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Research and Development and Patents Tax Incentives

A guide for clients

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R&D and patents

Research and development (R&D) and patent expenditure are treated generously for tax purposes.

The main provisions are:

- R&D relief
- Capital allowances for R&D
- The Patent Box.

What is R&D?

Tax relief in respect of qualifying R&D expenditure by limited companies has been available since April 2000 for SME's but take up rates on these credits has been surprisingly low, largely due to many businesses being unaware of what qualifies as R&D expenditure.

For accounting purposes, R&D is largely defined as expenditure that cannot qualify for tax relief unless it can first be accounted for as R&D against certain standards. Although this is the primary starting point, expenditure qualifying as R&D under UK GAAP does not automatically qualify for R&D tax relief as there is a wide range of tax guidance and legislation which must be satisfied.

R&D Projects

The key to a successful R&D tax relief claim is being able to prove to HMRC that the particular project falls within the definition of R&D:

'Expenditure incurred for carrying out research and development and expenditure incurred for providing facilities for carrying out research and development.'

The project that has been identified against potential research and development relief must be in relation to science or technology. It cannot be an advance within a social science for example economics or a theoretical field.

The aim of the R&D project can be to research or develop a new process, product/service or improve an existing one whilst ensuring it relates to the company's trade which can either be an existing trade or one that has the intention of being set up based on the results of research and development.

To ascertain research and development relief, the company will need to explain how a project:

- Looked for an advance in science and technology
- Had to overcome uncertainty
- Tried to overcome uncertainty and
- Could not be easily worked out by a professional in the field.

Show how the company has looked to advance in the field

The project must aim to create an advance in the overall field not just for business. Therefore, an advance cannot just be an existing technology that is now being used for the first time within the sector that the company falls. If the product, service or process has been developed by another company but is not made available or publicly known then this is still classed as an advance.

Show there was uncertainty

Whilst performing research and development to discover a process, product or service, it should not be known as to whether the scientific or technological parameters are feasible. Respectively this will mean the company enduring the project and experts who work within the field cannot already know about the advance nor how it was achieved.

Explain how the company has tried to overcome uncertainty

The company should show the project needed research, testing and analysis to develop it. The company will need to be able to explain the work that was done in order to overcome the uncertainty. This could be a simple description of the successes and failure during the project.

Be able to show a professional in this field could not work the advance out

This could be proven by showing how others attempts have failed to find a solution. There is also the option of showing that the people working on the specific project are indeed professional within that field and have them explain the uncertainties involved on the project.

Tip

If your company has no made an R&D claim before, make sure to apply for advance assurance from HMRC to check whether the R&D project and the company will both meet the conditions for the relief. We can help you with this.

Costs

Not all costs incurred during an R&D project will qualify for relief. There are specific costs that can and cannot be claimed. The qualifying costs are broadly those which fall into the following categories:

- direct staff costs
- subcontractor costs
- consumable items
- software
- payments to clinical trial volunteers

Direct staff costs

For staff working directly on the research and development project, you can claim a proportion of their:

- salaries
- wages
- class 1 NICs
- pension fund contributions

The company can claim for administrative or support staff who work to directly support a project. You cannot claim for clerical or maintenance work that would have been done anyway for example, managing payroll. Where an external agency provides staff for the project, the company is able to claim 65% of these particular payments.

Subcontractor costs

Subcontracted expenditure cannot be claimed unless it is directly undertaken by:

- A charity
- A higher education institute
- A scientific research organisation
- A health service body
- An individual or partnership of individuals

Consumable items

The company is able to claim for all consumable items used up in the research and development. This includes:

- Materials
- Utilities

There are numerous costs that cannot be claimed for. These vary from:

- The production and distribution of goods and services
- Capital expenditure
- The cost of land
- The cost of patents and trademarks
- Rent or rates

Who can claim?

Only companies can claim R&D tax relief; it is not available to unincorporated businesses.

The company must have no more than 500 employees and satisfy one or both of the following conditions in the current accounting year or the previous year:

- Annual turnover of no more than €100 million
- Balance sheet total of no more than €86 million.

The company must also be a going concern at the time the R&D claim is made. If its last published accounts were prepared on a going concern basis, and nothing in the accounts suggests that its trading status depends on its receiving R&D relief or tax credits, HMRC will accept that this condition is met.

A company in administration or liquidation cannot make a claim to R&D relief.

The company does not have to spend a minimum amount on R&D projects in the accounting period in order to claim R&D relief.

R&D relief

Additional relief is available for certain R&D expenditure. This relief is sometimes called a 'super-deduction' as the amount allowed exceeds the actual expenditure. This relief may be claimed by SMEs provided it is carrying on a trade or intends to carry on a relevant trade after incurring the expenditure. The R&D must be relevant to the trade.

SMEs may claim an additional 130 per cent. Thus R&D expenditure may be worth deductions of 130 per cent and 230 per cent respectively (previously 225 per cent pre April 2015).

A SME may claim the additional relief against profits. Alternatively, in loss-making circumstances it may be able to surrender some or the entire claim for a cash payment known as the R&D tax credit. The applicable rate is 11 per cent. This means that a company with a £100,000 claim can either:

- offset it against profits taxed at 20 per cent – saving £20,000 tax
- claim R&D credit of 14.5 per cent – a cash payment of £14,500

In practice, the company usually claims the cash payment only when it has yet to make a profit.

Note, the large company scheme has been replaced with the research and development expenditure credit (RDEC) for large companies. The RDEC is a tax credit for 12% of your qualifying R&D expenditure. The credit is taxable. Dependent on whether the company is profit or loss making the credit may be well used to discharge the liability or result in a cash payment. The tax credit can also be claimed by SMEs and large companies who have been subcontracted to do research and development work by a large company. Even if an SME is not subcontracted it may claim the RDEC if it does not qualify for the SME research and development relief.

Until 31 March 2016, a large company can choose whether to claim the additional relief as a super-deduction (as above), or claim above-the-line credit. For claims from 1 April 2016 to 1 April 2020, only the latter is available.

As per the Autumn Budget 2018 update, the amount of payable R&D tax credit that a qualifying loss-making company receive in tax year will be restricted to three time the company's total Pay As You Earn (PAYE) and NICs liability for the year. It is however important to note that this change is still subject to consultation and may very well change.

Above-the-line credit is given as 12 per cent of the expenditure. It increases the reported profits, making the tax benefit more obvious in the accounts.

We can make sure that you claim the maximum amount of allowable R&D relief.

R&D capital allowances

All allowable expenditure qualifies for a first year allowance of 100 per cent. Thus the whole of the expenditure may be deducted from taxable profits in the year the expenditure is incurred. This allowance is in addition to capital allowances for plant and machinery.

Costs of patents and know-how

A company may acquire a patent or pay for a licence to use a patent. For tax purposes, these are treated similarly. The cost of obtaining your own patent is not included within the scope of the R&D regime referred to above, but will usually qualify for tax relief under other tax provisions.

Similarly, a company may pay to acquire know-how. Know-how includes industrial information and techniques used in manufacturing, mining or agriculture but excludes commercial information such as client lists. It can include information about marketing, packaging and distribution.

Such expenditure is regarded as intellectual property. This expenditure can be written off over several years. In general, the tax treatment follows the accounting treatment.

We can advise you on how to show such expenditure in your accounts and tax returns.

Patent Box

Reducing corporation tax due on patent income

The patent box regime applies a reduced rate of corporation tax to profits attributable to qualifying patents and similar intellectual property (IP). Unincorporated businesses can't qualify for the patent box.

The patent box tax rate has gradually been reduced to 10% since the introduction of the regime in 2013 (see table):

Financial year starting 1 April	**Effective patent box rate when companies pay:**	
	Main corporation tax rate	**Small profits corporation tax rate**
2018	10%	10%
2017	10 %	10 %
2016	11 %	11 %
2015	12 %	12 %
2014	13.3 %	12.67 %
2013	15.2 %	13.2 %

To benefit from this reduced rate, your company must:

- hold a qualifying patent or other qualifying IP
- receive income relating to that patent or IP
- elect into the regime.

Qualifying patents or IP

Your company must own, or hold an exclusive licence to use, one or more patents issued by the UK Intellectual Property Office, European Patent Office or any of the following countries:

Austria, Bulgaria, Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Poland, Portugal, Romania, Slovakia and Sweden.

Your company can also qualify for the patent box regime if it holds any of the following:

- patents that would have been granted but for a prohibition on publication on the grounds of national security or public safety (such as for nuclear fuel)
- UK and European Commission plant breeders' rights
- regulatory data protection granted in respect of medicinal, veterinary and plant protection products
- marketing exclusivity granted to orphan status medicines and medicines for paediatric use
- supplementary protection certificates.

What is IP income?

Profits from the company creating or developing the patented invention, or from a product incorporating the patented item, qualify for the patent box regime.

Where the patented device is an essential component within a larger product, the income from that bigger product falls within the 'gross income' definition for the patent box regime. Profits from holding patents as investments do not qualify and are taxed at the normal rate of corporation tax, which is 19% in 2018/19.

We can help you with your Patent Box profit calculation and attaining the correct corporation tax relief.

Record Keeping

There's no specific record keeping requirement for R&D tax relief claims. But the general Corporation Tax requirement to keep sufficient records to support the entries on your Corporation Tax return still applies.

HMRC doesn't expect you to create new primary business records just for an R&D tax relief claim. But you may need to maintain your business records in a different way, so you can access the information you need easily.

Before you make your claim, you may want to involve your R&D staff in the process. This will help you identify qualifying activities and expenditure.

HMRC may ask to see your company or organisation's records when they make a compliance check into your Corporation Tax return or R&D tax relief claim made separately from a return.

You can read more detailed guidance on keeping records for R&D claims in the Corporate Intangibles Research and Development Manual on the HMRC website: www.gov.uk/hmrc

Advance assurance

HMRC is keen to encourage more companies to apply for R&D tax relief by providing them with an advance assurance that their company will qualify. This procedure can be used by small companies which haven't claimed R&D tax relief before, and which have:

- fewer than 50 employees; and
- annual turnover of no more than £2 million.

However, where the company is part of a group the tax history for the group must be examined. Where another member of the group has claimed R&D tax relief in the past the advance assurance won't be given. This doesn't bar the company from claiming R&D tax relief, it just blocks access to the advance assurance procedure.

The main benefit of advance assurance is that the company has a guarantee that HMRC won't raise further questions about the initial R&D claim, and for R&D claims submitted for the next 2 accounting periods. It is effectively a guarantee that R&D claims will be accepted for 3 consecutive accounting periods. We can help you with this advance assurance process.

Making a claim

The R&D tax relief claim should be included on the company's corporation tax return. There is detailed guidance on which boxes of the return to complete for this claim within HMRC's guide: research and development tax relief. Again this is an area where our experts can help you.

Deadline for claims

The deadline for submitting a claim for R&D tax relief is 2 years from the end of the accounting period in which the costs were incurred.

Before submitting an R&D tax relief claim for an earlier year, calculate whether that claim will create a trading loss for the year. If a loss is expected, the company should consider disclaiming capital allowances for that year or for a later year, in order to use the loss created by the R&D tax relief claim.

A capital allowance claim can be made or amended within 2 years of the end of the relevant accounting period, the same period during which the R&D tax relief claim can be made.

How BWM can help you

We can:

- Help you to interpret the qualification criteria – many companies incorrectly rule themselves out by failing to recognise qualifying activities and costs.
- Pull together a detailed and comprehensive claim that is based on proven experience and success.
- Submit the claim, track progress from start to finish and answer any HMRC questions or information requests.

Speak to us to find out whether your company qualifies for a share of these funds. It does not need to be something radical, it may be that you develop your own products or services, or aim to appreciably improve or enhance existing products, processes or services with the uncertainty of whether they will be a success.

Please contact John Elliott for more information.

FOR GENERAL INFORMATION ONLY

Please note that this help sheet is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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We are one of the leading, independent chartered accountancy practices in Liverpool. At BWM we provide a wide range of accountancy and business support services to organisations and individuals throughout the North West of England and beyond. Our experienced and skilled partners and their teams are ready to support you with high quality, individual yet affordable services however complex your personal or business needs.

For more details of how we can help you transform your business, please visit www.bwm.co.uk or call us on 0151 236 1494