

R&D - changes to the tax reliefs (Lecture B 1357 – 14.58 minutes)

One of the announcements that was made in the Autumn Statement on 17 November 2022 related to research and development tax credits.

There are currently two reliefs:

1. The relief for SME companies being an entity which has a staff headcount of less than 500 and either turnover not exceeding €100m or balance sheet total not exceeding €86m. Some companies within that definition do not qualify for the relief for various reasons and can claim under the large scheme. This allows an additional deduction of (currently) 130% of qualifying costs and an ability to reclaim (currently) 14.5% of surrenderable losses as a repayable tax credit. The surrenderable loss is the lower of:

1. the total unrelieved trading loss for the accounting period (although losses must first be treated as if they have been offset against other profits of the same period), and
2. 230% of the qualifying R&D expenditure for the accounting period.

The repayment has been subject to a potential cap linked to PAYE and NIC since 2021 and this is to be retained.

2. The relief for all other companies. This gives a taxable credit called RDEC of (currently) 13% which is then offset against corporation tax liabilities or other outstanding tax bills but can be repaid.

HMRC had already announced various measures to tackle abuse of the system but the Chancellor went further in the Autumn Statement by announcing that a consultation would consider the viability of moving to a single RDEC type scheme for all companies.

As a starting point, changes were made to the level of relief available. For SME businesses, the additional deduction is reducing from 130% to 86% from 1 April 2023.

The tax credit, which is currently at a rate of 14.5%, is allowed in relation to the 'surrenderable loss'. This figure will reduce to 10% from 1 April 2023.

The RDEC will rise from the same date from its current level at 13% to 20%.

Example of impact

Company incurs £100,000 on qualifying R&D and is eligible to claim under the SME scheme.

The current additional deduction would be £130,000 giving corporation tax relief of £24,700 at current rate of 19% (this is the amount that is gained on the additional deduction only as the allowable costs would still get tax relief even if no additional relief was available).

From 1 April 2023, the additional deduction would be £86,000.

This will give relief at £16,340 if the company is paying tax at the small companies rate (which is unlikely given the level of the relief) or £21,500 if paying at main rate. The benefit if the company has profits in between the lower and upper profit limits, paying a marginal rate of tax of 26.5%, will be higher.

If this was eligible for a payable tax credit, then currently would get £33,350 (£230,000 x 14.5%) based on the 130% deduction. From 1 April 2023, the company will get £18,600 (£186,000 x 10%) based on a lower deduction and lower repayment rate. This clearly represents a significant reduction in relief (56% of the previous figure).

If this company had been claiming under the RDEC scheme (assuming that they are in a net loss position), the RDEC would be £20,000 and the net repayable amount would be £15,000 (if paying at the main rate of CT, i.e. 75% x £20,000) or £16,200 (if paying at the small companies rate, i.e. 81% x £20,000) as you have to net off the corporation tax on the RDEC when calculating the repayment. So the company would be even worse off.

These changes apply for any expenditure incurred on or after 1 April 2022.

Other changes announced

The Autumn Statement also reiterated that other previously announced changes to R&D tax reliefs would be included within the Finance Bill to be published after the Spring Budget.

These include:

- Adding data costs and the costs of cloud computing to qualifying expenditure under the consumable and software costs category;
- Extending the scope of R&D relief to cover mathematical advances to enable the pure mathematics costs involved in the video gaming industry to be covered by these reliefs;
- Adding a new condition to the sections covering contracted out and independent R&D such that the expenditure will only be allowed if it is UK expenditure or qualifying overseas expenditure. Qualifying overseas expenditure will be defined as that which is attributable to activity undertaken overseas due to geographical, environmental or social conditions not present or capable of being replicated in the UK. Cost of the work and availability of workers are specifically excluded as factors.

Additionally, where R&D is undertaken through externally provided workers, they must be paid through PAYE;

- Introducing a requirement to have all CT returns containing an R&D claim to be submitted digitally through HMRC's tax return portal;
- Mandating that additional information be provided where a claim is made for R&D tax reliefs. This will include a description of the R&D undertaken, a breakdown of the qualifying costs, details of any agent who has advised on the R&D claim and a formal sign off of the claim by a senior officer of the company;
- A requirement that companies must notify HMRC in advance that they are going to make an R&D claim. This notification must be made within 6 months of the end of the chargeable period, but only if an R&D claim has not been made in the previous 3 years.

There are also measures which are to be changed to address previous anomalies or unforeseen consequences of previous changes:

- Schedule 18 FA1998 will be amended to allow a claim for RDEC where a corporation tax assessment is amended by HMRC.
- Schedule 18 FA1998 will be amended to permit a claim for RDEC to be made where the claimant made a claim for SME relief but was not entitled to do so.
- A new definition will be introduced giving the time limit for making claims.
- New legislation will clarify that where an enterprise is treated as an SME and a linked enterprise becomes large, the first enterprise will continue to be treated as an SME for that accounting period and the following accounting period.
- The definition of going concern is to be amended.
- There is to be an exception to the rules which preclude the making of a discovery assessment in various circumstances where such an assessment needs to be made to recover overpaid R&D tax relief or expenditure credit.
- The patent box provisions will be amended as required to include the changes to the definition of qualifying expenditure.

Contributed by Ros Martin