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R&D TAX CREDITS SOFTWARE

R&D TAX CREDITS GUIDE

A guide for accountants on everything you need to know about claiming R&D tax credits, whatever the industry or size of your client's organisation, whether you have one claim or hundreds.

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CATEGORIES

What are R&D Tax Credits?

Launched in the UK in 2000, the R&D tax credits scheme is a government incentive to encourage investment in innovation.

UK companies can claim back a portion of the money invested in scientific and technological research and development.

Depending on which criteria the claim falls under, companies will either receive a corporation tax reduction or a cash payout in the form of a payable tax credit.

Both are valuable sources of income for businesses to reinvest into further R&D and to grow the company and the relevant industry.

This ultimately results in greater wealth creation in the UK economy.

What are the criteria for claiming R&D Tax Credits?

Companies developing new products or tools are often eligible for an R&D tax credit. However, HMRC does have stringent criteria as to what projects qualify.

Your client's company will need evidence that their project:

- sought an advancement in a field of science or technology.
- experienced technological uncertainty and tried to overcome this uncertainty.
- could not be easily worked out by a professional in the field.

R&D tax credits are no longer only reserved for the pharmaceutical, technical and/or manufacturing sectors

As long as a company seeks to research or develop an advance in its field, it may qualify. Companies can even submit claims for unsuccessful projects.

The actual benefit your client could receive depends on whether your client is a large (LE) or small company (SME) and whether they are profitable or made a loss.

(You will find more detail on this further down in the guide.)

As R&D work often takes place over many years, with projects incurring varying amounts of expenditure over this time, it's important to note that a project is only eligible for R&D tax credits during the actual research and development stage of the project, so it is important to track when your R&D project begins and ends.

As an accountant, it is crucial to submit a comprehensive, well-prepared, and accurate R&D tax credits report, not just to maximise your client's claim but also to avoid an HMRC enquiry. After HMRC has reviewed your claim, and if no clarification is needed, R&D tax credits claims can be processed relatively quickly (within 4 - 8 weeks).

If further clarification is required, HMRC will conduct an enquiry and if there are errors identified in the claim this could result in a claim reduction or possible penalties for your client.

There are two schemes available to companies that want to claim R&D tax credits:

The **SME (small and medium-sized enterprises)** scheme and the **RDEC (R&D expenditure credit)** scheme.

The SME Scheme

As the name suggests, the SME scheme was designed for small and medium-sized businesses.

HMRC defines a business as being an SME if it has:

- **Less than 500 employees and,**
- **a turnover of less than €100m, or**
- **a balance sheet worth no more than €86m.**

The SME scheme offers relief of up to 33% of your client's total qualifying R&D costs. Your client can recoup the R&D tax relief as a cash payment, a corporation tax reduction, or a combination of the two.

All eligible businesses have much to gain by pursuing an R&D tax credits claim. However, there are a number of reasons that make them particularly beneficial for small businesses:

- **Business development and growth**
- **Increased efficiency and productivity**
- **A welcome cash injection, particularly in the turbulent early years**

Furthermore, as a result of the Covid-19 pandemic, firms have had to adapt quickly, which has resulted in a drive for SMEs to prioritise investment in technology and innovation in the coming years.

If your client's business is a startup, preparing the claim before submitting their first tax return will yield great results. The financial benefits of R&D tax credits for a young company are invaluable as they try to establish a business structure and processes that will yield successful results. HMRC has a time limit of two years from the end of your client's accounting period to submit a claim for qualifying costs. So it is important for your client to understand HMRC's timing parameters in order to take advantage of the R&D tax benefit. Eligible startups can also take advantage of HMRC's Advanced Assurance scheme, which guarantees that their R&D claims will be accepted.

Tips for SMEs to make the most out of R&D tax credits relief.

Claiming for R&D tax credits does come with complexities. The following tips will help equip you to deliver the maximum benefit to your client:

1. Understand the **size and structure of your client's business**, as this will determine which scheme they can claim through.

2. Be certain of what **projects and eligible costs** your client can claim for.

3. **Utilise your client's losses**, as loss-making SMEs are able to gain a tax credits through the SME scheme.

4. Make sure your **technical narrative is descriptive** and answers HMRC's questions.

5. Always **review the claim** for any inaccuracies or mistakes before submission.

6. **Using R&D tax credits software** such as made.simplr that takes care of the many complexities surrounding R&D tax credits and reduces the likelihood of human error.

The RDEC Scheme

RDEC is one of the two UK Corporation Tax reliefs designed to incentivise greater business investment in Research and Development (R&D). RDEC was introduced in April 2013 and gradually replaced the Large Company (LC) scheme which was abolished in 2016-17.

Much like the SME scheme, the RDEC scheme allows businesses to claim back a percentage of their R&D costs.

This gets delivered as a refund on their corporation tax and/or a payable expenditure credit. This credit is at a rate of 13% of the company's total qualifying R&D expenditure.

Employees - 500+

Turnover - €100m+

Balance Sheet - €86m+

Businesses with more than 500 employees, a turnover of over €100m and/or a balance sheet worth more than €86m can claim from the RDEC scheme.

The RDEC scheme is also available to SMEs that are ineligible for the SME R&D scheme in certain circumstances, such as if they have received grants or subsidies or if they have been subcontracted to do the R&D work.

The good news is that the credits received from the RDEC scheme gets shown 'above the line' in your client's income statement. This means it is visible as income and is great for future investment decisions and opportunities.

Using an R&D tax credits calculator is helpful in estimating your client's potential claim value and whether they are due a tax reduction or a cash credit.

Having this estimated claim value not only allows them to plan ahead but also kick-starts the process of preparing the claim, which is beneficial for maximising an R&D tax credits claim down the line.

An R&D tax credits calculator will ask you to input several variables, such as the size of the company, its turnover, how much corporation tax your client pays each year, whether the company made a profit or a loss, and the qualifying expenditure.

Use made.simplr's handy R&D tax credits calculator to calculate how much your clients could claim back in R&D tax credits.

What projects qualify?

Since the scope of work that is R&D is ever-evolving, businesses are often unaware that the projects they are working on qualify as R&D, and they might not know that they are eligible to claim R&D tax credits on their projects.

For SMEs especially, your client might be too preoccupied with the actual running of the business to consider whether their projects would qualify or not.

Furthermore, the recent pandemic has resulted in more and more businesses exploring technological avenues and looking to software development to improve work processes and solutions.

The following broad project areas are ones that may qualify for R&D tax credits:

- Adaptation of standard technology for new uses.
- Development of new systems and processes.
- Improving the performance, efficiency and/or capacity of existing systems and processes.
- Designing and producing technically improved products.
- Packaging solutions (improving product shelf life for instance).

To ascertain whether a project qualifies for R&D tax credits, get your client to answer these four questions:

1. Does the project overcome technological uncertainty?

2. Has it sought an advance in a field of science or technology?

3. Can your project show that research, testing, and analysis have occurred?

4. Do you employ qualified experts in a field of science or technology?

If you have answered yes to any of the above then your client is likely to qualify for R&D tax relief.

What expenses qualify?

Typically, the expenses that are eligible for an R&D tax credits claim are the day-to-day operational costs that are present when conducting R&D, such as:

- **Staff costs** - these include salaries, travel expenses, bonuses and pension fund contributions.
- **Consumables** - any materials, hardware, and utilities that are used directly for, or during, the R&D process.
- **Software** - software used in the R&D process can be claimed for. If the same software is used for other projects as well, a proportion of the cost can be included.
- **Prototypes** - the costs included in the development, creation and design of prototypes.

Third-party workers (such as staffing agencies), subcontractors (usually experts in their field), contributions made for research purposes (reserved for larger companies), and costs associated with clinical trials (which play a large part in pharmaceutical R&D, in particular) are also all eligible.

In addition, there are a number of expenses that are often overlooked. These include costs on protective clothing, systems migrations, efficiency-improving automation, and the use of AI.

A note to remember, the costs incurred need to be directly involved in the R&D project for them to qualify.

What expenses do not qualify?

- **Capital expenditure** - costs associated with fixed assets such as land, buildings and equipment do not qualify for R&D tax credits. However, they could qualify for Research and Development Allowances (RDAs).
- **Furloughed staff** - staff have to have actively worked on the R&D project so any expenses related to their staff costs while they were on furlough do not qualify.
- **Costs associated with patents and trademarks -** however your client might be able to benefit from Patent Box tax relief which reduces the rate of Corporation Tax on your income resulting from your licensed patents.
- **Prototypes intended for commercial purposes** - if a product is able to be sold, there is no longer any technological uncertainty and hence, it does not qualify.
- **The production and distribution of goods and services -** these costs are not eligible.
- **Rent cannot be included** in the R&D tax credits claim.

The benefits of R&D tax credits

While submitting an R&D tax credits claim might seem time-consuming and complicated, explaining to your clients why it's so beneficial is worthwhile.

In a nutshell, claiming R&D tax credits can significantly benefit your client financially:

- By providing a cash injection to grow your client's business as needed.
- By offering a significant reduction in tax liability.
- By allowing your client to offset their losses.

However, the financial gains from R&D tax credits are not the only benefit. R&D tax credits can also be instrumental in increasing a business's cash flow, which is important in R&D work specifically, as profits are often not seen until after the project is successfully completed. Cash flow can help tide the business over in the short term.

Your client can also claim for unsuccessful projects. Failed projects might present themselves as follows:

- Your client's project might only partly solve the uncertainty.
- They develop a prototype that doesn't fulfill its intended function.
- Their new tool developed does not improve on the previous version.
- A new experimental process intended to reduce costs or time is more costly and time-consuming.

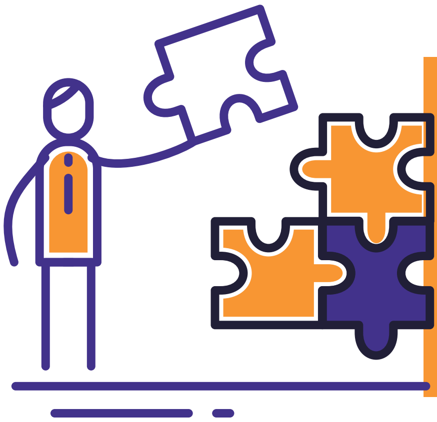
In fact, it is often through the trial and error of overcoming a technological or scientific uncertainty that groundbreaking innovations are made.

The positive influence of R&D tax credits on small businesses

When it comes to small businesses, R&D will often focus predominantly on improving products and creating new ones; hence, it is worth investigating which of your clients' projects would qualify, as R&D tax credits are particularly beneficial to small businesses. Here's why:

- R&D tax credits reduce the financial risk associated with R&D projects by ensuring an additional return on investment.
- They are a source of short-term funding.
- R&D tax credits can be complementary to other forms of government funding. However, your client may have to claim through the RDEC scheme.

Best practices for claiming R&D tax credits



As mentioned previously, claiming R&D tax credits can be a complex and time-consuming process, so it is wise to have a set of best practices to adhere to when submitting your client's claims.

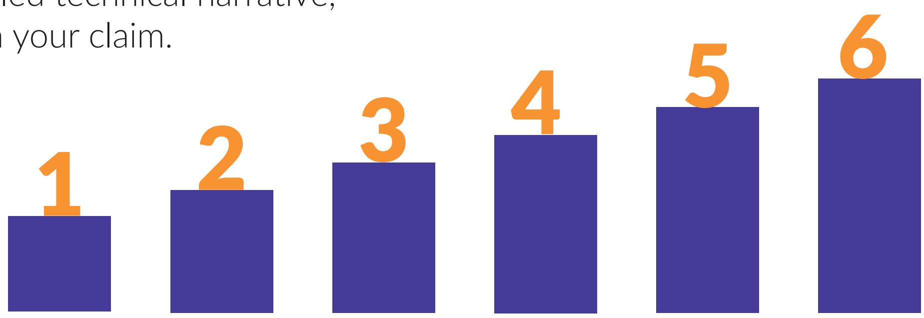
Firstly, understanding how R&D tax credits work and the ways they can support your client's business is key.

Secondly, establishing some best practices when preparing your client's claim is highly advantageous for maximising their claim and ensuring they get the maximum benefit.

These include the following, to name a few:

- Researching and understanding your client's operations,
- Knowing what projects and costs they can and can't claim for,
- Spending time crafting a detailed technical narrative,
- Double checking all figures on your claim.

At made.simplr, we suggest breaking the claims process down into six steps:



Step 1 – Decide on the projects you are claiming for.

Step 2 – Select the scheme relevant for client's profile.

Step 3 – Prepare and write the technical report.

Step 4 – Create a costing schedule.

Step 5 – Submit the claim.

Step 6 – HMRC processes and reviews the claim.

There are some common mistakes that companies often make when submitting their R&D tax credits claims. Mistakes could limit the amount claimable and potentially render the claim obsolete.

1. **Internal restructuring:** When a company's trade and/or assets are changed, this could affect the eligibility of a client's projects for R&D tax credits, so it may be worth completing all R&D projects before the restructuring takes place.

2. **Outsourcing:** If your client's outsourcing is badly organised, it can create issues with your claim. Subcontractors, external workers and whether the company is claiming under the RDEC scheme or not, all influence your claim, so it is important to know how to categorise each.

3. **Not including all qualifying R&D activities and costs:** This goes without saying, if you don't include all the qualifying costs, you could be doing your client a disservice.

4. **Including ineligible projects and expenses.** Including ineligible activities could result in an HMRC enquiry.

5. **Lack of record keeping.** It is vital to keep accurate records when it comes to R&D projects to ensure all qualifying work gets included in the claim and to ensure a positive outcome.

6. **Growing beyond the size of an SME.** In terms of R&D tax credits, SMEs receive a greater tax benefit, so if your client is rapidly growing or may be purchased by a large company, it is worth reviewing their options to maximise the benefit of the R&D claim.

Transitioning from loss-making to profit-making. Companies in loss can surrender their loss to HMRC for a cash credit. For many SMEs, this short-term cash injection is extremely valuable.

However, if your client expects to be profit-making in the following year, surrendering losses can be detrimental as the loss cannot be used to offset corporation tax moving forward. While it is not advisable to encourage your client to remain in loss, it is something to discuss and consider seeing as it affects the R&D tax credits claim.

Knowing what these mistakes are and how to avoid them is instrumental in maximising your client's benefit.

As an accountant, be it for a small or large corporation, it is important to have a comprehensive understanding of the R&D tax relief legislation and engage the services of an expert in the field to ensure compliance.

Fortunately, with the rise in automation in the accountancy industry, there is no need to hire an expensive specialist to do the job. By using an online R&D tax credits portal, you can efficiently and effectively submit your client's R&D tax credits claim. The software will calculate the eligibility, as well as automate much of the process. The process isn't entirely automated, though, and specialist support can be accessed at any point. Using an online R&D tax credits portal such as made.simplr, gives all the benefits of a specialist consultancy while streamlining the process, scaling up your operations and increasing revenue.

In continuing the theme of online solutions, it is also possible to prepare your claim completely remotely. In a post-pandemic world, remote-working has become more accessible and preparing an R&D tax credits claim is no exception. Using video calling, screen sharing and online meetings, you can gather all the information required for submitting your client's claim, which makes the process more cost-effective and efficient.

Gone are the days of R&D being reserved for the medical and science industries. These days almost any industry can benefit from R&D tax credits. However, some industries are benefiting more than others.

According to recent statistics, these are the top five industries in the UK benefiting the most from R&D tax credits:

1. Information and Communication

This sector has thrived in recent years thanks to the developments of its technology. Online media is considered a key marketing tool in almost any industry, and as such, it makes sense that many R&D claims would come from this sector.

2. Manufacturing

The nature of the manufacturing industry makes it ideal for qualifying for R&D activity as the focus is on improving products and processes. The sector is broad-reaching and can include electronics, food and drink, textiles, and automotive to name a few.

3. Professional, Scientific and Technical

Testing new technologies and materials goes hand-in-hand with the scientific and technical sector so it's no surprise this sector features high on the top industries list.

4. Wholesale & Retail trade, including repairs

This sector involves a lot of streamlining of solutions, including automation and software - which can be expensive.

5. Admin & Support Services

The increasing adoption of cloud-based services has seen a rise in R&D in this sector. Developing and improving these platforms often requires overcoming uncertaintanty.

The digital and technology sector has also seen an increase in growth in recent years and was responsible for 19% of R&D tax credits claims submitted during 2019-2020. The UK government has a strategy to invest heavily in the digital technology industry which can be seen in the increased investment from £1.2bn to £11.3bn between 2010 and 2020.

The future of R&D tax credits

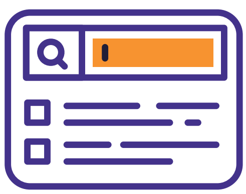
In the 2021 Autumn Budget speech, some changes to the R&D tax credits scheme were announced. These come in the form of greater investment in innovation and more eligible R&D costs. More specifically, the changes to the R&D tax credits scheme are:

- The **expansion of qualifying expenditure** with regards to software: Qualifying expenditure will now include cloud computing and data costs.
- Refocusing R&D tax credits to **innovation in the UK**: Currently, businesses can claim R&D tax credits on projects that are subcontracted outside of the UK, however the Chancellor announced that as of April 2023, relief will be refocused to innovation in the UK.
- An overall **increase in R&D investment**: The government will invest £20 billion in R&D by 2024/25, with a target of £22 billion annual R&D investment by 2026/27.
- **An extension of the temporary Annual Investment Allowance** (AIA) of £1m: To stimulate R&D work in the immediate future, the AIA has been extended until April 2023. (The temporary AIA increases the limit from £200,000 to £1,000,000 for expenditure on plant and machinery costs.)

These changes are due to come into effect in April 2023.

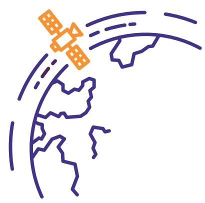
Investment in innovation

Furthermore, as part of the investment in innovation, the UK government has committed to investing in the following:



£10 million in developing new cybersecurity technology solutions to decrease the risk of hacking attempts (which has seen an increase with the growth in cloud adoption and remote working).

£213 million into upgrading the UK's scientific infrastructure to make the UK the best place globally for scientists and researchers to live and work.



£90 million into the aerospace sector, with the aim of ensuring that the UK is at the forefront of global efforts to develop aerospace technology that is greener and more sustainable.

Top tips from R&D experts

We have compiled a list of top tips from the experts at made.simplr to make the process of submitting a claim easier and more informed.

Get educated on the R&D Tax Credits Scheme.

There are a number of common misconceptions that may be discouraging your client from claiming R&D tax credits. We debunk five of those myths in this article.

Understand the consequences of receiving government grants.

To prevent companies from claiming State Aid for the same project from multiple sources, the government has placed certain limitations and restrictions on how R&D tax credits interact with other grants. Click here to read about how government grants affect the SME and the RDEC schemes. In the same vein, did your client receive financial support as a result of the Covid-19 pandemic? This article explains how Covid funding will impact R&D tax credits.

Don't forget about the often-overlooked RDAs.

RDAs stand for Research and Development Allowances. They are a form of capital allowance for R&D capital expenditure. When claimed together with R&D tax credits, your client could be looking at a substantial R&D benefit. Click here to learn more about RDAs and how they complement R&D tax credits.

Know when your client should surrender their losses and when not to.

A business in loss can still claim R&D tax credits. In fact, the SME tax relief scheme aims to support loss-making businesses by granting R&D tax credits as a cash injection. However, surrendering losses might not always be in your client's best financial interest. Click here to learn about when to advise your client to surrender their losses and when to hold onto them.

If R&D tax credits puts your client in a loss position, it might be beneficial to raise the capital to instill confidence in potential investors.

When a business spends a lot on R&D their tax relief could put them in a loss position; which may not look good on paper, especially if your client is trying to attract investors. However, there are ways to raise the capital they need to show a profit. This article explains how.

Take these steps to reduce the chance of an audit when submitting your claim.

With the rise in R&D tax credits claims submitted in recent years, HMRC have increased the scrutiny of their review process. An enquiry from HMRC can be a costly and time-consuming exercise. There are ways to reduce the risk of audit, which can be found in this article.

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How made.simplr can help

We trust this R&D tax credits guide has been useful in helping you understand how to claim R&D tax credits for your clients.

made.simplr's all-in-one R&D software can help you manage your claims easily and efficiently from start to finish. And our team of in-house experts is on-hand to assist you every step of the way.

Why not book a demo and see how we can help scale your operations and add value to your clients?

Book a demo today

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