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Tax relief for research and development

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Companies that carry out research and development (R&D) can often reduce their tax bills by claiming relief for some of their R&D expenditure.

What qualifies as R&D for tax purposes?

For the purpose of tax reliefs, research and development (R&D) takes place when a project seeks to achieve an advance in science or technology. This means an improvement in overall knowledge or capability by resolving systematic or technological uncertainties. The development may increase efficiency, functionality or productivity.

Companies can qualify by developing new products for resale or developing new products or processes for their own internal use.

As long as an activity qualifies as R&D, you may be able to claim two kinds of tax relief: R&D tax allowances and/or R&D tax reliefs.

R&D tax allowances

You can claim a 100% R&D allowance for capital expenditure on items such as plant and machinery related to your R&D work. This means that the full cost can be used to reduce your taxable profits in the year of purchase, instead of being spread over several years as with other capital allowances.

R&D tax reliefs

There are enhanced deductions for the costs of staff and other workers, subcontractors, software and materials, to the extent that they used in your R&D efforts. In addition from April 2023 data services and cloud computing costs can also be included within the claim.

These qualifying costs can relate to both direct and indirect activities. Indirect costs will qualify for enhanced relief provided they are incurred on the provision of direct support to those carrying out the R&D work.

There are two R&D tax relief schemes - a small company (SME) scheme and a large company scheme.

Small company scheme

The SME scheme currently allows a deduction of 230% (186% from April 2023) of qualifying

expenditure on R&D to be deducted when calculating the company's taxable profits.

Where this increase creates or adds to a loss, the loss may be surrendered for a payable credit of up to 33.35% (18.6% from April 2023) of the qualifying spend.

Alternatively, the loss may be carried forward and utilised against future profits, giving potential tax funding of up to 43.7% (46.5% from April 2023) of the qualifying spend.

To qualify under the SME scheme, a company previously had to incur expenditure of at least £10,000 but this minimum expenditure limit has now been removed. Also, it no longer needs to own the intellectual property generated by the R&D. However, it must not receive any external funding for the R&D project.

Large company scheme

Large companies can benefit from the research and development expenditure credit (“RDEC”), at the rate of 13% on qualifying R&D expenditure incurred on or after 1 April 2020 and 20% for expenditure incurred on or after 1 April 2023. This means that for taxpaying companies, the RDEC benefit reduces the claimant company's corporation tax liability. As the credit is taxable, the net saving is 10.53% of the qualifying R&D spend before April 2023 and 15% after this date.

Also, loss making companies can now benefit from claiming a credit, net of a notional tax charge, calculated at the current rate of corporation tax, as a cash receipt from HMRC. The notional tax deducted can be surrendered to another group company that has a corporation tax liability against which it can be offset or carried forward for offset against future corporation tax liabilities. However, the payment of the cash credit is subject to various restrictions.

Unlike the SME scheme, a claim may be made under the large company scheme even if the R&D activities have been contracted or funded by a third party.

Please note these rules will change on 1 April 2024 when we will update this document with the new rules.

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Need help?

For help and advice on any of the matters raised in this guide, please call us and talk to one of our friendly experts.

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Preventing abuse of Research and Development tax relief for small and medium sized enterprises

For accounting periods beginning on or after 1 April 2021, the amount of SME payable R&D tax credit that a company can receive in any one year will be capped at £20,000 plus three times the company's total PAYE and National Insurance contributions liability.

SME's are exempt from the cap if:

- The Employees are creating, preparing to create or managing intellectual property (IP) and,
- The Company does not spend more than 15% of its qualifying research and developments on subcontracting work, or the provision of externally provided workers by connected persons.

If your company undertakes development activities, it may benefit from making an R&D claim.

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