



Your essential guide to R&D tax credits

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YOUR ESSENTIAL GUIDE TO R&D TAX CREDITS

There are plenty of advantages for UK businesses that decide to innovate their products and services – one of which is being able to claim tax relief on Research and Development (R&D) activity.

The Government's recent decision to significantly increase R&D expenditure credits means there has never been a better time for businesses to apply for tax relief and fund their innovation.

According to the latest available figures from GOV. UK, approximately 86,000 businesses apply for R&D tax credits per year, with a subsequent £7.4 billion claimed back on R&D expenditure. On current forecasts, HMRC expects this to rise to £9.5 billion by 2027. The information and communication, manufacturing and professional, scientific and technical sectors have the greatest volume of claims, making up 64% of claims and 69% of the total amount claimed.

However, understanding the intricacies of R&D tax credits can be complicated, especially for business owners and directors with little experience in scrutinising eligibility criteria or providing technical justification for a project.

With that in mind, we've created this essential guide which will walk you through the process and help determine whether or not your business may be able to benefit from the scheme.

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WHAT ARE R&D TAX CREDITS?

R&D tax relief is a government-funded incentive designed to encourage innovation and investment in Research and Development. First introduced in 2000, the scheme works by allowing businesses to reduce Corporation Tax liability or receive tax credits, providing that their project meets a certain set of criteria.

Historically, there have been two main types of R&D tax relief to be aware of, one designed for SMEs and one predominantly used by larger corporations. There are also circumstances in which a business can apply for both tax reliefs simultaneously. However, a new merged scheme is being introduced for accounting periods starting on or after 1 April 2024 which combines element from both the SME and RDEC schemes.

Small and medium-sized enterprise (SME) R&D tax relief

SMEs with fewer than 500 staff and a turnover of under €100 million, or a balance sheet total under €86 million are welcome to apply for this scheme. The staff, turnover and balance sheets of any linked or partner enterprises should also be included in the total. Claims can be backdated to account for past R&D activity within the past two years.

Providing they meet those criteria; SMEs can benefit by:

- Deducting an extra 86% of their qualifying costs from their yearly profit, as well as the normal 100% deduction, to make a total of 186% deduction
- Claiming a payable tax credit if the company has claimed relief and made a loss, the payable credit is worth up to 10% of the surrenderable loss – the increased the 14.5% rate for ‘R&D intensive’ companies



Claims can be backdated to account for past R&D activity within the past two years.

- ‘R&D intensive’ SMEs are able to claim a higher 14.5% credit if their qualifying R&D expenditure constitutes at least 40% of their total expenditure

However, SMEs cannot claim this tax relief if:

- They have received State aid totalling more than €7.5 million for the project
- They have received any other State aid (excluding the SME tax relief) for the project
- The work has been subcontracted to their business
- The project has been subsidised in some other way, for example by a grant, but you may be able to claim on the part that is not subsidised

R&D expenditure credit (RDEC relief)

RDEC is a tax credit utilised by many larger companies though it is also open to SMEs that do not meet the criteria for SME R&D tax relief as detailed above. The expenditure credit is calculated as a percentage of your qualifying R&D expenditure and, as with SME relief, can be backdated to account for past R&D activity within the past two years. The UK Government recently announced an increase in the amount of relief that businesses are able to claim back from the RDEC scheme. The current rates are:

- 13% on expenditure incurred from 1 April 2020 up to and including 31 March 2023
- 20% on expenditure incurred from 1 April 2023 onwards

*Please note that businesses in the following sectors cannot make a claim for either SME R&D relief or RDEC relief:

- The arts
- Humanities
- Social sciences, including economics

WHAT TYPE OF COSTS AND EXPENDITURE CAN YOU CLAIM R&D TAX RELIEF ON?

Below is a non-exhaustive list of costs that businesses can claim relief for:

Allowed

- ✓ Staffing costs: including gross salary, employer's NIC and pension contributions, overtime/bonuses and reimbursed staff expenses
- ✓ Consumable and materials items: such as stationery, computer peripherals, R&D prototype materials, laboratory consumables and utility costs (gas, electricity, water)
- ✓ Software costs*
- ✓ Subcontractors or Externally Provided Workers** at 65% for unconnected parties (restrictions apply for the RDEC scheme)
- ✓ Independent research (RDEC scheme only)

Recent updates to qualifying cost categories

*Data licensing and cloud computing costs relevant to R&D are now allowable as software costs for expenditure incurred after 1 April 2023

**Overseas subcontracted expenditure will be removed for expenditure incurred after 1 April 2024 (there are certain exceptions to this rule)

A business is not permitted to claim relief on any of the following items:

Not Allowed

- ✗ Normal operational costs and capital expenditure
- ✗ Cost of land
- ✗ Cost of patents and trademarks
- ✗ Office space rental
- ✗ Travel expenses not related to R&D projects or paid for by the company
- ✗ Web hosting
- ✗ Costs of staff who are not actively or indirectly engaged in the R&D



WHICH PROJECTS QUALIFY FOR R&D TAX RELIEF?

The activities that qualify for R&D tax relief must form part of a clearly defined project that aims to make an advance in science or technology. The project in question must have a link to the nature of your business' operations or trade. It could be related to an existing product, service or process, or one that you intend to start following the completion of the R&D project.

R&D tax relief criteria

When evaluating claims, HMRC tends to look at four main criteria to determine whether or not a project is eligible for relief:

1) It looks for an advancement in the field

The R&D project must aim to make a significant advancement to science or technology in a particular field or industry, not just for the business. It's not enough to simply tweak an existing product; the project should seek to innovate in order to create something new.

2) It demonstrates a need to overcome scientific or technological uncertainty

The project must address questions or doubts regarding the feasibility of a specific outcome, and whether or not it is technologically possible. HMRC expects businesses to provide evidence of the uncertainties encountered during the project and how they actively worked to resolve them.

3) It explains how to overcome scientific or technological uncertainty

Research, testing and analysis all form part of a systematic approach to solve the challenges mentioned in the previous step. The plan should outline objectives, milestones, activities, failures and results of the project, and show exactly how the business intended to tackle scientific or technological uncertainty.

4) It cannot be easily worked out by a professional in the field

Work should go beyond what can be easily achieved by other experts with standardised knowledge in the field. Instead, HMRC is more interested in activities that require a high degree of experimentation and problem-solving, and that cannot be accomplished through routine or commonly practised approaches.

For expenditure on R&D activities incurred after 1 April 2023, the revised scheme has broadened the scope of what constitutes R&D for tax purposes to include pure mathematics, AI and Machine Learning. It is imperative to thoroughly understand the eligibility criteria to ensure your projects meet the necessary requirements for claiming R&D Tax Relief as descriptions of your projects must be provided to HMRC.



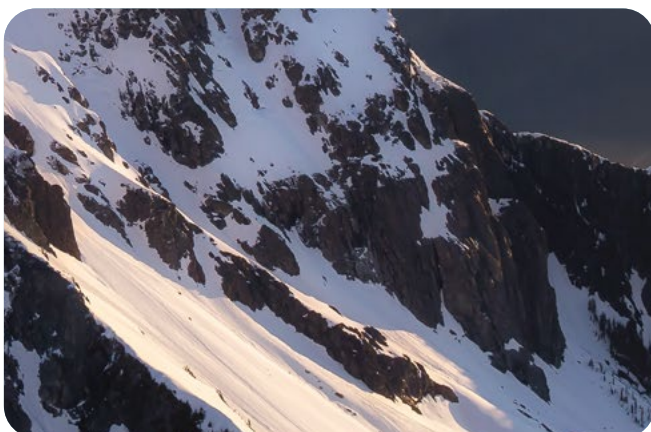
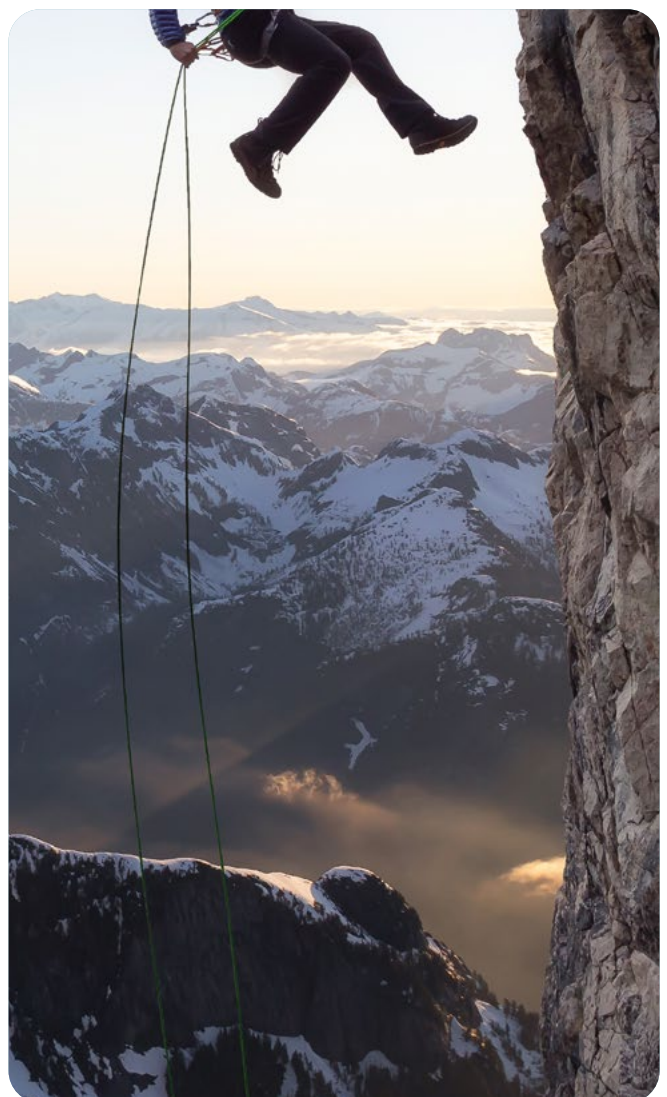


THE MERGED SCHEME IS BEING INTRODUCED FROM 1 APRIL 2024

Changes are on the horizon for businesses engaged in R&D as a merged R&D tax relief scheme is set to take effect for accounting periods starting on or after 1st April 2024. This marks a shift towards simplifying the existing landscape of R&D incentives, making it more accessible and streamlined for companies across various sectors.

The key takeaways from the announcement are:

- To be used by both Large Companies and SMEs (excluding Loss-making, R&D-intensive SMEs)
- Only applies for accounting periods starting on or after 1 April 2024
- Uses current 20% RDEC rate (small profits rate (SPR) applied to loss making companies, main tax rate applied otherwise)
- Customer claims for subcontracted activities that are part of their R&D
 - Subcontractors can only claim if it was their decision to undertake R&D OR
 - The customer isn't a UK-taxpayer
- The merged scheme will adopt the more generous PAYE and National Insurance contributions cap which is currently applied in the SME scheme
- Grants or subsidies no longer impact SMEs ability to claim for R&D tax relief





HOW DOES MY BUSINESS MAKE A CLAIM FOR R&D TAX CREDITS?

R&D tax credit claims are managed by HMRC and need to be submitted at the end of your accounting period along with your Corporation Tax return. A business can submit a claim for relief for any eligible projects that fall within two years from the end of the accounting period in which the R&D work took place.

Staying informed about updates to the compliance requirements and reporting obligations will help you avoid any pitfalls and ensure your claim is approved and processed swiftly.

Pre-notify HMRC of your intent to claim R&D tax relief:

Companies will need to pre-notify HMRC of their intent to claim for the first time (or if they haven't claimed in the last three accounting periods) for accounting periods starting on or after 1 April 2023. You have up to 6 months after the end of the period of account to submit the pre-notification through the Government Gateway portal.

Filing a successful R&D tax relief claim involves careful planning, documentation and compliance with specific guidelines. As of 8 August 2023, you must submit an additional information form to support your claim.

Within this, it's important to include comprehensive records of your R&D projects, including project plans, objectives, methodologies and timelines. Document the uncertainties you encountered and any steps taken to resolve them. HMRC will ask you for:

- Company details, including UTR, PAYE and VAT information
- Contact details for the dedicated R&D contact at the claimant company and the person or agent responsible for preparing the R&D claim
- Accounting period details

- The qualifying R&D expenditure needs to be broken down by project – this has not been an essential requirement in the past and will require granular financial analysis on a project-by-project basis
- The qualifying R&D expenditure relating to Qualifying Indirect Activities
- Detailed project descriptions, including references to the four main eligibility criteria - the number of projects required varies based on the total number of qualifying projects and their size

You will also need to send HMRC an additional information form before you submit your company's Corporation Tax return, stating your intention to apply for Corporation Tax relief in relation to an R&D project. If this is not submitted prior to the tax return HMRC will remove the R&D claim from the tax return.

If you are unsure about any details or criteria, make sure to get in touch with an expert [R&D tax relief adviser](#) to discuss before filing the claim with HMRC. Getting a section wrong can result in lengthy delays and may harm your chances of achieving a successful claim.

Can you still apply for tax relief if an R&D project was unsuccessful?

Yes, absolutely. There is no guaranteed success when undertaking a Research and Development project. That is precisely the reason why the R&D tax relief schemes exist, to pursue innovation in spite of the risk of failure.

In this sense, the tax credits should not be seen as a reward for success, but rather an incentive for businesses to take risks. Failed projects may also provide a foundation for further research in future and serve to demonstrate the difficulty of solving a particular scientific or technological challenge within an industry.



WILL HMRC INVESTIGATE MY R&D TAX CREDIT CLAIM?

It's not uncommon for HMRC to make an enquiry to the business making an R&D claim, particularly if best practice isn't followed when compiling the technical report, or there are any suspected breaches in eligibility.

HMRC carries out a 'risk triage' of all cases, whereby the nature of enquiries ranges in severity. Some businesses receive a request for additional information relating to a certain part of the claim. Others face a more detailed investigation into the nature of the project, or simply have their claim rejected outright.

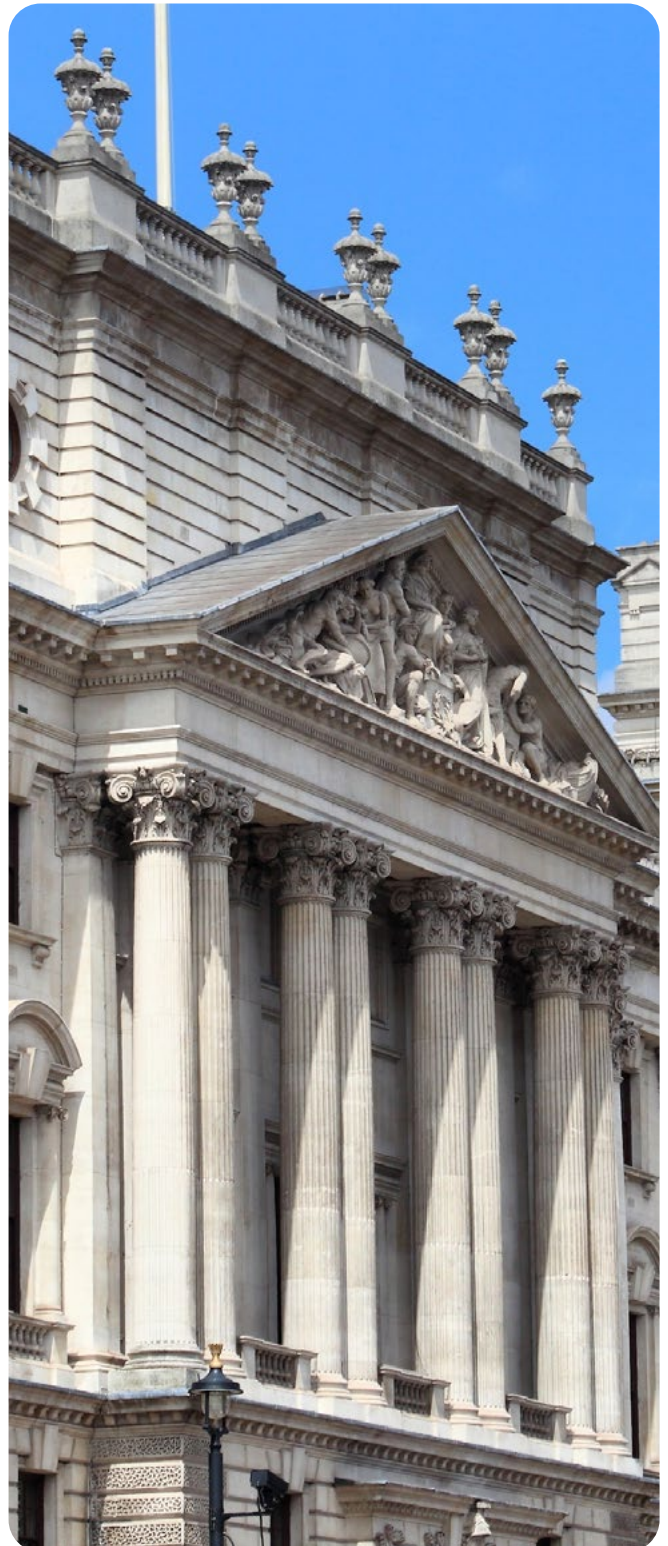
The worst-case scenario is that HMRC demands repayment of Research and Development funds, plus interest and penalties. They may also further scrutinise claims made in previous years if given reason to doubt their validity.

It's worth noting that there has been growing concern in recent years regarding abuse and boundary-pushing of the R&D tax relief schemes, particularly among SMES. HMRC has since introduced a mandatory random enquiry programme for SMES to better understand levels of non-compliance, which means they may also choose to enquire into a claim as part of a random sample.

In any case, in the event that HMRC does decide to conduct some form of follow-up investigation, it pays to have an adviser on your side that has experience dealing with enquiries.



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NEED SUPPORT WITH YOUR R&D TAX CREDIT CLAIM?

R&D tax relief can be a fantastic option for companies looking to offset the cost of their innovation; yet countless businesses miss out on significant savings every year because they aren't aware of the scheme, or they don't know how to navigate the complexity involved.

If your company is developing new products, services or processes, you face technical or environmental challenges, or if you employ engineers, scientists, software developers or technicians – it's probably worth exploring your eligibility for tax relief.

The team at Gerald Edelman is here to help if you'd like to find out more about R&D tax credits, and whether your business may be able to claim. We'd be happy to offer a free consultation to evaluate your situation and assess whether any projects might fall within the remit of R&D tax relief.



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Get in touch with the team at Gerald Edelman

Get in touch via the 'Contact' button below to arrange a quick chat with one of our team or email Leo French directly at lfrench@geraldedelman.com. [Click here to discover more about our R&D Tax Relief services.](#)

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