





# A Guide to Research and Development Tax Relief

Research and Development (R&D) tax relief is one of the most generous forms of Government funding available to UK businesses.

Aimed at innovative companies across all business sectors, the relief reduces a company's Corporation Tax liability and, in certain cases, can yield substantial cash credits.

## In this guide, we cover:

-  What qualifies as R&D for tax purposes
-  The two types of R&D relief and how they work
-  The types of expenditure that can qualify for relief
-  Our approach to R&D tax relief claims

Since R&D tax relief was introduced in 2000, we have helped hundreds of clients across a wide range of industry sectors make successful claims for relief.

A claim for R&D tax relief can be made up to two years after the end of any accounting period in which the company has incurred qualifying R&D expenditure. However, for first claims and in instances where three or more years have passed since a company's previous claim HMRC first need to be notified in advance of the intention to make a claim, within 6 months of the end of the accounting period.

This guide provides an overview of the key issues that need to be considered when determining whether your company might be eligible for R&D tax relief. For further information, please speak to your usual Blick Rothenberg contact, or get in touch with one of our experts listed on page 6.

There are, broadly speaking, eight steps to making an R&D tax relief claim:



# What qualifies for R&D for tax purposes?

R&D tax relief can only be claimed by companies that undertake qualifying R&D activities. It is therefore important to understand what this means, and how to identify whether your company's activities qualify.

## What is R&D?

R&D tax relief can only be claimed where a company has undertaken an R&D project that meets the required threshold for scientific or technical innovation.

For tax purposes, R&D takes place where a company undertakes work that aims to achieve an advance in science or technology.

This means that the company must be aiming to do more than create a new commercial product, or to advance its own capability – it must be looking to expand on the available science or technology.

An advance in science or technology can be exhibited in a number of different ways. For example, an R&D project might aim to:

- Generate and apply scientific or technical knowledge;
- Create a process, material, device, product or service that is new to the field; or
- Appreciably improve something that already exists through scientific or technological change.

The advance must be a non-trivial one, meaning that there must be a sufficient degree of 'scientific or technological uncertainty'. This exists where knowledge about whether the project objective is scientifically possible or technologically feasible, or how to achieve it in practice, is not readily available or deducible to a competent professional working in the relevant field of science or technology.

## Qualifying R&D activities

The R&D project as a whole will start when work to resolve the scientific or technological uncertainties begins and ends when the uncertainties have been resolved or when the project is aborted.

However, not all activities associated with the project will be 'qualifying R&D activities' for the purpose of R&D tax relief.

Activities that directly contribute to achieving the intended advance in science or technology through the resolution of scientific or technological uncertainty are R&D.

In addition, certain other types of expenditure associated with these activities can qualify. These are known as "indirect qualifying activities" and include, for example:

- Finance, administration and clerical activities, insofar as they are undertaken specifically for R&D purposes
- Training required to directly support an R&D project
- Data collection to devise new testing methods, even where this is not R&D in its own right.

Other activities will not qualify. For example, design activities or activities to improve the cosmetic or aesthetic aspects of a new software platform would not be R&D unless they directly contribute to the resolution of technological uncertainty within the project.



# The two types of R&D relief

There are two R&D relief schemes in the UK. The Enhanced R&D Intensive Support (ERIS) scheme is aimed at loss-making, R&D intensive SMEs while the new, merged scheme will apply to all other businesses.

## How the two schemes compare

### ERIS scheme

The ERIS scheme functions in the same way as the existing SME relief, which gives the company an enhanced deduction equal to 186% of its qualifying R&D expenditure (see next page) however it is only available for loss-making businesses.

If the company is a loss making “R&D intensive” SME, the cash payment can increase to 14.5% which corresponds to £26.97 for every £100 of qualifying expenditure, meaning the tax authorities are funding about a quarter of the company’s R&D expenditure.

Subject to certain exemptions, the cash amount receivable is limited to £20,000 plus 300% of total PAYE and NIC for the period.



*R&D intensive SMEs can surrender their tax losses for a cash payment of up to £26.97 for every £100 of qualifying expenditure incurred*



### Merged scheme

In contrast, the merged scheme provides the company with a credit equal to 20% of its qualifying R&D expenditure. This credit is treated as a part-payment of the company’s tax liability. This will come into effect for accounting periods beginning on or after 1 April 2023.

However, the credit itself is taxable, so the overall benefit (net of 19% or 25% Corporation Tax) is £16.20 or £15 for every £100 of qualifying expenditure incurred.

If the company has no tax liability, it can seek payment of the (post-tax) credit in cash.

## Determining which scheme applies

The basic rule is that the merged scheme will apply to all claimants unless the company is a loss-making SME, and deemed to be R&D intensive.

### What is an SME?

For R&D purposes, an SME is a company that has:

- fewer than 500 employees
- either an annual turnover not exceeding €100m or gross assets not exceeding €86m.

However, when assessing the size of the company it is necessary to include:

- the employee, turnover and gross assets figures for all group companies (on a consolidated basis)
- a proportion of the figures of the company’s partner enterprises’ (broadly, all companies that have an interest of between 25% and 50% in the company and/or its group, or which the company and/or its group has that level of interest).

This is a simplified version of the rules, but for now it is sufficient to note that determining whether or not a company is an SME can be a complex exercise in certain cases. An R&D intensive SME is an SME for which qualifying R&D expenditure constitutes at least 40% of total expenditure for accounting periods beginning on or after 1 April 2023, and 30% for accounting periods beginning on or after 1 April 2024.

Qualifying R&D expenditure and total expenditure of connected companies need to be aggregated in this calculation and so determining whether or not an SME is R&D intensive can also be a complex exercise.

### Other issues

There are other matters that can influence whether an SME is able to make a claim under the SME scheme:







- The subsidy provisions will no longer apply, and therefore SMEs that were previously claiming under the RDEC scheme may be able to claim under the ERIS scheme if the relevant conditions are met.
- New and extensive commentary on subcontracting has been introduced. It will now be the case that only the company that “intended or contemplated” R&D will be able to claim for the qualifying project(s). Groups will be able to choose which business makes the R&D claim.

# Qualifying R&D expenditure

Once qualifying R&D activities have been identified, and the relevant R&D scheme has been confirmed, the next step is to identify the qualifying expenditure associated with those activities.

## Qualifying R&D expenditure

The six types of expenditure that qualify for R&D relief are as follows:

-  1. Staffing costs
-  2. Subcontracted R&D
-  3. Externally provided workers (EPWs)
-  4. Consumable and transformable materials
-  5. Software, data licences and cloud computing services
-  6. Payments to clinical trial volunteers

### 1. Staffing costs

These include:

- salary payments (including bonuses)
- employer's Class 1 NICs
- employer pension contributions
- payments to reimburse employees for certain business expenses

Where employees spend part of their time on qualifying R&D activities and part on non-qualifying activities, only the relevant proportion of the staffing costs associated with that employee will qualify for R&D tax relief.

### 2. Subcontracted R&D

This includes payments made to subcontractors engaged to carry out qualifying activities that form part of the company's R&D project. Subcontractors must be located in the UK, and overseas subcontractors will only be allowable in limited circumstances.

In order to qualify, a specific part of the R&D activities must have been subcontracted out. Subcontracted R&D does not include payments under a contract for general services – so, for example, the work of consultants that provide expert advice and charge for their time would not qualify.

Under the merged scheme, all businesses will be able to claim for subcontractors, aligning the existing RDEC and SME regimes. These costs will be restricted to 65%. Expenditure on qualifying bodies no longer qualifies.

Under both schemes, if the company and the subcontractor are connected, different rules apply – these are more complex and require an analysis of the expenditure incurred by the subcontractor.

### 3. Externally provided workers (EPWs)

Broadly speaking, EPWs are individuals engaged by the company through a staff provider – such as a staff agency or another group company – rather than directly.

Where the company and the staff provider are unconnected, 65% of the payments made for EPWs in relation to qualifying R&D activities can be included in the claim.

Where the company and the staff provider are connected, the rules are more complex and require an analysis of the expenditure incurred by the staff provider.

Under the merged scheme, EPWs must be physically located in the UK. Additionally, the EPW must be getting paid via PAYE that is set up by the third-party provider.

### 4. Consumable and transformable materials

This includes the cost of materials that are used up or transformed as part of the R&D process. The cost of water, fuel and power used for qualifying R&D activities is specifically included in this category.

Materials used in the production of a product that is subsequently sold are not eligible.

### 5. Software, data licences and cloud computing services

This includes expenditure on software licences and software-as-a-service subscriptions to the extent the software is used for qualifying R&D activities.

For accounting periods beginning on or after 1 April 2023, licences to access and use digital data, and cloud computing services such as data storage and operating systems may also be included in some situations.

### 6. Payments to clinical trial volunteers

This includes payments made to individuals in return for their participation in clinical drug trials.

# Our approach to R&D claims

We tailor our approach to the size and the complexity of the claim, and our clients' individual preferences. We charge on a fixed-fee basis wherever possible.

## Our approach

We have significant experience of helping clients make claims for R&D tax relief and have advised a broad range of clients – from start-ups to FTSE-listed groups – on how they can optimise their claims.

We only accept R&D relief assignments where we consider there is a strong basis for a claim.

Following an initial review of the company's activities in order to assess the potential for a successful claim, we will work with you to estimate the potential claim benefit as soon as possible. This will enable us to recommend a suitable approach to the work and provide an estimate of our fees, to include:

- assistance with completion of the "Additional information form" and preparation of the claim report
- discussions with your technical staff
- advice on the types of expenditure to include
- preparing an R&D claim report / summary to support the claim
- updating the tax computations to include the claim (or reviewing the updated tax computations if prepared by other advisers), and
- ongoing guidance and advice throughout the process.

It is important to us that our clients trust our integrity and impartiality. As such, it is always our preference to charge on a fixed-fee basis, rather than to benefit from a 'success fee' based on a percentage of the claim benefit.

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## The process

No two R&D claims are the same; we tailor our approach according to the size and complexity of the claim, and the specific requirements of each client.

## Additional information form

All R&D claims are now required to have an "Additional information form" submitted in advance. The completion of this form requires detailed, granular information in respect of the company's qualifying R&D spend on a project by project basis, and a detailed narrative explaining how each of the company's main projects meet the criteria to qualify for the relief.

Contact details for the main senior internal R&D contact in the company who is responsible for the R&D claim and any agent involved in the R&D claim are also required to be included.

The R&D landscape has changed substantially, and this has led to an increase in compliance activity by HMRC.

The team have extensive experience in dealing with HMRC enquiries, including working closely with an ex-HMRC inspector, and a track record of successfully defending claims.



## Our team



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Ele is an R&D tax relief specialist, who is a Chartered Tax Advisor (CTA) qualified with nearly 10 years' experience advising clients. Ele is passionate about helping companies access R&D tax incentives and the positive impact it can have on a business, working closely with companies who wish to claim R&D tax credits in the UK. Her goal is always to provide a seamless service that helps companies navigate and understand the increasingly complex R&D landscape.



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Neil has been advising on business tax for 30 years, working in both practice and industry. His early experience in the Big 4 accountancies, and then in industry, brought with it significant exposure to large corporate tax issues. Since then, Neil has specialised in providing tax advice to owner-managed businesses, in particular start-ups, and focusing on the tax opportunities to create or unlock value at key stages of the business life cycle. In particular, he has advised on R&D tax relief across many sectors, including fintech, biotech and other technology-driven businesses.

