

Oury Clark Quick Guides:

# Research & Development Tax Relief



**R&D Tax Credits are a UK tax incentive designed to encourage companies to invest in R&D. Companies can reduce their tax bill or claim payable cash credits as a proportion of their R&D expenditure.**



### **What is the definition of Research and Development?**

An R&D project is one that seeks to achieve scientific or technological advances. It will aim to advance the overall knowledge or capability in a field of science or technology and will involve significant scientific or technological uncertainty.

It is not necessary for a company to be involved in a high tech field in order to qualify for R&D relief. All that is needed, is a problem without a readily deducible or freely available solution which the company is attempting to solve by developing an advance.

There are some restrictions on what counts as an advance, with social science in particular being excluded. A Company does not need to succeed in its R&D projects in order to qualify for R&D relief. Indeed the idea behind R&D relief is that the outcome of R&D projects is uncertain and projects may experience frequent failures before success is achieved.

### **What is Research and Development Tax Relief?**

R&D tax relief is a relief claimable by trading companies of all sizes. Companies making qualifying expenditure on R&D can claim under two schemes, the Research and Development Expenditure Credit (RDEC) or the SME Relief Scheme

#### **SME Scheme**

To qualify for the SME Scheme a company must fulfil the following conditions:

- Fewer than 500 Employees
- Turnover below €100m or a balance sheet total below €86m
- The project must not be benefiting from notifiable state aid.
- The company must not have been subcontracted by another company.

When determining the first two conditions you must include staff, turnover and balance sheets of any linked companies (>50% parent and subsidiaries) and a proportion of staff, turnover and balance sheets of any partner companies (>25% share holdings).

SME's may deduct an additional 86% of qualifying expenditure and if loss making may make a tax credit claim of 10% of the surrenderable loss. (The relief rates are 130% and 14.5% respectively for expenditure incurred before 01 April 2023).

The tax credit is capped at £20,000 plus three times the Company's total Pay As You Earn (PAYE) and NICs Liability for the year. An exemption exists for companies that meet the following criteria:

1. The company is creating, preparing to create or actively managing relevant intellectual property that it holds. Companies preparing or conducting R&D will fulfil this requirement so long as the work is mainly performed by employees.
2. The total qualifying expenditure incurred for the relevant accounting period on connected subcontractors is less than 15% of the qualifying R&D expenditure.

Where the exemption applies there is no cap on the amount of tax credit that may be claimed.

## RDEC Scheme

The RDEC scheme is available to all companies engaged in R&D including those SME's disqualified for receiving state aid or performing subcontracted work.

The scheme provides a taxable 20% (13% on expenditure before 1 April 2023) credit on qualifying expenditure and may result in a cash credit depending on the company's individual circumstances. There is a prescribed method for applying the tax credit and it is important this is done correctly as it can impact future tax years.

## What is qualifying expenditure?

In order to qualify as R&D expenditure an expense must fit exactly into one of a number of categories HMRC has set. The most common ones are:

- Staffing costs directly and indirectly related to research and development projects.
- Materials, water, fuel and power used directly in carrying out research and development.

- Software purchased and used in the development. For accounting years commencing after 01 April 2023\*, the definition of software has been expanded to include data and hosting costs.
- 65% of sub-contracted research and development costs subject to some restrictions under the RDEC Scheme. The sub-contractor does not need to be based in the UK for expenditure in accounting years commencing before 01 April 2024\*. From 01 April 2024 subcontracting expenditure will only be eligible if the work is performed in the UK or where the work is performed overseas, it is due to conditions that cannot be reasonably replicated in the UK\*
- Capital Expenditure is not included, but 100% tax relief may be available for R&D capital costs.

If an expense does not fit into a category it cannot be claimed no matter how vital it may be to the R&D being performed.

## What are qualifying indirect activities?

A number of categories permit the inclusion of expenses that are only indirectly supporting the R&D process. Typical examples of indirect costs are:

- Scientific information services which are conducted for the purpose of R&D support
- Indirect supporting activities such as security, administration, finance and personnel, which are undertaken for R&D
- Training required to support an R&D project
- Research into new testing or sampling methods
- Feasibility studies to develop strategic direction of a specific R&D activity

# Let us Introduce Ourselves



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**Disclaimer:** This note does not contain a full statement of the law and it does not constitute legal advice. Please contact us if you have any questions about the information set out above.

## Making a claim

Companies can make or amend an R&D claim within two years of the end of the relevant accounting period. An overview of the R&D claim containing information specified by HMRC must be included with the company corporation tax return. The requisite information is to be determined by forthcoming Secondary Legislation\*.

From April 2023\*, companies that wish to obtain R&D relief will need to notify HMRC within 6 months of the end of the accounting period of their intention to claim. This notification is to be made via an online form and the exact information required is to be determined by HMRC regulations. Companies that have made an R&D claim within any of the 3 periods preceding the claim period.

HMRC aim to respond to submissions within 40 working days either by way of making the repayment or issuing a request for additional information.

Many companies can benefit from significant cash tax savings either by way of reduced tax liabilities, refunds, or cash tax credits.

\*Marked items are part of the proposed R&D relief reforms and do not currently have force of law. These are expected to be enacted on conclusion of HMRC's R&D consultation in Spring 2023.