BLICK ROTHENBERG

International Business Review

Research and development tax incentives
Large companies

The UK has a generous Research & Development ("R&D") tax credit system for companies undertaking qualifying R&D. This has been designed to encourage investment in R&D and to make the UK an attractive location for innovative businesses.

There are two regimes depending on the size of the company. This factsheet summarises the R&D incentives for large companies. A separate factsheet has been produced for the small and medium sized enterprise ("SME") regime. A company is 'large' if it has either:

- 500 or more employees; or
- an annual turnover of at least €100m and a balance sheet of at least €86m.

In broad terms, where a company is a member of a group, the holding company and all companies in the group must together meet this definition.

Definition of R&D

HM Revenue & Customs ("HMRC") and the Department of Business, Energy and Industrial Strategy have issued guidance on the meaning of R&D for tax purposes. In broad terms, for R&D activities to qualify for relief, they should aim to achieve an advance in science and technology through the resolution of a scientific or technological uncertainty. HMRC has indicated that the definition should be applied to all branches of science and technology, including software development.

An advance in science or technology work that:

- generates scientific or technical knowledge:
- creates process, material, device, product or service which is new to the field; or
- appreciably improves something which already exists through scientific or technological change.

The R&D should not be seeking to create what is already available (except if it is a trade secret) or could readily be made available by a competent professional working in the relevant field.

Companies should ensure that they have sufficient records and documentation available to demonstrate how the work which they have done falls within the definition of R&D.

How it works

Large companies obtain R&D relief by claiming an R&D Expenditure Credit ("RDEC"). The RDEC is an amount, paid to the company by HMRC, equal to 12% of the company's qualifying R&D expenditure. The credit itself is taxable, but can be offset against the company's tax liability. As such, the net benefit for a company taxed at the current rate of corporation tax (19%) is 9.72%.

Loss-making companies may receive the RDEC in the form of a cash payment, capped at the level of payroll taxes incurred in respect of R&D employees during that year. Any excess is then carried forward as a credit for the following year.

The following expenditure typically qualifies for the R&D tax relief:

- the cost of staff directly involved in the R&D work;
- 65% of the cost of externally provided workers such as agency staff engaged by the company to work on the R&D project provided the two parties are not connected;
- the cost of software and consumable items such as fuel, power and water;
- amounts paid to certain organisations, e.g. universities and hospitals, for R&D undertaken on the company's behalf; and
- contributions to independent research undertaken by individuals and certain organisations providing it is relevant to the trade of the company.

The RDEC claim is included in the claimant company's corporation tax return and must be made within two years of the end of the accounting period in which the expenditure was incurred.

For expenditure to qualify for R&D relief it must relate to the trade of the company and must not be capital in nature. However, capital allowances of 100% are available on expenditure on capital assets, excluding land, used for R&D activities.

Subcontracted R&D

Large companies cannot claim R&D relief where the R&D has been subcontracted to them.

SMEs (i.e. companies that are not large under the definition above) cannot claim R&D relief under the SME regime where the R&D has been subcontracted to it by another company. However, where the R&D has been subcontracted by a large company or a company outside the scope of UK tax (e.g. an overseas parent company), the subsidiary may be able to claim under the large company regime.

Worked examples

Profit making	No claim £'000	RDEC claim
Operating profit before R&D expenditure	55,000	55,000
Qualifying R&D expenditure	(20,000)	(20,000)
RDEC	-	2,400
Profit before tax	35,000	37,400
Tax liability (= PBT x 19%)	6,650	7,106
Less: RDEC	-	(2,400)
Tax payable	6,650	4,706

Loss making	No claim £'000	RDEC claim £'000
Operating profit before R&D expenditure	5,000	5,000
Qualifying R&D expenditure	(20,000)	(20,000)
RDEC	-	2,400
Loss before tax	(15,000)	(12,600)
Tax loss carried forward	(15,000)	(12,600)
Repayable RDEC (£2,400 - £456 = £1,944)	-	1,944

If the company does not elect to surrender the loss to another group member, the RDEC gives rise to a cash payment to the company. After set-off against any current-year tax liability (including the notional corporation tax applicable to the RDEC income, at 19%), the ability to use the remaining amount of the RDEC is subject to a cap. This cap is the amount of PAYE and Class 1 National Insurance Contributions paid by the company in respect of qualifying R&D employees for the year.

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