

# RESEARCH AND DEVELOPMENT TAX RELIEFS FOR SMALL AND MEDIUM-SIZED COMPANIES

The aim of this article is to set out the operation of the research and development tax relief that may be claimed by small and medium sized companies, the qualifying conditions that must be satisfied and the items for which relief may be obtained.

## QUALIFYING COMPANIES

This article only addresses the relief available to small or medium sized companies. A company is regarded as small or medium sized if it:

- ▶ has fewer than 250 employees and either or both of:
  - a) annual turnover not exceeding 40m euros; and
  - b) a balance sheet total not exceeding 27m euros; and
- ▶ has less than 25% of its capital or voting rights owned by one or more companies that are not small or medium sized (with certain limited exceptions).

## QUALIFYING EXPENDITURE

The expenditure qualifying for relief must satisfy certain criteria as follows:

- ▶ the expenditure must be at least £10,000 per accounting period;
- ▶ if the accounting period is more or less than twelve months in duration then the £10,000 is adjusted pro rata;

- ▶ the expenditure must be revenue expenditure attributable to research and development which is related to the trade of the company and is carried out by the company or on its behalf; and
- ▶ the expenditure must relate to:
  - a) Cost of employing qualifying staff;
  - b) Consumable stores;
  - c) Subcontractor costs (with restrictions).

The company claiming the relief should own the intellectual property which is developed as a result of the work.

## SPECIFIC DETAIL CONCERNING THE QUALIFYING COSTS

### a) Qualifying staff

These are staff who are directly involved in the research and development. They could be researchers or managers. The staff costs must be apportioned between research and development and other activity where the staff are not involved full time with the research and development. The staff need not be



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directly employed by the company but certain conditions must be met. Costs that qualify include salaries, bonuses and national insurance contributions as well as pension contributions.

### b) Consumable Stores

Consumable stores are items directly utilised in the research and development. They include materials and equipment where the latter has a short useful life. Computer software and transformable materials also qualify and these include water, fuel and power.

Equipment that will be retained for the longer term and provide benefits over a number of periods is capital expenditure and does not qualify for this relief although other allowances may be available.

### c) Subcontractor Costs

Typically a subcontractor who is providing services in relation to research and development to a company cannot claim relief on its costs because it does not own the intellectual company that is created. The subcontractor does not have to be



small or medium sized and it need not be a UK company. There are special reliefs available where the subcontractor and the company claiming the relief are connected so as to ensure proper relief is given for the costs incurred.

### **OWNERSHIP OF THE INTELLECTUAL PROPERTY**

The company claiming the relief must own the intellectual property. Even if the research and development fails, the cost still qualifies for relief providing it would have qualified had it been a success. There is one exception of this which is for small and medium sized companies where work is subcontracted to them.

### **THE NATURE OF THE RELIEF**

The relief is a deduction from profits for tax purposes. However if the business is loss making the additional loss can be surrendered in exchange for an immediate repayment of tax rather than be carried forward to be set against future profits.

#### **a) Claim against profits**

If the research and development relief is to be claimed as a cost against profits then the relief is calculated by adding a further 50% to the qualifying expenditure for tax purposes. This is then claimed in addition to the 100% of the costs already available. For a tax paying company this reduces the liability. For a loss making company it increases the loss available to carry forward (or backward) or to use against other income or to surrender to other companies. So for instance if a company spent £20,000 on qualifying expenditure then it will get relief against its profits totalling £30,000; this is the £20,000 of cost and the extra £10,000 of relief.

#### **b) Claim as a tax credit**

If the company is loss making then it may be that a relief as a deduction from profits is not attractive. In this situation the company can obtain a repayment of tax from HMRC but only up to the lower of:

- a) 16% of the surrenderable loss (i.e. 24% of the qualifying expenditure); and
- b) The total PAYE and Class 1 National Insurance paid by the company in that accounting period.

The loss surrendered to a tax credit is equal to the lower of:

- ▶ 150% of the qualifying expenditure; and
- ▶ The total loss of the trade after any claims made or which could be made against other profits or gains of the same period, and other reliefs claimed in respect of the losses.

### **MAKING A CLAIM FOR RELIEF**

Relief by claiming the enhanced cost against the income of the company is made in the company's corporation tax return in the relevant period. This must be made within six years.

If a repayment is to be claimed then this must be claimed within one year of filing the tax return for the company.

### **OTHER RELEVANT ISSUES**

#### **a) Pre-trading expenditure**

Where a company has not yet commenced its trade then it can still claim the research and development tax relief providing the research and development is related to the trade it is anticipated will be commenced in due course.

#### **b) Joint ventures**

It is quite common for a company to carry on research and development through a joint venture so as to bring together the skills and abilities of two complimentary companies.

Where a corporate joint venture is used then it is the joint venture company that needs to claim the relief.

Where instead there is a non corporate joint venture each company will normally own the research and development which they each create. Each of the two companies will be able to claim the relief on the relevant part of their expenditure.

#### **c) Grants and subsidies**

Where some form of qualifying government grant or subsidy is received by the company then none of the cost for the project qualifies for the research and development tax relief. This is the position irrespective of whether the entire cost of the project is covered by that grant or subsidy. However, those companies may be able to claim large company relief as that is not classed as a state aid. There are certain exceptions where the grant or subsidy provided by the company is not paid state aid.

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