A boost to business

Nigel Holmes explains why advisers can help to propel small businesses forward with the financial benefits of research and development tax relief.

TEN SECOND SUMMARY

1. **Research and development tax relief is designed to encourage UK companies to innovate.**
2. **The scheme for small and medium-sized enterprises provides an enhanced deduction against profits.**
3. **The benefits of research and development relief can be reduced if state aid funding is received.**

Nigel Holmes FCA CTA
is a senior R&D tax consultant at Catax and a nominee for Tax Writer of the Year in Tolley's Taxation Awards 2017.
T: 0300 303 1903
Visit: www.catax.com

As Brexit approaches, Britain must remain innovative and competitive to succeed in the global marketplace. Regardless of this, the ability to claim research and development (R&D) tax relief should not be up for debate.

For many, tax is a topic that conjures up mixed feelings and varied thoughts such as avoidance schemes and big companies not paying enough tax. Tax avoidance is thought or believed to be immoral, or at least that is the way it's viewed today. Tax evasion was and is illegal and those involved deserve punishment. However, when I first started specialising in tax, the term tax avoidance wasn't seen in such a bad light. People and companies would enter schemes and transactions to lower their tax bills and, as a result, tax legislation simply could not keep up. Times and views change.

Changing times

Over time, measures have been taken to ensure it is no longer worth attempting tax avoidance. Further, press coverage and the "naming and shaming" of sports people and celebrities undertaking such practices has brought the matter into the public eye. During the financial crisis, these actions were not viewed positively.

But what about tax planning? Where does legitimate tax mitigation move into tax avoidance? This is subjective, but those who think all tax planning should be viewed in the same way as avoidance have misunderstood the purpose of the tax legislation. Every person and company is entitled to take commercially acceptable planning steps to lower their tax bills. Those who remain to be convinced should remember that putting savings into an ISA, making a pension contribution, or transferring an unused personal allowance to their spouse is tax planning.

R&D relief is also tax planning – it is there, in black and white, in CTA 2009. It is designed to encourage UK companies to innovate which is encouraging for the UK in the global marketplace.

The relief for SMEs

So, who and what qualifies for R&D relief? When the scheme for small and medium-sized enterprises (SMEs) was introduced in April 2000, companies carrying out eligible R&D work could claim an enhanced deduction against their profits for specific expenditure

© iStockphoto/Cecilie_Arcurs

– mainly consumable items, staff costs and subcontracted services. Since then the relief has been amended many times, mostly to increase the amount that can be claimed and to simplify the process. The enhancement rate is now 130%: in other words, £100,000 of qualifying R&D spend, attracts a further £130,000 deduction against profits.

This scheme allows tax liabilities to be substantially reduced – creating large tax repayments where the tax has already been paid – and a claim can be made for the previous two accounting periods. Where a loss is created or increased, it can be surrendered in return for a 14.5% cash repayment, even if the company has never paid any tax to HMRC.

Many companies may wrongly believe they are not undertaking R&D. The relief is not just for "men in white coats" – think engineering, electronics, IT and manufacturing. Think process, not just product. Think small – a large project may have just a small (but costly) R&D element to it.

Clients may simply not be aware of R&D relief; HMRC does try to engage with companies, but it is down to tax advisers to push it. There are many ways to obtain advice in this area; whether through larger accountancy practices or specialist firms. Many accountants will feel uncomfortable passing R&D tax work to larger firms because they may fear losing work. Specialists work alongside the accountant, complimenting the existing service a company is receiving.

The Brexit effect

What is likely to happen following Brexit? There will be changes to the way R&D is carried out, but for now things remain the same.

The SME scheme falls within the definition of EU state aid. Whether we have a soft, hard or "somewhere in-between" Brexit, at some point R&D tax relief will no longer be defined as such. However, I am sure it will be here to stay in some form to keep the UK competitive for innovation. Under the current rules, and in simple terms, state aid cannot be received for the same matter twice. Thus, if an SME has received some form of grant or subsidy towards R&D, it cannot have the SME tax relief too. To the untrained eye, it would appear that all is lost from a tax perspective. But think again.

HMRC has acknowledged that there is an issue and introduced legislation (CTA 2009, s 104A(b)) so that an SME in receipt of state aid could claim R&D tax relief under the (less generous) large company scheme. However, there was one major difference between the schemes: the one for large companies did not offer a tax credit for losses. Hence SMEs with state funding could not surrender any tax losses for cash.

This was solved when the large company scheme was replaced by the R & D expenditure credit (RDEC) in 2013. Now, repayable credits are available to companies claiming under the large scheme either due to funding or size. RDEC is worth about 9% of the qualifying spend. In the November 2017 Budget, the Chancellor increased the credit percentage from 11% to 12% for expenditure on or after 1 January 2018. The net effect is, therefore, worth nearly 10% of the qualifying spend.

A trap to avoid

Let's take the example of a company that has spent £100,000 on qualifying R&D and received 50% EU state aid funding. The cost to the company, after the additional RDEC tax relief available, would be around £40,000.

If the amount of funding is small, many companies may have made their financial position worse by opting for the funding rather than the tax relief.

Unfortunately, many companies claim grants only to become aware of the R&D tax relief much later, by which time advice is too late. By grant providers and R&D advisers working more closely together, at the outset, the client can receive the best all-round funding advice.

Conclusion

Having spoken to clients who have benefited from this tax relief we are pleased to learn that most reinvest the financial benefit back into more R&D. Therefore, despite concerns from some quarters, the tax relief system is generating more R&D and is not merely a way to reduce the company's tax liability to enable it to pay more dividends to the shareholders.

FURTHER INFORMATION

As a strategic partner to the IFA, Catax are market leaders and specialists in R&D tax credits, having delivered more than £150m of tax relief for clients to date. The firm offers guidance and support surrounding the intricacies of R&D tax relief. Not only that, their 100 employees work with accountants to help identify eligible clients or qualifying activity to maximise claims when possible. With their largest initial refund of more than £750,000 and an average client benefit of £43,000, Catax do all the hard work, leaving accountants free to provide more advice.
T: 0300 303 1903
Visit: www.catax.com