

R&D tax credits for SMEs (Lecture B1254 – 9.12 minutes)

A company which has claimed an enhanced deduction for qualifying costs under the SME R&D scheme may claim a payable tax credit if it has losses which are created or enhanced by the R&D costs.

Clause 19 and Schedule 3 introduce a cap on the amount of tax credit that could otherwise be claimed by limiting the amount to the sum of £20,000 plus three times the 'relevant expenditure' in the relevant accounting period. The 'relevant expenditure' is broadly the PAYE and NIC costs of the company, but this is discussed further below.

The £20,000 is proportionately reduced if the accounting period is less than 12 months.

Example

A loss-making SME has R&D spend of £100,000 which would attract an enhanced deduction of £130,000 giving total R&D costs of £230,000. Its losses exceed this amount.

The tax credit which could be claimed is 14.5% of the surrenderable losses so without the cap, the potential claim is £33,350.

The PAYE and NI expenditure for the year is £3,000.

The cap therefore limits the amount which can be claimed to £20,000 plus (3 x £3,000), i.e. £29,000.

'Relevant expenditure' is:

- The total of the PAYE and NIC liabilities for the payment period less any disregarded amounts (to avoid double counting);
- If the company is connected with another company and has incurred qualifying expenditure on externally provided workers, the relevant proportion of any staffing costs for the payment period incurred by the connected company in providing any of those workers for the company; and
- If the company is connected with another company and has incurred qualifying expenditure on contracted out R&D, any staffing costs incurred by the connected company in undertaking the contracted out R&D.

Staffing costs in this context is given its normal definition as per s1123 CTA 2009 so it includes remuneration (excluding benefits in kind), pension contributions and reimbursed qualifying expenses. However, care needs to be taken as whilst this appears to suggest it is the total staffing costs which are used, the calculation shows it is just the PAYE and NIC costs that the connected company has incurred in respect of the externally provided workers or the contracted out R&D.

The relevant proportion of the staffing costs that can be claimed where there is provision of externally provided workers is calculated as follows:

Step 1

Calculate the expenditure incurred by the connected company in providing the externally provided workers, that has been incurred on staffing costs and forms part of the total PAYE and NIC liabilities for the payment period.

Step 2

Calculate the appropriate percentage being $R/T \times 100$, where

- R is the amount of qualifying expenditure on the externally provided worker which is taken into account for the purposes of the R&D claim, and
- T is the total qualifying expenditure on the externally provided worker.

Step 3

The amount found at step 1 is multiplied by the percentage found at step 3 to give the amount that can be relevant expenditure for the cap on the tax credit.

Example

A loss-making SME has R&D spend of £100,000 which would attract an enhanced deduction of £130,000 giving total R&D costs of £230,000. Its losses exceed this amount.

The tax credit which could be claimed is 14.5% of the surrenderable losses so without the cap, the potential claim is £33,350.

The R&D claim includes £50,000 of payments to a connected company for externally provided workers. The actual payment made for those workers is £60,000 but the connected company's costs are only £50,000 so the qualifying expenditure for R&D credit purposes are limited to this amount. The total PAYE and NIC liability of that company is £5,000.

The claimant company has no staff of its own undertaking R&D work.

The cap therefore limits the amount which can be claimed to £20,000 plus $(3 \times (£5,000 \times 50,000/60,000)) = £32,500$.

The relevant proportion of the staffing costs where there is provision of subcontracted R&D is the amount of the PAYE and NIC liability incurred on staffing costs for the purposes of undertaking the subcontracted R&D.

Example

A loss-making SME has R&D spend of £100,000 which would be attract an enhanced deduction of £130,000 giving total R&D costs of £230,000. Its losses exceed this amount.

The tax credit which could be claimed is 14.5% of the surrenderable losses so without the cap, the potential claim is £33,350.

The R&D claim includes £50,000 of payments to a connected company for subcontracted R&D. The staff are working 75% on the subcontracted R&D. The total PAYE and NIC liability of that company is £5,000.

The claimant company has no staff of its own undertaking R&D work.

The cap therefore limits the amount which can be claimed to £20,000 plus $(3 \times (£5,000 \times 75\%)) = £31,250$.

New S1058B CTA 2009 makes it clear that the PAYE and NIC liabilities we are looking at here are the amounts which have to be paid over to HMRC under the PAYE regulations plus the amount of Class 1 NICs which have to be paid over to HMRC. In calculating the figures, it is necessary to disregard deductions in respect of tax credits and statutory payments.

An anti-avoidance provision is introduced to stop double-counting of costs. An example given in the guidance notes considers a situation where Company A subcontracts R&D activities to Company B, which also carries out R&D in its own right for which it claims tax credit. Company B would calculate the cap based on its total PAYE and NIC liabilities but Company A might also include some of those costs in the calculation of its cap. In this case, Company A would get the right to include the PAYE and NICs in its calculations.

Exceptions to cap

The cap does not apply if the company meets conditions A and B:

Condition A is met if the company is engaged in

- Taking or preparing to take steps which will mean that relevant IP will be created
- Creating relevant IP
- Performing a significant amount of management activity in relation to relevant IP it holds

These activities are only relevant if they are undertaken by the employees of the company. IP is only relevant if the whole or a greater part of the whole was created by the company, which means created in circumstances in which the right to exploit it vests in the company, either alone or jointly with others. IP means patents, trademarks, registered designs, copyright, design rights or plant breeders' rights or similar. Management activity means formulating plans and making decisions in relation to the development or exploitation of the IP.

Condition B is met if the amount of expenditure on externally provided workers and/or subcontracted R&D, where there is a connection between the company and the provider or subcontractor as appropriate (or where an election has been made for connected party treatment to apply), does not exceed 15% of their qualifying R&D expenditure.

Commencement

This applies for accounting periods beginning on or after 1 April 2021 although any periods straddling that date will be split.

Northern Ireland companies

Schedule 4 provides separate legislation for the cap on the tax credit which would apply if the Northern Ireland Assembly were to vary the rates of Corporation Tax for Northern Ireland companies. This is designed to ensure that the value of the relief remains the same for Northern Ireland and non-Northern Ireland companies.

Social investment tax relief (Lecture B1254 – 9.12 minutes)

Social investment tax relief encourages individuals to invest in qualifying social enterprises and trading charities by offering tax reliefs similar to those which apply for Enterprise Investment Scheme companies.

When it was introduced in 2014, it was designed to be short-term and it was intended that it would finish in 2019. It was extended to 5 April 2021 by F(No.2)A 2017 and Clause 20 of this Finance Bill extends the end date so that investment made before 6 April 2023 will qualify assuming all conditions are met.