



R&D for Small and Medium Enterprises

Innovation Tax Relief - Research and Development (R&D) tax credits

- + Chartered Accountants
- + Tax Specialists
- + Business Advisers



The UK government have introduced several incentives to encourage UK companies to undertake R&D activities. One such incentive is the R&D regime for Small and Medium Enterprises (SME), which is considered in this factsheet.

The Relief

R&D relief for qualifying expenditure increases the amount that is deducted from taxable profits. For expenditure incurred by a SME up to 31 March 2023, an extra 130% of qualifying costs can be deducted from profits. For expenditure incurred from 1 April 2023, the extra amount that can be deducted from profits has been reduced to 86% of qualifying costs, however this continues to allow a significant potential tax saving.

Large companies are subject to a separate regime which is beyond the scope of this factsheet.

Where an SME is loss-making in a period in which qualifying expenditure is incurred, it can surrender this loss in exchange for a payable credit - HM Revenue & Customs (HMRC) will make a cash repayment to the business. For expenditure up to 31 March 2023 the credit was 14.5%, but this reduces to 10% for expenditure from 1 April 2023.

However, to provide further support for loss-making R&D-intensive SME's, a SME payable credit of 14.5% will continue to apply for expenditure incurred on or after 1 April 2023. A company is considered R&D intensive where its qualifying R&D expenditure is worth 40% or more of its total expenditure.

Cap on Relief

Note that for accounting periods beginning on or after 1 April 2021, the amount of payable credit that a company can receive in any one year will be capped at £20,000 plus three times the company's total PAYE and National Insurance contributions liability for that period. There are exemptions for companies holding IP and with less than 15% subcontractor costs or externally provided workers.

Changes to the R&D claim process from April 2023

For accounting periods starting on or after 1 April 2023, companies will be required to notify HMRC within 6 months of the end of accounting period that they intend to make an R&D claim. Notification will not be required if the company has made an R&D claim for any of the 3 previous years.

Example - expenditure up to 31 March 2023

A Ltd is an SME which incurs qualifying R&D expenditure during the year ended 31 March 2023 of £100,000.

If A Ltd is profitable in the period, it will be able to deduct a total of £230,000 from taxable profits. Assuming a corporate tax rate of 19%, it would **reduce A Ltd's corporation tax liability by £43,700**, meaning the company gets additional tax relief of 24.7% on the qualifying expenditure incurred.

If A Ltd is loss making in the period, the £230,000 can either be carried forward and set against future profits in the company; or it can be surrendered for a payable credit at a rate of 14.50%. This would result in a **cash repayment of £33,350**, meaning an effective rate of relief of 33.35% of qualifying R&D expenditure.

Example - expenditure from 1 April 2023

A Ltd is a SME which incurs qualifying expenditure during the year ended 31 March 2024 of £100,000.

If A Ltd is profitable in the period, it will be able to deduct a total of £186,000 from taxable profits. Assuming a corporate tax rate of 25%, it would **reduce A Ltd's corporation tax liability by £46,500**, meaning the company gets additional tax relief of 21.5% on the qualifying expenditure.

If A Ltd is loss making in the period, the £186,000 can either be carried forward and set against future profits in the company, or it can be surrendered for a payable credit at a rate of 10%. **This would give a cash repayment of £18,600**, meaning an effective rate of relief of 18.6% of qualifying R&D expenditure.

Qualification of R&D activities

The first step in preparing an R&D claim is to establish which activities meet the definition of R&D for tax purposes.

To qualify, a product or process under development should utilise new techniques or information which increase the capabilities of the industry in which the company operates. The knowledge employed does not have to be new, but it does have to represent an improvement on what went before. Essentially, a qualifying R&D project will be looking to resolve an uncertainty blocking the realisation of the new product/service.

Our approach, based on guidance issued by HMRC, is to understand the following:

- + What is the advance sought?
- + What are the scientific or technological uncertainties involved in the project?
- + How and when were these uncertainties overcome?
- + Why was the knowledge being sought not readily deductible by a competent professional working in that field?

Quantifying the expenditure

Once the qualifying projects are identified, we can move toward quantifying the amount of qualifying expenditure, which must be:

- + Revenue and not capital in nature. (Please note: separate relief is available for qualifying capital expenditure in the form of enhanced capital allowances).
- + The amounts must not be incurred in carrying out activities contracted to the company by another person (however relief may be available under the Research & Development Expenditure Credit).
- + The expenditure must not have been met by another person (if the R&D project is funded in whole or part by 'State Aid' such as government grants, it may be that none of the expenditure would attract R&D relief).

You must make a claim for R&D relief in your company tax return.

Next step

If you think you have undertaken projects that exhibit the hallmarks referred to in this factsheet, why not have an initial discussion with one of our specialists (details below) to see how you might be able to benefit from this generous regime. You can also visit mapartners.co.uk and view our free online resources.



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