

R&D Expenditure Credit (Lecture B1289 – 16.55 minutes)

A company is large if it has:

1. More than 500 employees and either
2. Revenues exceeding €100 million, or gross assets exceeding €86 million

RDEC can also be claimed by SMEs on certain costs such as R&D costs that have been subsidised and sub-contract work from a large company.

The tax credit is 13% of qualifying R&D costs, with qualifying R&D costs having the same meaning as for SMEs apart from the exceptions noted above.

Illustration

A large company spends £1 million on qualifying R&D in its year ended 31 December 2020.

The tax credit is 13%, i.e. £130,000

This is recorded as income in the P&L (chargeable to corporation tax) and a corresponding amount of tax recoverable from HMRC.

- Dr Tax recoverable	130,000	
- Cr P&L income		130,000

The calculation of when and how the tax recoverable is actually recovered requires a methodical approach, broken down into steps and is best illustrated by examples.

Example 1 – profit-making company

Step 1 – assume year ended 31 March 2021

“The set off amount is to be applied in discharging any liability of the company”

Turnover		16,500,000
R&D expense	10,000,000	
Other expenses	<u>5,000,000</u>	<u>(15,000,000)</u>
Profit		1,500,000
RDEC (13% of £10,000,000)		<u>1,300,000</u>
Pre-tax profits		£2,800,000
CT at 19%		532,000
RDEC		<u>(1,300,000)</u>
Payable credit after discharging CT liability		<u>£768,000</u>

Step 2

If amount remaining after step 1 exceeds net value of the set-off amount (R&D credit minus the main rate of CT) reduce that amount to net value of the set-off amount.

i.e. Compare the amount remaining after step 1 with the net value of the credit i.e. after deducting the potential corporation tax on the credit.

- Amount remaining from step 1 £768,000
- Net RDEC (£1.3m less 19%) £1,053,000
- Carry forward the lesser of the two i.e. £768,000

Step 3

Amount brought forward from Step 2	768,000
Relevant PAYE/NIC (say)	<u>(300,000)</u>
Carried forward to next accounting period and added to expenditure credit for that period	<u>£468,000</u>
Capped amount carried forward to Step 4	<u>£300,000</u>

Step 4

Amount remaining after Step 3 applied in discharging any liability of the company to pay corporation tax for any other accounting period.

Brought forward from Step 3	300,000
Other period CT liability (say)	<u>(nil)</u>
Balance c/f to Step 5	<u>£300,000</u>

Step 5

If the company is a member of a group, it may surrender the whole or any part of the amount remaining after Step 4 to any other member of the group.

Brought forward from Step 4	£300,000
CT liabilities of the group (say)	<u>(£100,000)</u>
Balance c/f to Step 6	<u>£200,000</u>

Step 6

The amount remaining after Step 5 is applied in discharging any other liability of the company to pay a sum to HMRC.

Brought forward from Step 5	£200,000
Set off against any other liability (say)	<u>Nil</u>
Amount remaining	<u>£200,000</u>

Step 7

The amount remaining after Step 6 is payable to the company, ie £200,000.

Summary

Discharge against current liability	532,000
RDEC credit c/fwd	468,000
Company liability of group companies	100,000
RDEC paid	<u>200,000</u>
Total	<u>£1,300,00</u>

Example 2 – loss making company

Step 1

The set off amount is to be applied in discharging any liability of the company.

Turnover		5,900,000
Expenses		
R&D	10,000,000	
Other	<u>5,000,000</u>	<u>(15,000,000)</u>
Profit/(loss) before credit		(9,100,000)
RDEC (13% x £10,000,000)		<u>1,300,000</u>
Adjusted loss		<u>(£7,800,000)</u>
CT due		Nil
RDEC		£1,300,000
Amount remaining (no liability to be discharged)		£1,300,000

Step 2

Take smaller of the 2 figures below to Step 3

1. Amount remaining from Step 1 £1,300,000
2. Net RDEC (£1,300,000 less 19%) **£1,053,000**

The restricted amount of (£1.3m - £1.053m), ie £247,000 is not available as a payable credit.

- Carried forward to following years and brought in at Step 1 in preference to a later year's payable credit
- Should it be recognised as a tax asset?
- Based on principles for DT assets, no (existence of tax losses is a strong indicator that future profits will not be available for set-off)
- The company would have to show why they would be, eg that the tax loss is a 'one-off'

Step 3

Brought forward from Step 2	(3) 1,053,000
PAYE/NIC (say)	<u>(4) (400,000)</u>
	<u>£653,000</u>

If (4) is less than (3) – capped at £400,000 c/fwd to Step 4

£653,000 must be c/fwd to next year

Step 4

The amount remaining after Step 3 is to be applied in discharging any liability of the company to pay corporation tax for any other accounting period.

Brought forward from Step 3	£400,000
Other period CT liability (say)	<u>(Nil)</u>
Balance c/fwd to Step 5	<u>£400,000</u>

Step 5

If the company is a member of a group, it may surrender the whole or any part of the amount remaining after Step 4 to any other member of the group.

Brought forward from Step 4	£400,000
CT liabilities of the group (say)	<u>(£190,000)</u>
Balance c/f to Step 6	<u>£210,000</u>

Step 6

The amount remaining after Step 5 is to be applied in discharging any other liability of the company to pay a sum to HMRC.

B/fwd from Step 5	£210,000
Any HMRC liability	<u>Nil</u>
Amount remaining	<u>£210,000</u>

Step 7

Amount remaining after Step 6 is payable to the company £210,000.

Summary

Tax withheld available to set off against next year's liability	247,000
PAYE capped credit c/fwd	<u>653,000</u>
Total c/fwd	900,000
CT liability of other group companies	190,000
Paid to company	<u>210,000</u>
Total	<u>£1,300,00</u>

Example 3 – profit making but only because of RDEC

Step 1

The set off amount is to be applied in discharging any liability of the company.

Turnover		12,000,000
Expenditure		
R&D	10,000,000	
Other	<u>2,500,000</u>	<u>(12,500,000)</u>
Loss before RDEC		(500,000)
Expenditure credit (13% x £10,000,000)		<u>1,300,000</u>
Profits		<u>£800,000</u>
CT @ 19%		152,000
RDEC		<u>£1,300,000</u>
Amount remaining after discharging liability		<u>£1,148,000</u>

Step 2

Smaller of 2 figures below goes to Step 3

- | | | |
|----|---|--------------------------|
| 1. | Amount remaining from Step 1 | <u>£1,148,000</u> |
| 2. | Net expenditure credit (£1.3m less 19%) | <u>£1,053,000</u> |

Restricted amount of (1,148,000 - 1,053,000), £95,000 must be carried forward to future periods.

Step 3

b/fwd from Step 2	(3) <u>1,053,000</u>
Relevant PAYE/NIC (say)	(4) <u>465,000</u>

If (4) is less than (3) this amount goes to Step 4

The difference (1,053,000 – 465,000) £588,000 must be carried forward to future periods.

Step 4

B/fwd from Step 3	465,000
Other period CT liability (say)	(Nil)
Balance c/fwd to Step 5	<u>£465,000</u>

Step 5

Brought forward from Step 4	465,000
CT liabilities of the Group (say)	<u>(50,000)</u>
Balance c/fwd to Step 6	<u>£415,000</u>

Step 6

B/fwd from Step 5	415,000
Set off against any other liability	<u>Nil</u>
Amount remaining	<u>£415,000</u>

Step 7

Payable £415,000.

Summary

Discharge against current liability (Step 1)	£152,000
Carried forward to future periods (95 + 588)	683,000
Set off against other group companies (Step 5)	50,000
RDEC paid to company (Step 7)	<u>415,000</u>
Total	<u>£1,300,00</u>

Contributed by Malcolm Greenbaum