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R&D Tax Benefits for Large Companies



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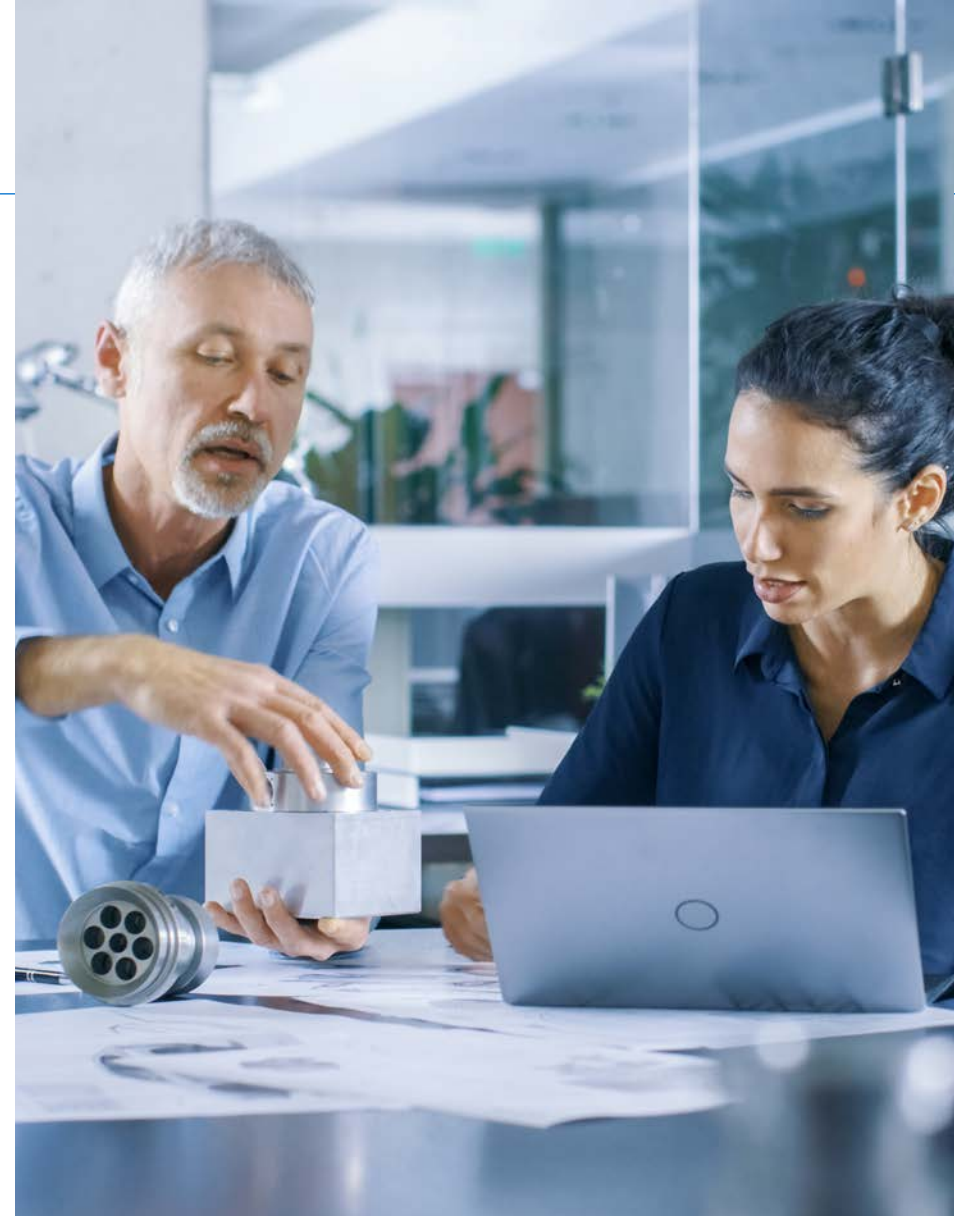
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Introduction

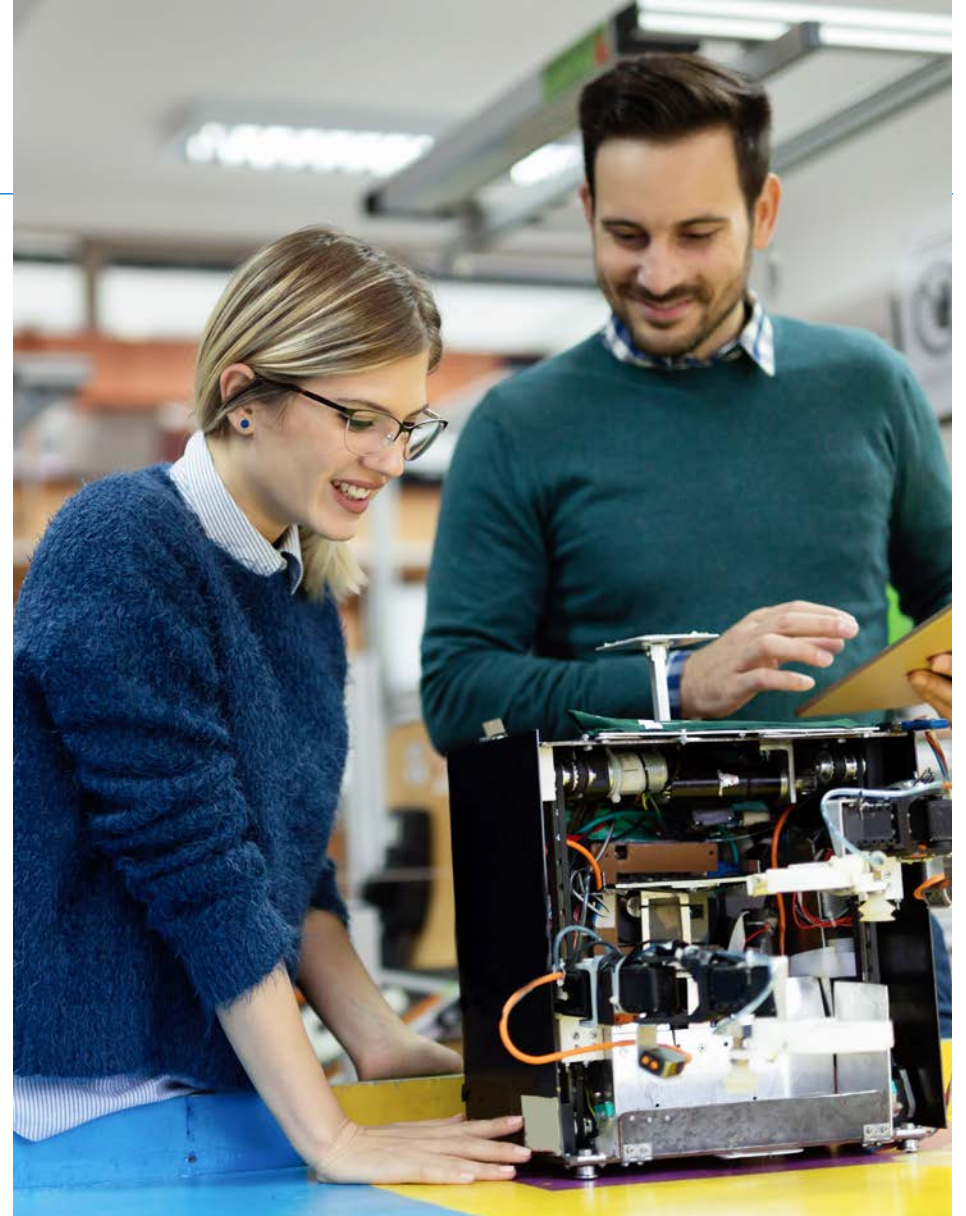
This brief guide gives an overview of the R&D tax benefits for large companies, known as the R&D Expenditure Credit (RDEC) scheme.

It describes:

- what is meant by a 'Large Company.'
- the level of credit offered.
- the criteria used to determine the eligibility of R&D projects.
- the categories of qualifying expenditure; and
- the process of submitting a claim.

By so doing, we hope that the document provides a useful introduction to the scheme.

It must be remembered, however, that in many cases the combination of the technical justification and the tax situation can become complex and we recommend that detailed advice be sought prior to the preparation of any claim for credit under the scheme.



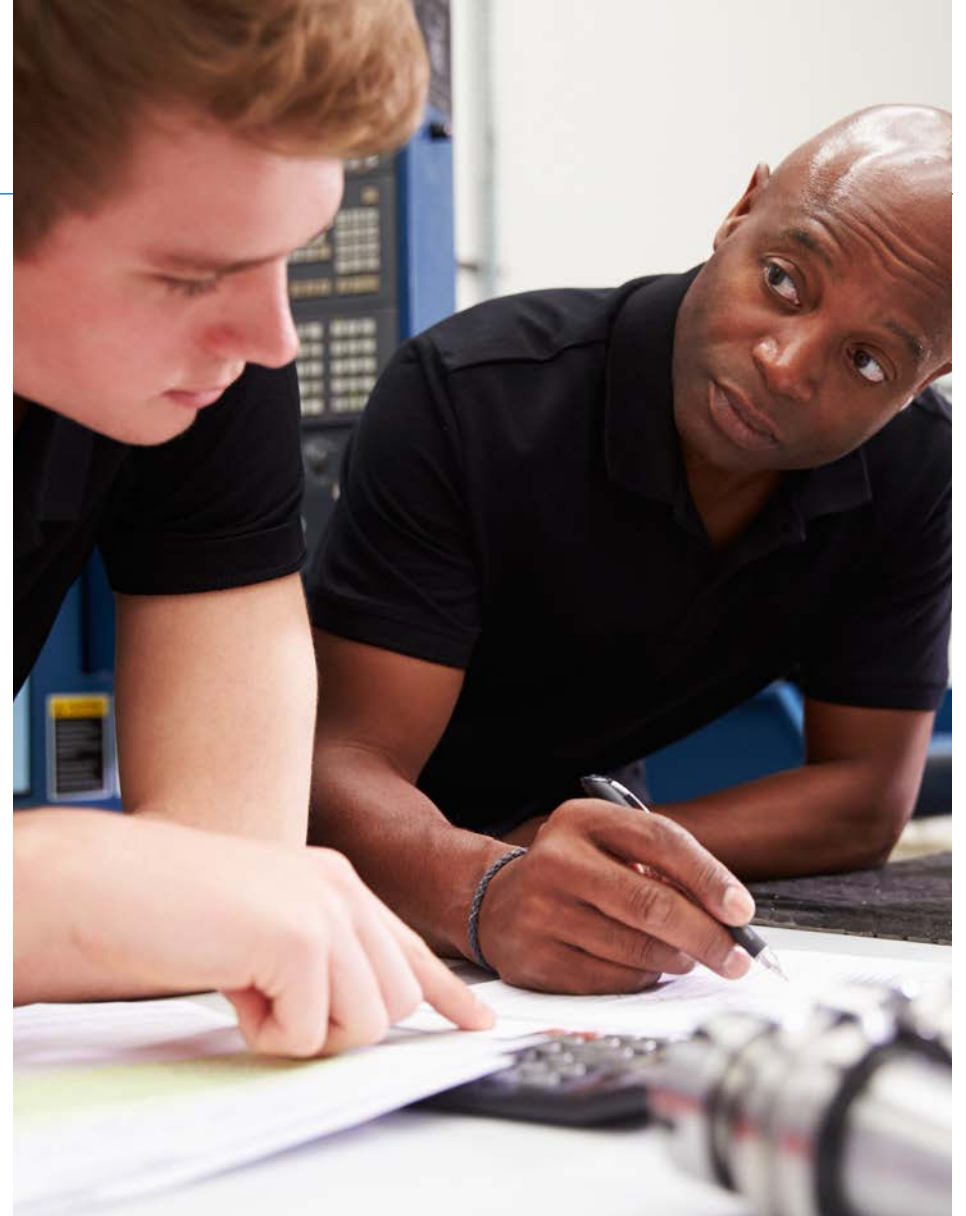
Which companies can benefit from RDEC?

Companies able to make a claim for RDEC as large companies are those that exceed the scale limits set down in the European Commission's definition of a Small to Medium-sized Enterprise (SME).

The definition requires the company, together with certain related enterprises such as companies in the same group, to have fewer than 500 employees and either annual turnover not exceeding €100m or annual total balance sheet assets not exceeding €86m.

The definition of SME provides exemptions, in some circumstances, from the inclusion of data associated with certain types of investor companies, including universities.

Although, in general, the benefits available under the RDEC scheme are not as generous as those under the R&D tax relief scheme for SMEs, they are still significant and an important source of additional funding for innovative projects.



What benefits are available?

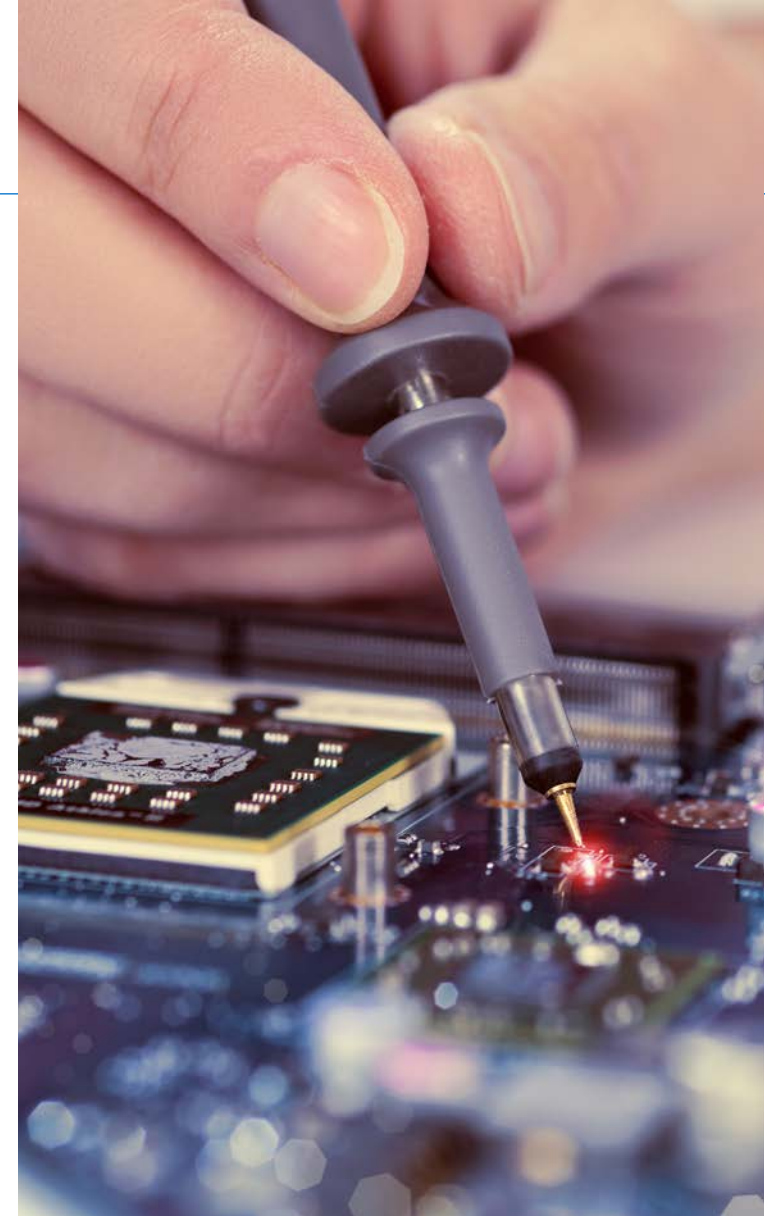
The RDEC scheme is essentially a grant - a payable, taxable sum, set at 12% (13% from 1 April 2020) of the expenditure, that must be included in a company's taxable profits.

For the majority of companies, with a corporation tax liability for the period, HMRC will simply deduct the RDEC from any tax owing. So, for example for a company that has spent £1m on qualifying R&D, the RDEC will be £120,000 and will be included in its taxable profits. As a result, tax will be due on the RDEC itself, therefore at a tax rate of 19% the net benefit will be £97,200 or 9.72% of the actual expenditure, even though the credit set off against the overall tax bill will still be £120,000.

If there is insufficient corporation tax liability to absorb the RDEC in full, or even no liability at all due to losses, the RDEC, net of notional corporation tax, can potentially be used in other ways, after being capped at the level of the company's PAYE and NIC for R&D staff in the year.

If there is no other outstanding corporation tax owing to HMRC for other periods it can be surrendered to another company in the same group to offset its own tax liability; if that is not possible it can then discharge any other taxes owed to HMRC. Finally, if none are owed then the net RDEC is payable in cash to the company, provided it is a going concern.

Since the benefit is more like a grant than a tax relief, the scheme is often referred to as an above-the-line (ATL) credit since accounting rules permit the booking of the credit in the pre-tax profit or loss.



What activities are eligible?

Usually, the aspects of the claim process that companies find most difficult are:

- judging the eligibility of projects against the definition of R&D; and
- ensuring that all eligible work is included.

The general principle is that an activity will qualify as R&D for tax purposes if it would be treated as R&D under normal accounting practice and meets the definition set out in the Guidelines issued by the DTI.

The fact that a company has not actually disclosed its expenditure on R&D within its accounts need not, however, prevent it from qualifying. Of course, a key pre-requisite is that there is in fact an activity in a field of science or technology - "research" or "development" in other areas such as social sciences, as well as innovation in purely a commercial sense, do not qualify.

However, the Guidelines are neutral as regards different fields of science or technology, giving, at least in theory, a level playing field, whether a project is in nanotechnology, life sciences, engineering or software. In practice the BEIS Guidelines usually form the sole basis for assessment of eligibility by HMRC and they should be considered in full when making a claim.

In summary, the Guidelines state that an eligible R&D project is one that meets two key criteria:

- (1) It must be seeking to achieve an advance in science or technology. This requires that the work is aimed at increasing the overall knowledge or capability in a field of science or technology. It may have a tangible outcome, such as a new or appreciably improved product or process, or more intangible consequences, such as new knowledge alone. Catching up with the industry generally is not regarded as an advance, although attempting to replicate an advance that has already been made elsewhere, but where the solution is not in the public domain, can qualify.
- (2) It must seek to resolve scientific or technological uncertainty. Uncertainty exists when knowledge of whether something is scientifically possible or technologically feasible, or how to achieve a desired result in practice, is not readily available or deducible by a competent professional working in the field. This includes system uncertainty, where the components in a complex system might be well-known and established in themselves, but where their integration gives rise to scientific or technological uncertainties. It is important to be able to show that the project is carried out as a systematic process of experimentation and that staff with the appropriate technical qualifications (i.e. who are themselves competent professionals working in the field) are engaged in the work. However, a key point is that success in achieving the technical goals is not essential - it is the attempt and the way in which the work was conducted that counts. In fact, since failure is frequently indicative of technical challenges and a departure from the routine, unsuccessful projects are often good candidates for an R&D claim.

What expenditure qualifies?

Once it has been established that the company carries out eligible activities, the next stage is to identify the associated qualifying expenditure to include in a claim.

Qualifying expenditure for large companies, which must be revenue in nature, comprises the following:

- Staff costs of employees directly and actively engaged in R&D, comprising salaries, bonuses, employer's NICs and employer's pension contributions including contributions paid under approved pension schemes in the EU and EEA.
- Expenditure on consumable or transformable items, i.e. materials used up during the R&D process and not reflected in the final product or sold to any third party. This category will normally include expenditure on prototypes but specifically includes water, fuel and power, as well as software.
- Payments made for externally provided workers, i.e. staff provided by agencies or other third parties who work on R&D projects under the supervision, direction or control of the claimant company. Normally only 65% of payments for externally provided workers qualifies. However if the supplier of the externally provided workers is connected to the paying company, for example they are under common control or are in a group,

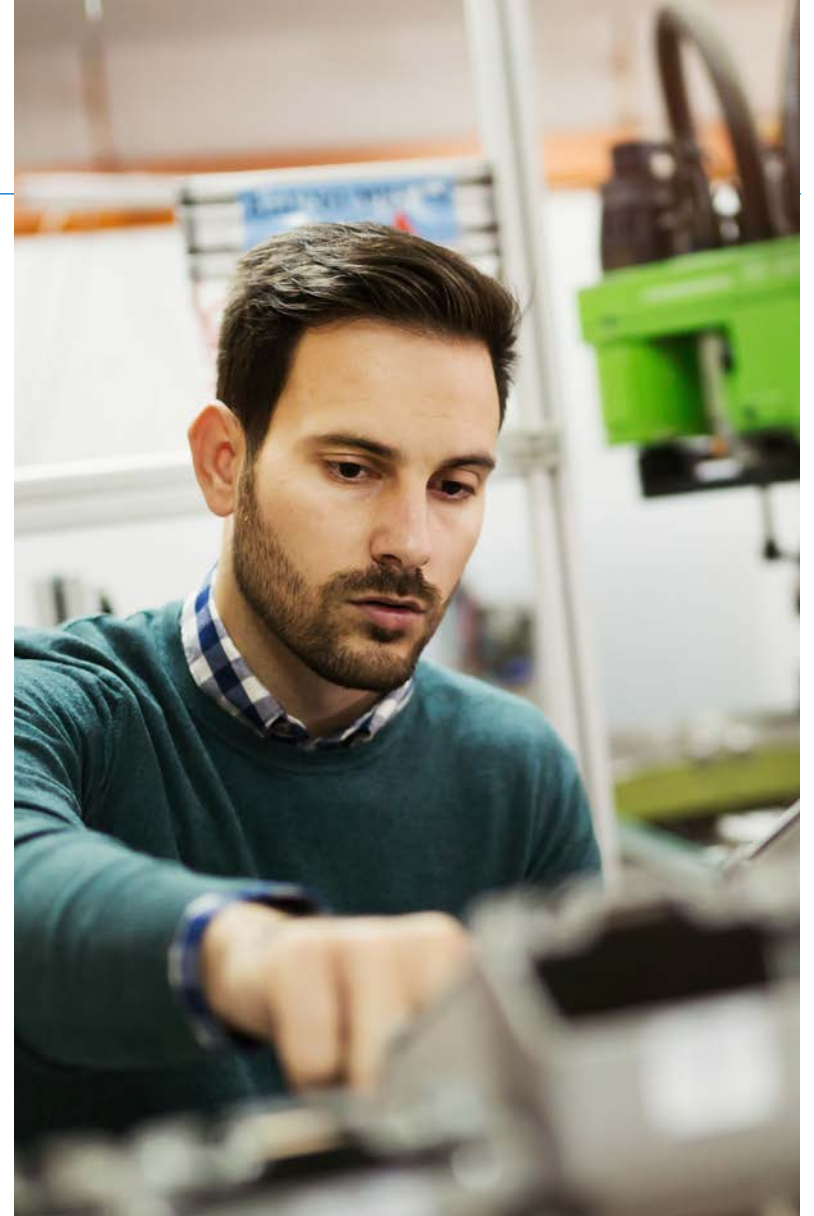
then the qualifying expenditure is the lower of the actual payment made or the qualifying staff costs incurred by the provider itself. Where both parties are unconnected the claimant company and the provider can make an irrevocable election for the same treatment as connected parties.

- Payments for R&D subcontracted to individuals, partnerships of individuals, or "qualifying bodies" - charities, institutions of higher education such as a university, a scientific research organisation or a health service body.
- Contributions to fund R&D carried on by qualifying bodies listed above.
- The cost of paying clinical trial volunteers.

Where groups of companies split out the separate elements of the R&D project into different companies, it is possible for the separate activities to lose their character as R&D. For example, a company might provide testing services that could be routine in nature for that company, even though the testing is needed to confirm whether the project has met its technical objectives. The relief for large companies alleviates this problem by deeming such an activity as an R&D project for the testing company, if it would have been eligible if performed by the paying company as part of its R&D project.

What other conditions apply?

- The R&D must be relevant to the company's existing trade or to a trade that the company is intending to carry out.
- The expenditure must not be capital in nature. However, expenditure that is revenue for tax purposes but put to a balance sheet account is also capable of qualifying. Expenditure that is recorded on the balance sheet as part of the cost of an intangible asset can qualify when incurred. Note that in some instances, expenditure may be properly treated as revenue in the accounts but may still be capital for tax purposes. This can often be a complex area and should be considered carefully.
- A separate relief is available for R&D expenditure that is actually capital for tax purposes, giving a 100% deduction in the year of expenditure in place of the more usual capital allowances that are given over several years. This can include expenditure on buildings and such claims can therefore result in an absolute tax saving since buildings do not often qualify for any allowances otherwise, especially given the phasing out of Industrial Buildings Allowances.
- R&D that has been contracted to the company and paid for by a third party still qualifies, as long as the payer is either a large company itself or an entity not chargeable to UK tax on its trade profits. The purpose of this measure is to avoid claims by more than one UK company for effectively the same expenditure, since under the R&D tax relief scheme for SME companies payments made to subcontractors qualify from their perspective.



How is a claim made?

A claim for RDEC is made in the company's annual corporation tax return (CT600). The ultimate deadline is two years from the end of the accounting period.

Although the statutory filing requirements are minimal, it is best practice to submit details of the claim with the return. Although HM Revenue & Customs has specialist staff dealing with R&D claims, including a network of specialist offices dealing with R&D tax relief claims for companies not dealt with in the Large Business Service, it does not employ scientists or technologists to review claims.

This means that it is essential that the project information is carefully presented in order to be understandable to a lay person, while still technical in nature. The inspector has the power to enquire into the claim and to withhold repayment of tax until the enquiry is complete.

The most common reasons for making an enquiry include:

- requiring further evidence that the project meets the criteria to be treated as R&D; and/or
- concerns that incorrect categories of expenditure have been claimed.

In the past, enquiries were normally conducted by correspondence although today it is more usual for the Inspector to request a face-to-face meeting with the company's technical staff, which often proves a more effective way to answer his or her queries and secure agreement.



How do I get further information?

For further information on making an R&D tax relief claim, please speak to your usual contact at Pronovotech or e-mail us at info@pronovotech.com.





About Pronovotech

Pronovotech specialises in the implementation of the government's scheme of tax incentives for research and development (R&D) work, helping technology companies to claim their entitlement to this important benefit.

Our approach combines the technical and tax expertise required for this very specialised aspect of the tax system; our services range from support for specific aspects of the claim process, working with your accounting or tax advisory firm, to management of the entire claim lifecycle, including liaison with the HMRC inspectors.

Our aim is to:

- Reduce the overall cost of the claim process for you.
- Ensure that all of your eligible work is included.
- Speed up the process and acceptance of your claim by HMRC.
- Maximise the probability of success.

We also transfer the knowledge required for future claims to be managed largely in-house.

Whether you are already familiar with the process and claiming successfully, have a specific issue with a claim or have not yet considered your eligibility for the benefit, we would be delighted to see if we can help you.



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