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**Research and Development
should be on your
agenda now**

Why? First, because of a backdrop of increasing HMRC scrutiny. HMRC's dedicated compliance team has more than doubled in size in recent years.

Then there's the built-in complexity of the rules. Add to that significant change – and it's not the time to get a claim for Research and Development (R&D) tax relief wrong. Equally, it's worth taking stock if your business hasn't considered R&D eligibility before.

Who is the regime for?

Companies. It's a corporation tax relief and exists to incentivise R&D spending. At present, there are two types of tax relief:

- small and medium-sized enterprise (SME) R&D tax relief and
- R&D expenditure credit (RDEC) for large companies.

It's not exclusively about size, though. RDEC can also be claimed by SMEs who have been subcontracted to do R&D by a large company.

For R&D purposes, an SME is defined as:

- a UK limited company, subject to UK corporation tax and
- the company or group to which it belongs has fewer than 500 staff and
- its turnover is less than 100m euros or
- its balance sheet total is less than 86m euros.

Change possible: A government decision on creating a single, simplified 'RDEC-like' scheme for all claimants is due shortly. At the earliest, change could apply to expenditure incurred from 1 April 2024.

What's the tax advantage?

R&D tax relief provides significant financial support for companies working on innovative projects in science and technology. It allows them to claim enhanced deductions against taxable profits for what is classed as qualifying R&D expenditure.

Latest news: The rates of relief have recently changed. For expenditure incurred on or after 1 April 2023, relief decreases under the

SME scheme and increases under the large company scheme.

RDEC: This allows companies to claim a taxable credit of 20% for eligible expenditure incurred on or after 1 April 2023 (13% before 1 April 2023). The credit can be used to settle a corporation tax liability of the current, future or a prior period: or if no corporation tax is due, to settle other tax liabilities instead. Alternatively it can be turned into a repayment, net of tax.

R&D relief for SMEs: For expenditure incurred on or after 1 April 2023, this provides:

- an enhanced deduction of 86% against taxable profits (130% before April 2023)
- in addition to the actual expenditure - a 186% deduction in total.

This can represent an additional corporation tax reduction of up to 22.79% of the expenditure incurred, depending on the rate of corporation tax applicable to your company.

If the R&D claim creates a tax loss, you may be able to surrender the loss for a cash repayment. This is calculated at 10% for expenditure incurred on or after 1 April 2023: it was 14.5% before April 2023. A surrendered loss can therefore generate a repayment of up to 18.6% of the expenditure. If the company counts as R&D intensive, it may obtain a higher rate of repayable credit (14.5%), for such expenditure. To qualify as R&D intensive, broadly the ratio of qualifying expenditure must be 40% or more of the company's total expenditure for the period. Special rules apply where a company incurs qualifying R&D expenditure before it starts trading.

Maximum claim: There is a cap to the amount of R&D tax credit which can be paid to a loss-making SME, usually £20,000, plus three times the company's relevant expenditure on workers. This is the company's PAYE and National Insurance contributions (NICs) for

the period: importantly, this refers to the company's whole PAYE and NIC liability. If the company is supplied with workers by a connected company, the relevant workers' expenditure includes a proportion of these costs as well.

Is it R&D? Clearing the hurdles

R&D tax relief can only be claimed by companies that have incurred expenditure on qualifying R&D projects relevant to their trade. For tax purposes, R&D takes place when a project is innovative, seeking to achieve an advance in science and technology through the resolution of scientific or technological uncertainty.

What might a qualifying project look like? Work to develop new spark plugs for use in an existing engine, perhaps: or work to increase the life of a battery. It's worth bearing in mind that though projects must be innovative, they don't necessarily need to create something completely new from scratch. Activity could include making an appreciable improvement to a product or process, such as exploring new cost effective materials to make a product perform better.

Establishing that a project is R&D is only the first hurdle. The next step is to identify the activities being undertaken that relate to the project. These are classed as activities directly contributing to achieving the advance; and certain activities indirectly contributing to it. Direct activities might include scientific or technological planning. Indirect activities include information services such as preparation of R&D reports.

Almost every word of the guidance, from advance to uncertainty, has specific implications and needs careful consideration. The definition of advance is a case in point. For R&D, an advance is an advance in science and technology extending the overall knowledge or capability in a particular field. It's not something that just represents an advance for your company. It includes adapting knowledge or capability from another field of science or technology, if that adaptation isn't readily deducible.

Then there's the need to establish what is, and isn't, qualifying expenditure. This is another complex area. Qualifying expenditure falls into specific categories: staffing costs; software; expenditure on consumable or transformable materials; cost of work done by subcontractors and externally provided workers; costs of clinical trial volunteers; and data and cloud computing costs. Expenditure must be revenue in nature and paid by the time the R&D claim is submitted. Getting these areas right can be demanding and time-consuming.

What's changed?

From 1 April 2023, the definition of R&D has been changed to include mathematical advances. These are now treated as science and are potentially eligible for relief.

Qualifying expenditure: The definition of software costs has changed so that expenditure on software, data licences and cloud computing services for claims in accounting periods commencing on or after 1 April 2023 can now be included in R&D claims.

Stricter rules on some overseas expenditure were delayed from 1 April 2023. The new rules concentrate the R&D regime on activity undertaken inside the UK, and impact payments to subcontractors and externally provided workers. A decision is expected once the design of a single R&D relief is announced, and change is possible from 1 April 2024.

How do you claim?

Claims are made on the corporation tax return, though as explained above, there is extensive preparatory work to get to this stage. There are also significant changes to the claims process in 2023.

What's changing?

There are new steps to the claims procedure, pushing procedures online. Specifically, there are:

New advance notification rules applying for accounting periods beginning on or after 1 April 2023, for claims to both the SME relief and RDEC.

Companies need to use a new online form, accessed on gov.uk, to tell HMRC they plan to claim relief if:

- they have not claimed before or
- they claimed for the previous tax year, but not until after the last date of the claim notification period or
- they last claimed more than three years before the last date of the claim notification period.

Failure to make advance notification will invalidate the claim for relief. Where a corporation tax return has already been submitted, but HMRC has not been notified in the new format, it will remove the claim for R&D tax relief from the return. There is a deadline for submission of advance notification. This is six months after the end of the period of account to which the claim relates.

Advance notification requires a range of information, including the main senior internal contact responsible for the R&D claim and a summary of the high-level planned activities. It also requires details of any agent advising on the claim.

New additional information requirement:

There is a new mandatory online form to support all claims for R&D relief submitted from 1 August 2023 (though it can be filed before then). If not filed before the corporation tax return is submitted, HMRC will remove the claim for relief from the return.

The information needed is extensive. It includes contact details of a named senior officer of the company; details of any agent involved in the claim; details of the R&D projects undertaken and details of qualifying expenditure. It will be important to check that relevant details are being captured. This new submission doesn't rule out providing a separate R&D report as well, as many companies have done in the past. HMRC is encouraging larger companies, in particular, to continue to do so.

Understand the rules, appreciate the risks

An estimated £469 million was lost to R&D error and fraud in 2021/22. HMRC attributes most of this to the SME scheme. It is currently subjecting claims to enhanced checking and opening many more enquiries into claims. Among the errors routinely picked up are claims that include project activities that are outside the scope of R&D; and claims for expenditure that doesn't qualify.

HMRC is also concerned about the operation of a minority of 'rogue' R&D advisers who significantly underplay the requirements of the regime. On the grounds that some companies were in a sector 'deliberately targeted by third parties to make inaccurate R&D claims', it wrote recently to more than 2,000 companies which had claimed R&D relief, asking them to review claims submitted.

With HMRC's letter was a checklist of questions such as:

- have you read and understood the HMRC guidance on R&D?
- have you considered the conditions for making an R&D claim?
- are you happy that the project is seeking an advance in the field of science and technology?
- do you understand what you're claiming for?
- who has helped with the supporting R&D report and are they qualified to do so?

Reap the benefits

Taking competent professional advice is an important step in R&D compliance. So, too, is a good grasp of the rules on R&D. For a discussion of whether your company might reap the benefits in this area, do please get in touch.