SEPTEMBER 2024

SPOTLIGHT ON:

Understanding R&D tax credits

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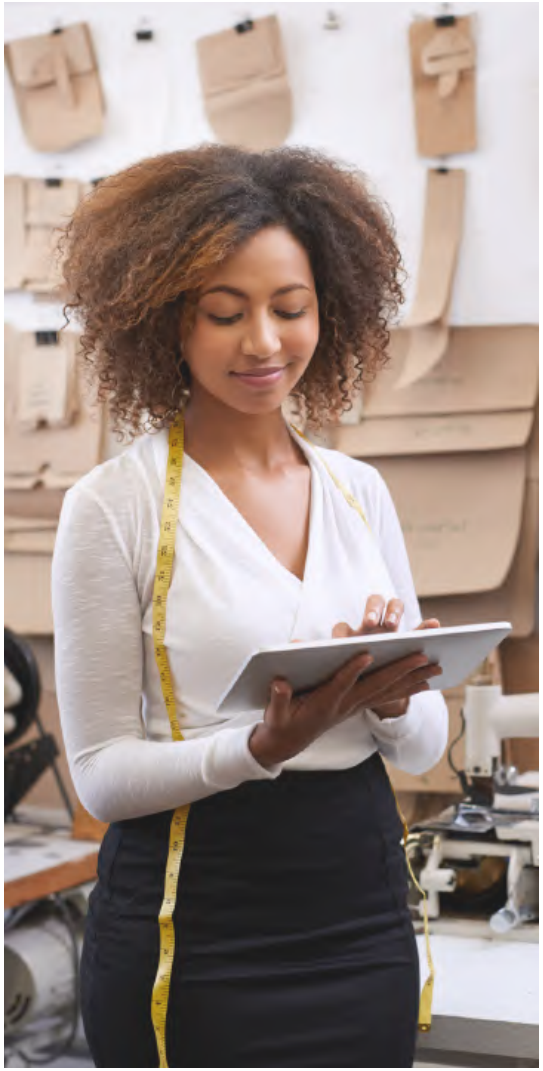
UNLOCK THE BENEFITS OF R&D TAX CREDITS FOR YOUR BUSINESS

Research and development (R&D) tax credits are a crucial incentive designed to encourage businesses to innovate and invest in new technologies, processes and products. Yet, despite their significance, many businesses either aren't aware of their potential benefits or aren't fully utilising them.

We explore what R&D tax credits are, who can claim them, and how businesses can maximise their potential.



WHAT ARE R&D TAX CREDITS?

R&D tax credits are government incentives designed to encourage businesses to spend more on R&D activities. The purpose is simple: by reducing a company's tax bill or providing a cash lump sum, these credits make it easier for businesses to reinvest in innovation. They're available to a wide range of companies, from large corporations to small and medium-sized enterprises (SMEs), regardless of their industry.

WHO CAN CLAIM R&D TAX CREDITS?

One of the most common misconceptions about R&D tax credits is that they are only for companies involved in scientific research or high-tech industries. This isn't the case. Any company undertaking a project seeking to advance science or technology can potentially claim R&D tax credits. This includes activities such as developing new products, processes or services and significantly improving existing ones.

ELIGIBLE PROJECTS

To qualify for R&D tax credits, a project must meet certain criteria set out by HMRC. It should:

- aim to create an advance in science or technology
- attempt to overcome scientific or technological uncertainties
- not be readily available or easily deducible by a competent professional in the field.

Importantly, these projects don't need to succeed to qualify. Even if the project fails or the company doesn't fully achieve its objectives, the R&D expenditure could still be eligible for tax relief.

HOW R&D TAX CREDITS WORK

The process for claiming R&D tax credits can seem complex, but it essentially revolves around calculating the company's eligible R&D expenditure and applying the relevant tax relief. The calculation differs slightly depending on whether the company is an SME or a large business.

R&D TAX CREDITS FOR SMES

For SMEs, R&D tax credits are particularly generous. To qualify as an SME, a company must have fewer than 500 employees and either an annual turnover under €100m or a balance sheet total under €86m.

R&D EXPENDITURE CREDIT FOR LARGE COMPANIES

Large companies that don't qualify as SMEs can claim R&D tax relief through the R&D expenditure credit (RDEC) scheme. The RDEC offers a credit of 20% of qualifying R&D expenditure, which is taxable, resulting in a net benefit of 15%. While this rate is lower than the SME scheme, it still represents a significant incentive for larger companies to invest in R&D.

This scheme can also be used for SME's whose expenditure doesn't qualify for the SME scheme (e.g. the expenditure was covered by grant funding or was "customer-led").

NOTABLE CHANGES TO THE RULES

The UK Government has announced it will be merging the SME and RDEC R&D tax relief schemes into a single, streamlined scheme from April 2024 (although elements of the SME scheme still remain for R&D-intensive companies in the form of the enhanced scheme).

This new approach will follow the RDEC model but retain some SME benefits. While the consolidation aims to simplify the process, it may result in reduced relief for certain SMEs, especially those that don't qualify for the enhanced R&D intensive scheme. The merger also introduces changes such as subcontracting rules and relief caps, making the claims process more complex and reinforcing the importance of seeking specialist advice. The HMRC website is regularly updated with relevant information.

COMMON MISCONCEPTIONS ABOUT R&D TAX CREDITS

Despite the availability of R&D tax credits, many businesses miss out on claiming them due to common misconceptions.

MISCONCEPTION 1: R&D TAX CREDITS ARE ONLY FOR LARGE, HIGH-TECH COMPANIES

As mentioned earlier, this is not true. Companies of all sizes and across various sectors can claim R&D tax credits. Whether a business is involved in manufacturing, construction, agriculture or even creative industries, there's a good chance that R&D tax credits are relevant.

MISCONCEPTION 2: THE APPLICATION PROCESS IS TOO COMPLEX

While the process of claiming R&D tax credits involves detailed documentation and a clear understanding of what qualifies as R&D, it's not as daunting as it seems. Many companies choose to work with specialist advisers who can guide them through the process, ensuring that all eligible activities are identified and accurately claimed.

MISCONCEPTION 3: WE DIDN'T ACHIEVE OUR PROJECT GOALS, SO WE CAN'T CLAIM

One of the biggest benefits of the R&D tax credit scheme is that it rewards innovation, even when projects don't go as planned. If your company attempted to resolve a technological or scientific uncertainty, it could still qualify for relief, regardless of the outcome.

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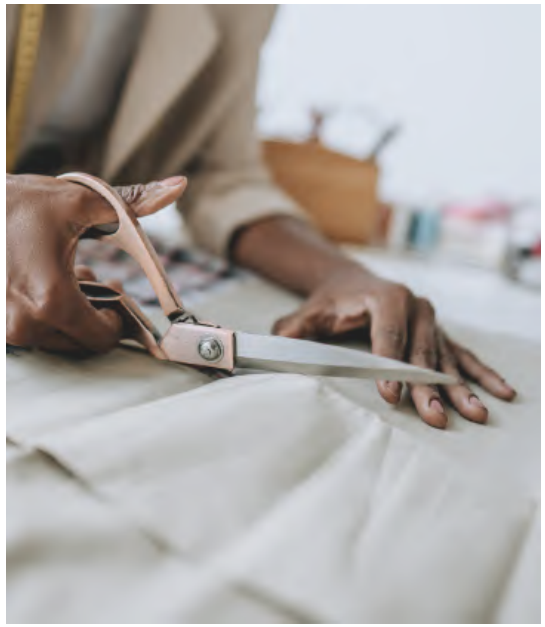
HOW TO MAXIMISE YOUR R&D TAX CREDIT CLAIM

Given the significant financial benefits, businesses should approach the R&D tax credit claim process with a well-planned strategy. Here are some tips to ensure you're getting the most out of your claim.



1. KEEP DETAILED RECORDS

Accurate and comprehensive records are crucial for a successful R&D tax credit claim. This includes documenting project objectives, methodologies, time spent by staff and all related costs. The more detailed your records, the easier it will be to substantiate your claim and maximise the benefit.

2. IDENTIFY ALL QUALIFYING ACTIVITIES

It's easy to overlook certain activities that qualify as R&D. Beyond obvious R&D work, consider whether your company has been involved in process improvements, software development or even trials and testing that attempted to solve scientific or technological challenges. An experienced R&D tax adviser can help identify these activities.

3. UNDERSTAND THE SCOPE OF ELIGIBLE COSTS

R&D tax credits cover a wide range of costs, not just direct R&D expenses. Qualifying costs can include:

- staff salaries, wages and other associated costs like employer NICs and pension contributions
- costs of materials and consumables used in R&D
- utilities like power and water which are used in R&D processes
- software costs directly related to R&D activities
- payments to subcontractors and external agencies, provided they relate to R&D (Note: For the accounting period starting 1 April 2024, the subcontractor needs to be based in the UK).

By thoroughly understanding the scope of eligible costs, you can ensure that your claim is as comprehensive as possible.

4. WORK IN 'PROJECTS'

It is helpful to think of your R&D activities as distinct projects, each representing its own area of innovation. HMRC typically prefers claims to be split into projects, so keeping detailed records for each project throughout the year will help ensure a well-organised and comprehensive claim.

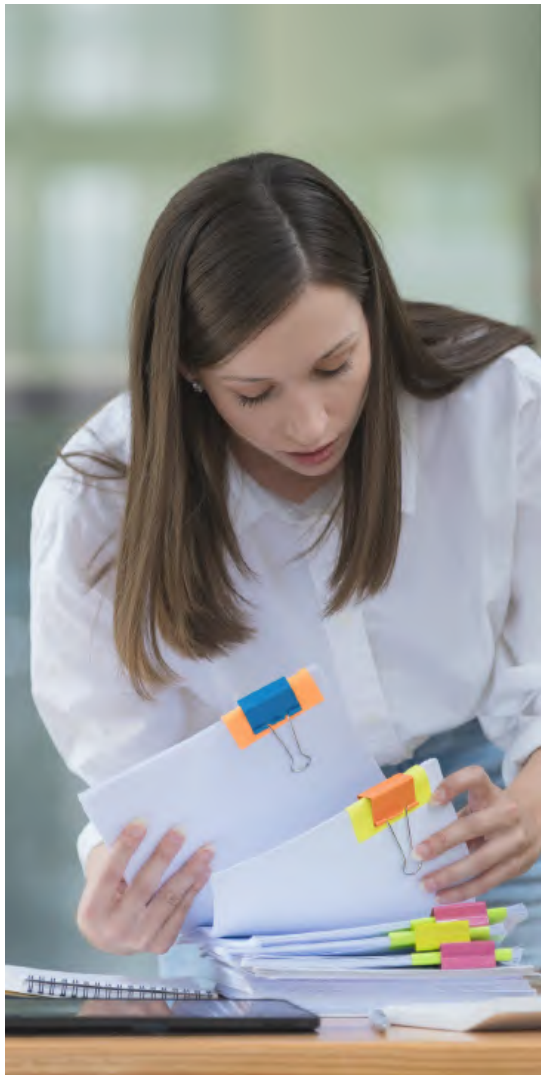
5. REVIEW PAST CLAIMS

R&D tax credits can be claimed for previous years, typically up to two years from the end of the accounting period in which the R&D expenditure occurred. If your company has overlooked R&D tax credits in the past, it might be worth reviewing previous periods to see if there's potential for a claim.

6. WORK WITH A SPECIALIST ADVISER

While handling R&D tax credit claims internally is possible, working with a specialist adviser can significantly increase the likelihood of a successful and maximised claim. Advisers have the expertise to identify all qualifying activities and costs, and they can help navigate the intricacies of HMRC's requirements.

Significant changes have recently been made and continue to be made to the schemes, making claims even more complex, further justifying the need for an adviser. Furthermore, historically, HMRC enquired for further detail on 1% of claims, but to reduce fraudulent claimants abusing the scheme, now look into 20% of claims.



THE IMPACT OF R&D TAX CREDITS ON BUSINESS INNOVATION

R&D tax credits are more than just a tax relief; they're a catalyst for innovation. For many companies, the financial relief these credits provide makes the difference between pursuing and shelving a new idea due to cost concerns.

According to HMRC's statistics, for the tax year 2021 to 2022, over 90,315 companies claimed R&D tax credits, amounting to £7.6bn in tax relief. This represents a significant investment in the future of UK businesses, helping to drive forward new technologies, products and services.

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ENCOURAGING GROWTH AND COMPETITIVENESS

By lowering the financial barriers to innovation, R&D tax credits help businesses of all sizes remain competitive. They enable companies to take risks on new projects, invest in research and develop cutting-edge solutions that might otherwise be unaffordable. This, in turn, strengthens the UK economy by fostering a culture of continuous improvement and technological advancement.

SUPPORTING SMES AND LARGE BUSINESSES ALIKE

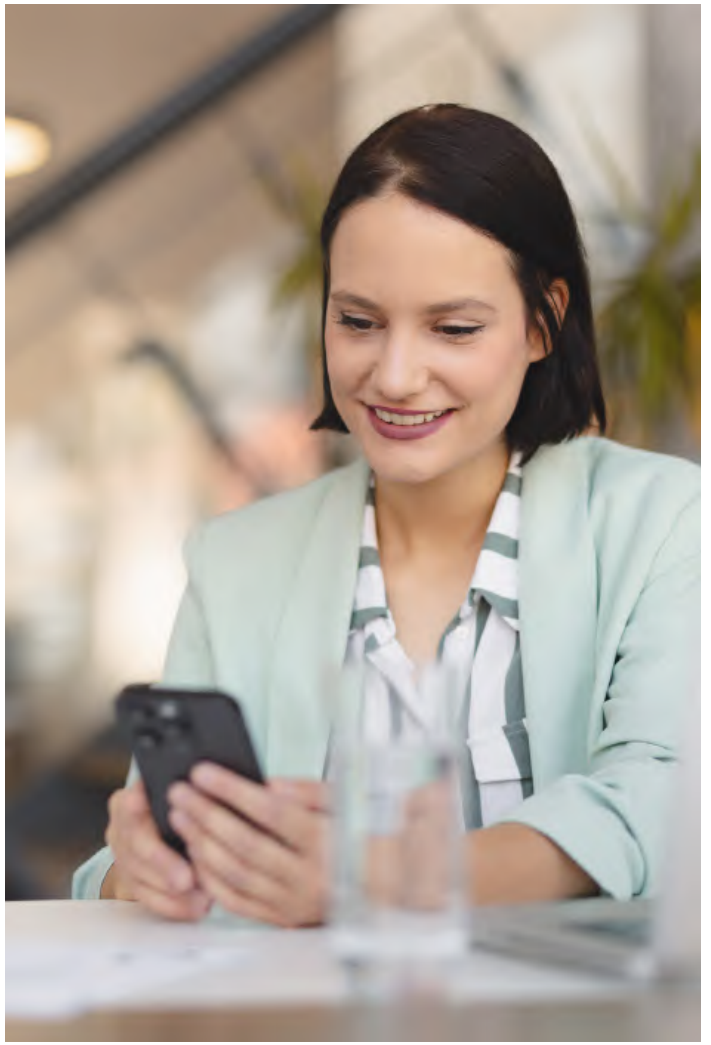
While large companies often have the resources to dedicate entire teams to R&D, SMEs may find allocating funds to innovative projects more challenging. R&D tax credits level the playing field by making it more feasible for smaller companies to invest in research and development. As a result, SMEs can compete on a global scale, bringing new products and services to market and driving economic growth.

DON'T MISS OUT ON R&D TAX CREDITS

R&D tax credits are an invaluable resource for UK businesses, providing financial support that can be reinvested into further innovation. Whether your company is a small startup or a large enterprise, engaging in activities that advance science or technology could make you eligible for significant tax relief.

To ensure you're making the most of this opportunity, keep detailed records of your R&D activities, identify all eligible costs and consider seeking advice from a specialist. With the right approach, R&D tax credits can provide the boost your business needs to stay ahead in a competitive market.

Get in touch with us today to learn more about how we can help your business innovate and grow.



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