



# Research & Development Tax Relief



**R&D Tax Credits are a UK tax incentive designed to encourage companies to invest in R&D. Companies can reduce their tax bill or claim payable cash credits as a proportion of their R&D expenditure.**

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## **What is the definition of Research and Development (R&D)?**

An R&D project is one that seeks to achieve scientific or technological advances. It will aim to advance the overall knowledge or capability in a field of science or technology and involve significant scientific or technological uncertainty.

It is not necessary for a company to be involved in a high tech field in order to qualify for R&D relief. All that is needed, is a problem without a readily deductible or freely available solution which the company is attempting to solve by developing an advance.

There are some restrictions to what counts as an advance, with social science in particular being excluded. A Company does not need to succeed in its R&D projects in order to qualify for R&D relief. Indeed, the idea behind R&D relief is that the outcome of R&D projects is uncertain and projects may experience frequent failures before success is achieved.

## **What is Research and Development Tax Relief?**

R&D tax relief is claimable by persons subject to Corporation Tax. Companies making Qualifying Expenditure on R&D can claim under two schemes, the SME Relief scheme and/or the Research and Development Expenditure Credit.

### **Qualifying expenditure**

In order to qualify as R&D expenditure an expense must fit exactly into one of a number of categories HMRC has set. The most common ones are:

- Staffing costs directly and indirectly related to research and development projects.
- Materials, water, fuel and power used directly in carrying out research and development.
- Software purchased and used in the development. For accounting years commencing on/after 01 April 2023, the definition of software has been expanded to include costs relating to data, cloud computing and hosting costs.
- 65% of sub-contracted research and development costs, subject to some

restrictions under the RDEC Scheme. The sub-contractor does not need to be based in the UK for expenditure in accounting years commencing before 01 April 2024. For accounting periods commencing on/after 01 April 2024, subcontracting expenditure will only be eligible if the work is performed in the UK or where the work is performed overseas, it is due to conditions that cannot be reasonably replicated in the UK.

- Capital Expenditure is not included, but 100% tax relief may be available for R&D capital costs.

If an expense does not fit into a category it cannot be claimed no matter how vital it may be to the R&D being performed.

### **What are qualifying indirect activities?**

A number of categories permit the inclusion of expenses that are only indirectly supporting the R&D process. Typical examples of indirect costs are:

- Scientific information services which are conducted for the purpose of R&D support.
- Indirect supporting activities such as security, administration, finance and personnel, which are undertaken for R&D.
- Training required to support an R&D project.
- Research into new testing or sampling methods.
- Feasibility studies to develop strategic direction of a specific R&D activity.

### **SME Scheme**

To qualify for the SME Scheme the following conditions must be fulfilled:

- Fewer than 500 Employees
- Turnover below €100m or a balance sheet total below €86m
- The project must not be benefiting from notifiable state aid.
- The R&D activity must not have been subcontracted to the claimant by another party.

For the first two conditions you must include staff, turnover and balance sheet totals of any linked companies (>50% parent and subsidiaries) as well as a proportion of the same for any partner companies (>25% share holdings).

SME's may deduct an additional 86% of qualifying expenditure and if loss making, may claim a repayable tax credit of 10% of the surrenderable loss. (These relief rates are 130% and 14.5% respectively for expenditure incurred before 01 April 2023).

The tax credit is capped at £20,000 plus three times the Company's total Pay As You Earn (PAYE) and NICs Liability for the year.

An exemption from this cap exists for companies that meet the following criteria:

- The company is creating, preparing to create or actively managing relevant intellectual property that it holds. Companies preparing or conducting R&D will fulfil this requirement so long as the work is mainly performed by employees.
- The total qualifying expenditure incurred for the relevant accounting period on connected subcontractors is less than 15% of the qualifying R&D expenditure.

### **RDEC Scheme**

The RDEC scheme is available to all companies engaged in R&D including those SME's disqualified for receiving state aid or performing subcontracted work.

The scheme provides a taxable 20% (13% on expenditure before 1 April 2023) credit on qualifying expenditure and may result in a cash credit depending on the company's individual circumstances. There is a prescribed method for applying the tax credit and it is important this is done correctly as it can impact future tax years.

### **Merged Scheme**

For Accounting Periods commencing on or after 1 April 2024, the current RDEC and R&D SME scheme will be merged into a single scheme. This merged scheme will run alongside the SME R&D intensive scheme.

Like the RDEC, the new Tax Credit will be a taxable receipt in the hands of the recipient. There will however be some lightening of the requirements in line with the previous SME R&D Scheme. The eligibility criteria will remain the same.

The effective credit for loss making companies will be 16.2%.

### **Relief for “R&D intensive” companies**

This is a new concept introduced by HMRC to prevent start-ups with a high level of R&D activity from being negatively impacted by the introduction of the new scheme.

This relief will be available to companies if their qualifying R&D expenditure is 40% (30% for periods commencing after 1 April 2024) or more of the total expenditure for an accounting period. When assessing this percentage, companies are required to include the relevant costs of any associated companies.

This relief is given using the same methodology as the existing SME scheme where eligible costs are enhanced with an 86% additional deduction and then any eligible losses may be surrendered at a rate of 14.5%. This treatment will continue after the withdrawal of the SME scheme and the introduction of the merged scheme.

### **Making a claim**

Companies can make or amend an R&D claim within two years of the end of the relevant accounting period.

### **Additional Information Form**

Companies submitting an R&D claim must also submit an Additional Information Form (AIF) to HMRC prior to making the claim. The form requires information about the project's relief is claimed on and details of the key individual responsible.

### **Claim Notification Form**

For accounting periods beginning on or after 1 April 2023, a mandatory Claim

Notification Form (CNF) must also be submitted to HMRC if

- You are claiming R&D relief for the first time; or
- You haven't made an R&D Claim within three years.

If required, the CNF needs to be submitted within six months after the end of the accounting period in question. For example, for a company accounting period which runs from 1 January 2024 – 31 December 2024, then the pre notification form needs to be submitted between 1 January 2024 - 30 June 2025.

The CNF includes details such as Company UTR, Senior Internal R&D contact responsible for the claim, a summary of the high-level planned R&D activities.

### **Repayments**

From 1 April 2023, Tax Credits will be paid directly to claimants only. No nominations will be allowed for an R&D Tax Credit service provider.

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**Disclaimer:** This note does not contain a full statement of the law and it does not constitute legal advice. Please contact us if you have any questions about the information set out above.

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