



Tax Talk with Charles Green

Encouraging innovation

Tax breaks for research and development expenditure



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CHARTERED ACCOUNTANTS

Politicians have for a long time recognised that what they define as "Small and medium sized companies" or "SMEs" are vital to the economy as a source of growth and innovation. However, smaller businesses are often held back by the lack of resources available to them and need support if they are to invest in the research and development (R&D) required for major projects.

The government has recognised the need to provide this encouragement and has introduced generous tax reliefs and credits for R&D expenditure. This has proved to be very successful and small and medium-sized companies now claim over £250m a year in R&D tax relief. Directors need to be aware of the tax breaks on offer so that they do not miss out on their share.

What is research and development?

For these purposes, R&D takes place when a project seeks to 'achieve an advance in science or technology'. This means an advance in overall knowledge or capability in a field of science or technology - not a company's own state of knowledge or capability alone. A degree of innovation is required.

Qualifying expenditure

Companies can claim R&D Tax Credits for their revenue expenditure on (amongst other things):

- employing staff directly and actively engaged in carrying out R&D
- materials used directly in carrying out R&D
- power, fuel, water and software used directly in carrying out R&D
- expenditure on sub-contracted R&D

The minimum spend on R&D before relief is available is £10,000 (per accounting period) but there is no upper limit.

The tax relief for SMEs

An additional tax deduction of 50% is given on qualifying expenditure. For example, if a company's R&D expenditure is £20K, for taxation purposes it is allowed to offset £30K against its profits.

Alternatively, when a company has made losses in an accounting period, as often occurs when there is heavy spending on R&D, it is entitled to cash in its loss and can claim a payment from the Revenue. The amount claimable is 16% of the R&D expenditure (to the extent that this hasn't been used against any profits). Taking into account the 50% uplift this gives an effective repayment rate of 24% of the expenditure.

For example: if, as above, the R&D expenditure

is £20K then the amount claimable from the taxman is £4,800 ($£20K \times 150\% \times 16\%$).

In fact, the relief is likely to become more favourable in the future. In the 2007 budget, the Chancellor announced that the rate of the uplift will be increased, allowing SMEs to claim 175% of their qualifying expenditure. The government intend to legislate on this in the 2008 Finance Act.

There are, however, a couple of restrictions to be aware of:

- The amount claimable as a payment cannot exceed the company's payroll taxes.
- There is a restriction to the deductions that can be claimed in relation to the R&D payments to unconnected sub-contractors.

Capital allowances

For R&D expenditure on capital items it is possible to claim a 100% allowance, not just on plant and machinery, but also on other items such as trading premises.

To summarise, the R&D reliefs offer a real and valuable incentive to businesses to innovate and invest for the future. If you would like to discuss R&D reliefs for your business, please contact Charles Green on **020 7022 0050**.



To discuss your personal or business tax requirements, please contact Charles Green on 020 7022 0050 or email crg@clarksonhyde.com

