure maths, statistical methods or modelling do not qualify**, even if these involve substantial innovation

– although the way in which the outcome is adapted or applied in a business context may qualify.

- **Care is needed with the allocation of expenditure**
– for a lot of projects or assignments where only part of the expenditure qualifies, it will be important to be able to identify the point at which the technological uncertainty was overcome, as expenditure after this point will not qualify.
- HMRC’s view in principle is that a business which is **simply copying innovations already made by a competitor will not qualify**, because even if the new business has to gain certain knowledge, the knowledge itself is already available to the industry. In practice, it is rare for matters to be as black and white as this may suggest, and until an innovation becomes widely known or industry standard practice, other businesses may well have to find ways of adopting or applying what may have become a known concept and this process may involve development.
- Not all businesses which are innovative or involve a lot of highly qualified professionals will qualify: **the relief is only available on any elements of spend involving actual technical uncertainty**. The relief is not available for generic “research” in the form of collating or providing information. For example, even if an enormous amount of effort goes into identifying, compiling and collating relevant research as part of a subscription only website dedicated to developments in a particular industry, R&D relief will not be available for that work. However, if there are innovative elements to the technology involved or the way in which users can interact with this, spend on developing these may be eligible.

Significant exclusions

There are exclusions which need to be checked. Among the key factors to note are:

- the relief is only available to companies, not individuals or partnerships;
- expenditure funded by certain grant or subsidies isn’t covered;
- the full relief isn’t available for capital expenditure; and
- for most subcontracted work, only 65% of the subcontracting cost is available, and if the work is subcontracted to a connected company specific restrictions apply.

For expenditure funded by a grant or subsidy, a different form of relief may be available but this is less generous – it is the large business scheme form of relief.

The distinction between capital and revenue expenditure has some grey areas but, broadly, capital expenditure is one off spend on items that have a lasting benefit for the business. Equipment or premises used for research may qualify, for example. This spend is still very much worth identifying because it will be eligible for 100% relief in the first year of spend, even if not eligible for the temporarily enhanced rate of capital allowances at 130% or 50% for spend on qualifying plant and machinery.

Practicalities

We are aware of key pitfalls and can identify quickly any areas of concern and cost breakdown issues as well as helping you with the technical narrative so that this is presented in the best way to support your claim.

We will be fair and transparent on costings, flexible on our approach (including in some cases deferring fees until a successful claim) and we won’t charge you for work you don’t want – if you simply want advice on a key problem area, and have the skills in house to do the rest of the claim yourself, we’re happy to support you on the basis which is right for your business.

We can also review the R&D claims history of businesses preparing for sale to identify and resolve any issues ahead of pre sale due diligence (the company sale equivalent of a survey) taking place.

In some cases, claims are challenged by HMRC, often because of a lack of adequate supporting evidence. We have experience of helping businesses reach settlement with HMRC in such cases and can advise on the best approach to achieve cost effective resolution.

Who to contact

Should you wish to discuss any of the issues raised in this article, please contact:



Martin Cook
Director

T +44 (0) 117 301 6989
M +44 (0) 7971 830 048
E martin.cook@burges-salmon.com



Alex Lloyd
Director

T +44 (0) 117 902 7730
M +44 (0) 7815 465 751
E alex.lloyd@burges-salmon.com