



7 October 2008

Research and development tax relief – an update

Companies that are engaged in research and development (R&D) activities may qualify for enhanced or accelerated tax relief and in some cases a tax repayment in respect of the costs that they incur on qualifying R&D.

This relief has proved popular with many companies for whom the tax repayment has been a lifeline for their business.

This relief does not only apply to traditional 'R&D companies'; it is available to any company providing it is undertaking qualifying R&D activities.

Qualifying R&D activities are those that seek to achieve an advance in science or technology through the resolution of technological or scientific uncertainties.

Note that the advance is not limited to something that is new to the company carrying out the R&D, but it must be an advance for the industry.

Capital expenditure

R&D expenditure on capital items qualifies for an immediate tax deduction – there is no enhanced relief, but this does enable the company to obtain tax relief for the cost at an early stage.

Examples of such expenditure include a dedicated R&D facility or plant and machinery engaged in the R&D activity.

Revenue expenditure

This relates to expenditure which would not normally be treated as capital. It includes expenditure such as employee costs, sub-contractor payments, clinical trial volunteer payments and consumable items directly engaged in qualifying R&D.

There are two separate schemes which are, broadly speaking, divided by the size of the company that is claiming tax relief.

- one scheme is for Small and Medium-Sized Enterprises ('SME'); and

- the other is for large companies. In circumstances where the company does not qualify for relief under the SME scheme it may be entitled to claim relief under the large company scheme.

In both schemes the minimum R&D expenditure to obtain tax relief is £10,000 per annum.

SME definition

A key factor is therefore the definition of an SME.

For expenditure on or after 1 August 2008 an SME is a company that alone or together with 'linked' or 'partner' organisations has up to 500 employees and either turnover below €100 million or gross assets below €86 million.

For expenditure incurred prior to this date the definition related to up to 250 employees, €50 million and €43 million respectively.

SME scheme

An SME can claim enhanced tax relief at 175% of qualifying revenue costs (as outlined above) incurred on qualifying R&D projects. Expenditure incurred prior to 1 August 2008 qualified for tax relief at 150% of qualifying costs.

If the SME incurs a trading loss it can surrender the amount of the loss that relates to the R&D relief for a tax repayment. For expenditure incurred on or after 1 August 2008 this repayment is 14% of the uplifted expenditure; expenditure incurred prior to this date attracts a repayment at 16% of the uplifted expenditure.

The maximum tax repayment that the SME can claim is limited to its total PAYE and NIC liabilities for the period (i.e. if it does not have any employees it **will** be able to claim tax relief but **will not** be able to claim a tax repayment).



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If a project is subsidised, then only the excess costs are available for relief under the SME scheme. The subsidised costs may be eligible for relief under the large company scheme.

If a project is subsidised from grants etc that are notified state aid (under EU provisions) none of the costs relating the project are eligible for relief under the SME scheme. They may however, be eligible for relief under the large company scheme.

Following additional changes on 1 August 2008, companies that are in difficulty (i.e. where the accounts are not prepared on the “going concern” basis) are unable to make a claim for relief under the SME scheme.

Similarly, SMEs can only claim up to €7.5 million on a single R&D project.

In order to qualify under the SME scheme the intellectual property (“IP”) has to vest in the company claiming the relief (i.e. the company has the potential to exploit the IP if it has use or value. According to HMRC guidance, IP held for a scintilla of time in transit to another owner is not sufficient to meet this condition).

Large company scheme

A large company (plus some companies that are SMEs but do not qualify under the SME scheme) can also claim relief for qualifying expenditure on qualifying R&D projects.

The amount of tax relief available for a large company is 130% of its qualifying expenditure. For expenditure incurred prior to 1 April 2008 such a company can only claim tax relief for 125% of the qualifying expenditure.

A tax repayment cannot be claimed by loss-making companies under the large company scheme.

Summary

Key things to look out for:

- look specifically at the activities of the company concerned: is it undertaking any R&D activity? It does not have to be a traditional R&D company;
- consider the size of the company – particularly companies with between 250 and 500 employees that may now qualify as an SME under the changes from 1 August 2008;
- if the company is loss-making and is an SME, it may be eligible for a tax repayment – check that it does have a PAYE and NIC liability;
- ensure that the accounts are prepared on the going concern basis; and
- for the SME relief, ensure that the IP vests in the company claiming the relief.

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