

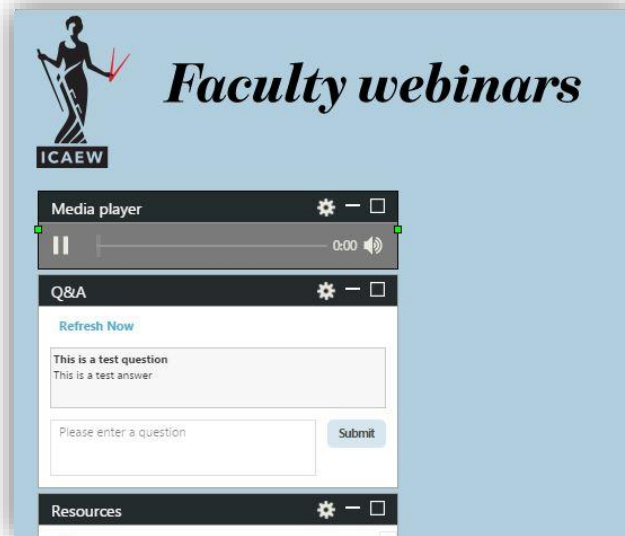


# *Getting Research and Development claims right*

23 FEBRUARY 2021

JAMES TETLEY, RSM

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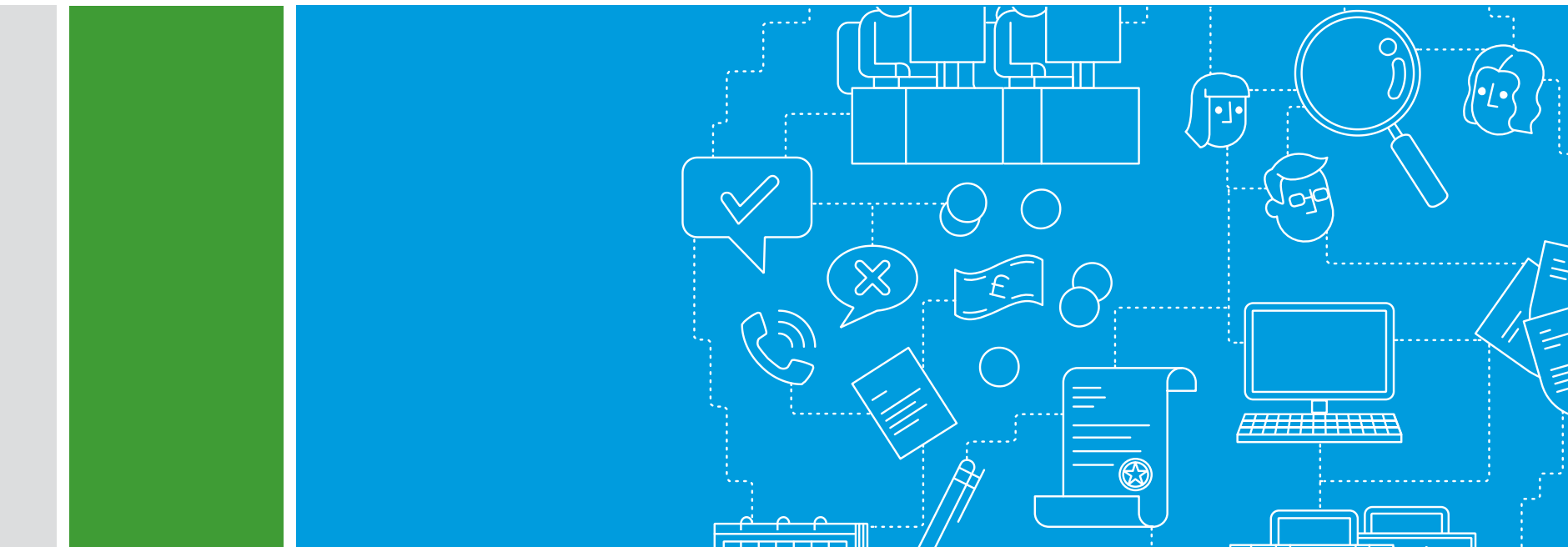
## *Today's presenters*



***Moderator***  
*Richard Jones*  
*Business Tax Manager*  
*ICAEW*



***Speaker***  
*James Tetley*  
*Partner and Head of Innovation Reliefs*  
*RSM*



## GETTING RESEARCH AND DEVELOPMENT CLAIMS RIGHT

JAMES TETLEY – PARTNER AND HEAD OF INNOVATION RELIEFS, RSM

# Agenda

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- An overview of the R&D landscape, including recent changes in legislation, consultations issued by HMRC, and recent tax cases
- A practical look at 'what is R&D', how to spot it, and how to make an R&D claim.
- Where to look for help, and what form that help might take.

# Overview of current R&D tax incentives

## SME regime – Enhanced deduction

Relevant dates	Additional deduction	Tax rate	Net benefit at main tax rate	Rate of payable credit if loss-making	Cash credit available if loss-making
2018-present	130%	19%	£24 per £100 of qualifying expenditure (QE)	14.5% of surrenderable loss	£33 per £100 of QE

## Large company regime - R&D Expenditure Credit (“RDEC”),

Relevant dates	Tax credit rate	Tax rate	Net benefit at main tax rate	Benefit
1 January 2018 to 1 April 2020	12%	19%	9.72%	Over £970 credit per £10,000 QE
From 1 April 2020	13%	19%	10.53%	Over £1,000 credit per £10,000 QE

# What is qualifying R&D expenditure?

Costing category	SME	Large Co
Staffing costs – Gross salary, bonuses, car allowances, employer's NIC, employer pension contributions and reimbursed expenses.	✓	✓
Externally provided workers (EPW's)– Workers supplied to the company via a staff provider.	✓ Restricted to 65%	✓ Restricted to 65%
Subcontracted activities – Any element of the R&D process subcontracted to a third party.	✓ Restricted to 65%	✗ Except for payments to certain qualifying bodies
Consumable/utility items – Items consumed or transformed during the R&D process, including a relevant proportion of light, heat, power and water.	✓ Except where sold on	✓ Except where sold on
Software – A proportion of annual/monthly computer software licence costs for software used within the R&D process.	✓	✓
Contributions to independent research – Includes payments to qualifying bodies, such as to universities, Scientific Research Organisations, some industry bodies, individuals or partnerships	✗	✓

# Recent changes in legislation

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- Increased rate of RDEC to 13% from 1 April 2020
- Preventing abuse in the SME scheme – introducing a PAYE cap from 1 April 2021

# Consultations

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- Looking at updating definition of qualifying costs

# AHK Recruitment Case

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- Company provided HR services and systems, and claim was made in relation to seeking to develop a technological system harnessing AI to predict applicant suitability for a job.
- No evidence provided in the original submission
- Unable to offer evidence of a competent professional
- Failed to prove quantum of qualifying costs
- Claim dismissed in full

# Hadee Engineering Case – the facts

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- First tier tribunal case relating to an HMRC enquiry into R&D claims for accounting periods in 2009 and 2010.
- Hadee Engineering is a mechanical engineering company making bespoke installations of equipment and large fixtures – e.g. access and handling equipment to be used within steel making plant.
- Claim included 7 named R&D projects with details, in each a customer or potential customer had asked the company to provide specific output.
- Claim originally prepared by a boutique who were then unable or unwilling to substantiate when challenged. The owner of the business appeared to not be close enough to the detail of the R&D cost analysis or the projects themselves in order to satisfy the tribunal.
- In some cases HMRC challenged whether projects included qualifying R&D. More importantly, they challenged whether the work done was subcontracted to Hadee and therefore not the company's R&D.

# Hadee Engineering Case – the conclusions

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- It was found that where a design brief was provided, Hadee was not carrying on R&D to fabricate this unit.
- This was particularly true on a project where design time was invoiced to Sheffield Forgemasters, meaning that Hadee did not take on the risk for this key R&D activity.
- We have begun to see examples of HMRC referencing the Hadee case in examples where a claimant has a project associated with ultimately delivering specific item(s) to a customer.
- It is important to demonstrate why key facts present in Hadee led to the ruling that the project being undertaken amounted to subcontracted R&D.
- As with AHK, HMRC argued insufficient and unreliable evidence and records
- Unable to offer a competent professional
- Frustration by HMRC over conduct during the enquiry

# What does this all tell us about HMRC's stance?

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- Levels of scrutiny are high
- Resourcing has been increased – enquiries will increase
- Expectation around due care and process
- But...HMRC are far from unreasonable!

# Practical look

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- A practical look at 'what is R&D', how to spot it, and how to make an R&D claim.

# Definition of R&D for tax purposes

Seek to achieve an **advance in science or technology**



- **The extension to overall knowledge** or capability in a field of science or technology;
- **The development of a new**; product, process or device.
- The **appreciable improvement** to an existing; product, process or device.
- The use of science or technology to **duplicate the effect** of an existing product, process or device.
- The advance is measured against knowledge in the **public domain**
- **Success is not a requirement!**

Seek to overcome **scientific or technological uncertainties**



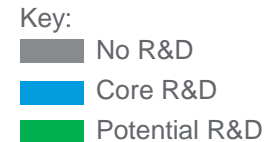
- Uncertainty whether something is scientifically possible or technologically **feasible to achieve**, or the **route to achieving it in practice**.
- Includes scientific and technological uncertainty whether it is possible to achieve the aims in a **cost-effective, reliable or reproducible manner**.
- This includes **system uncertainty**.
- The concept of uncertainty marks the **start and end of R&D**.

# Qualifying direct activities

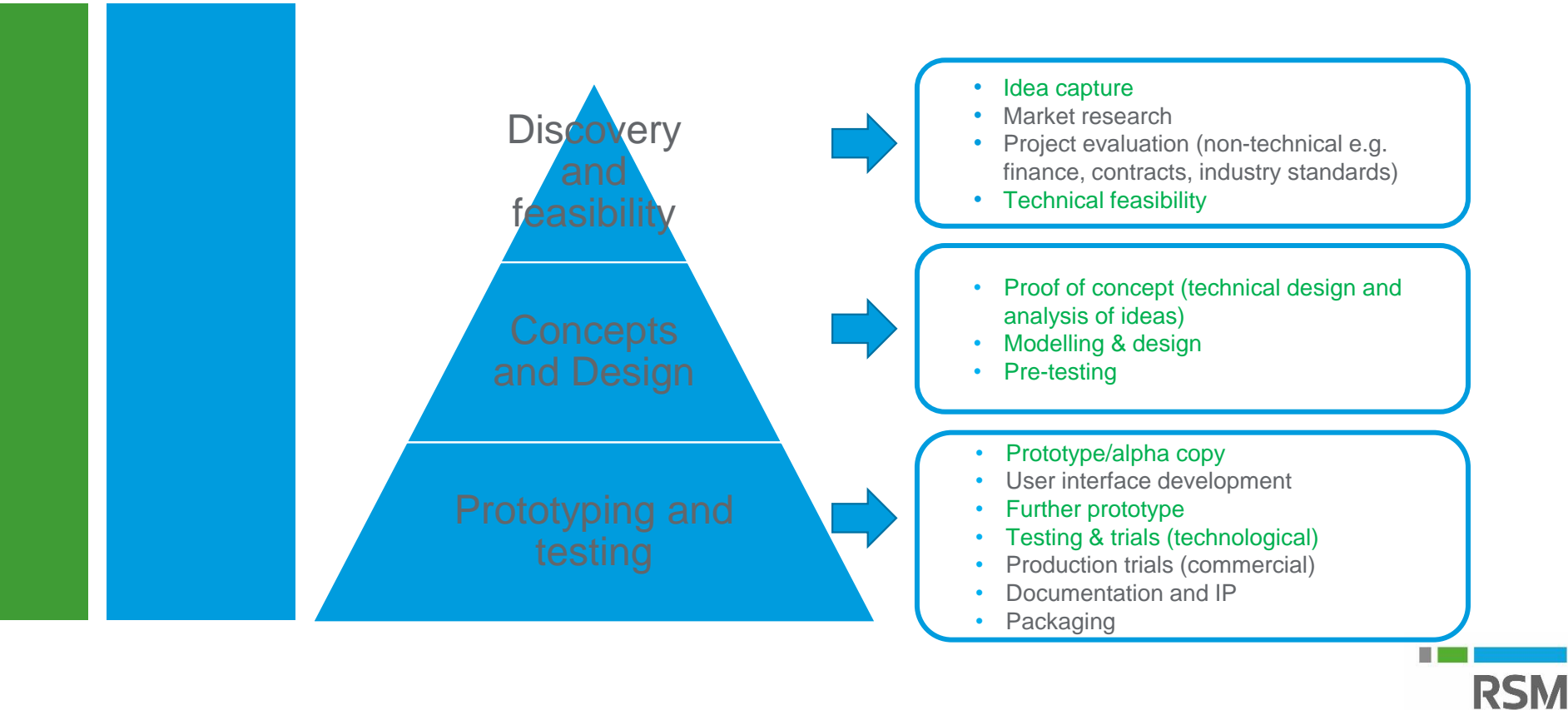
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- Those activities which **directly contribute** to achieving an advance in science or technology through the resolution of scientific or technological uncertainty
- These activities potentially include:
  - Activities to **create** new or improve existing software, materials or equipment needed to resolve the scientific or technological uncertainty
  - **Planning the R&D activities** – defining the technological objectives, assessing technological feasibility, estimating development time, detailed planning and management of the R&D work
  - **Design, testing and analysis** undertaken to resolve the uncertainty
  - Designing, constructing and testing prototypes

Category	Percentage
Green	60%
Blue	40%



# Cycle of software development



# Examples of qualifying R&D activity - Food & Drink



Revisions of recipes to meet newly introduced regulatory standards and consumer demands.



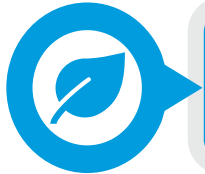
Seeking to improve environmental performance through improvements to existing production process to minimise; waste, water usage, gas or electric consumption.



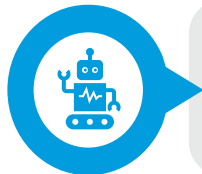
Investigation into new raw materials, or managing quality issues such as; significant seasonal variation.



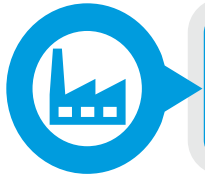
Development of new or improved packaging, where the type and design of the packaging impacts on the product.



Making improvement to shelf life of product.



Automation of packaging processes or introduction of new; bottling, labelling or casing technology.

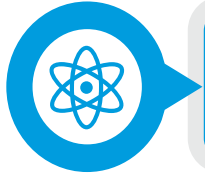


Developing new or improving existing manufacturing process to; improve quality, increase production rate or reduce cost.

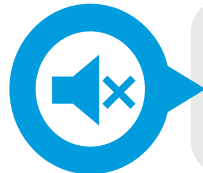


Projects seeking to introduce or integrate significant new IT infrastructure, which is non-trivial in nature.

# Examples of qualifying R&D activity - Construction



Development of new materials to meet mechanical property requirements (e.g. strength, tension, shear strength) by a specific design criteria or regulation.



Modifications made to processes and equipment to overcome challenges of listed building, or environmental sensitivities; e.g. sophisticated propping techniques, noise and vibration abatement



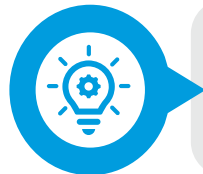
Significant reduction of waste, material usage and/or costs through innovative design of specific construction phases and techniques



Innovative development of novel building tools and equipment used in preparing site terrain and laying down building foundations, including scaffolding & temporary works.



Building process design and development to overcome difficulties of access to construction site, including precast concrete design & implementation.



Breakthroughs and achievements made in the use of the modern building technologies; e.g. post-tensioning, innovative formwork designs or temporary works, and modular construction.



Building process design and development to intelligently distribute a building's load across fragile terrain, including innovative floor slab, raft foundation & cavity shell design.

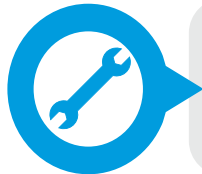


Soil remediation processes, geotechnical survey analysis, ground and foundation reinforcement used to overcome technologically challenging site constraints

# Examples of qualifying R&D activity - Software



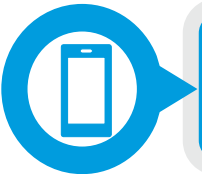
Building bespoke software applications utilising currently trending technology principles such as cloud computing, Saas and NFC



Major updates or modifications to existing software packages



Implementation of a software package to integrate existing systems of different technologies



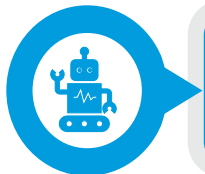
Development of web based interfaces using technologies like Web2.0, Webkit for electronic gadget browsers and displays



Development of a complex web based database management system to improve information speed, security and bandwidth



Development of integrated solutions interfacing hardware and software for seamless reservation systems, cashless system payments.

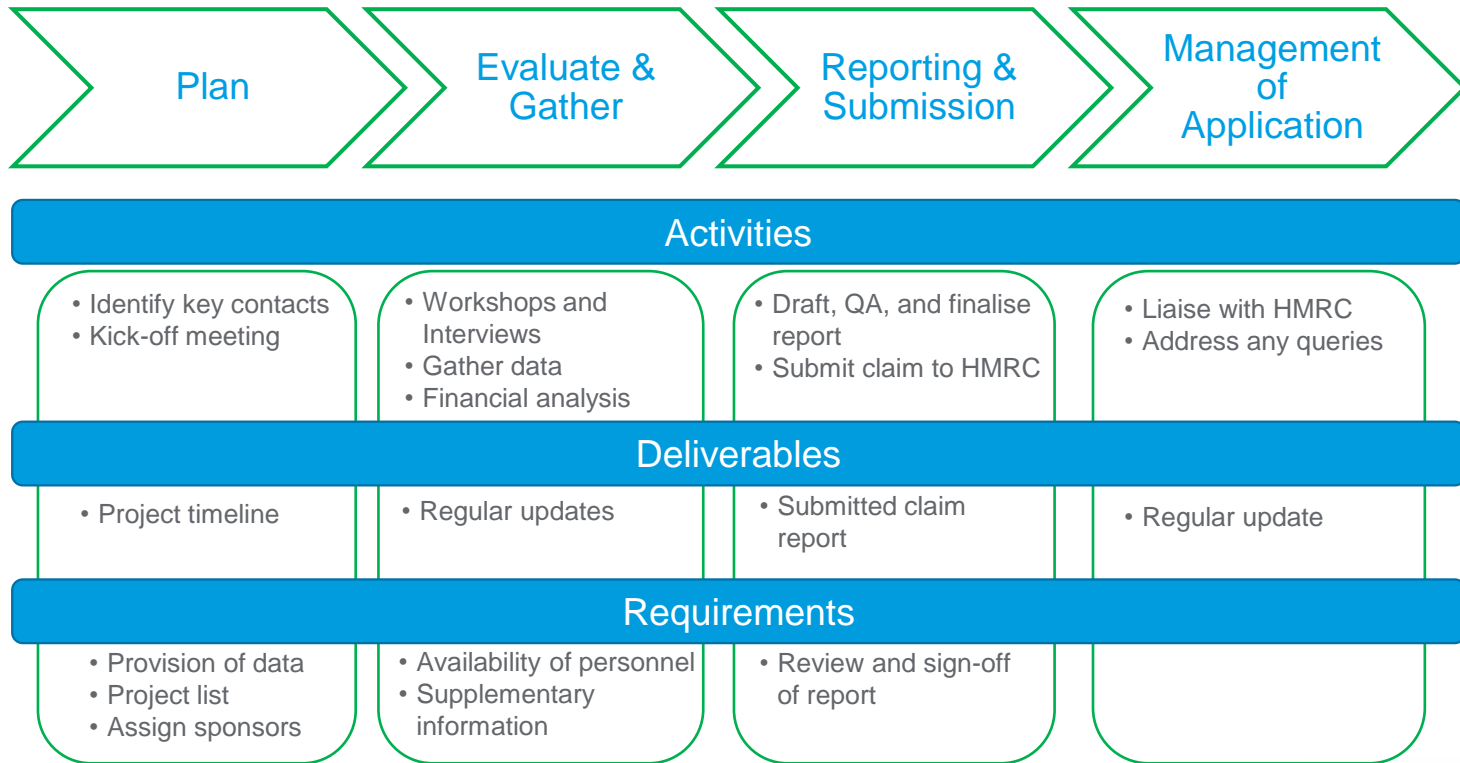


Design of software to automate a manual process applying complex modelling and algorithm techniques



Improvements to existing capabilities to improve security and latency, notably for extending the number of users accessing systems

# How to make a claim



# Covid complexity

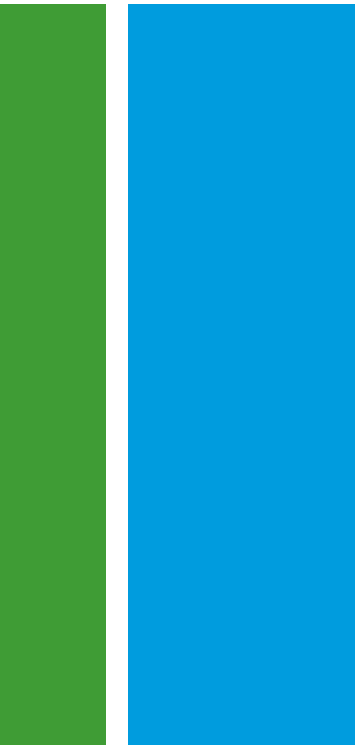
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- CBILs, CLBILs and BBLs are notifiable EU state aid – may impact a claim
- Furlough claims need to be taken into account
- Statutory sick pay rebate scheme – notifiable EU state aid
- Time to Pay/ Deferral of taxes
- Can't file a claim without signed accounts on a going concern basis

# Where to look for help

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- Where to look for help, and what form that help might take.



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# QUESTIONS AND ANSWERS?

# *Future webinars*

- Tax Faculty webinars
  - 04 March 2021 – Key tax risks for companies in 2021
  - 05 March 2021 – Tax Faculty Budget 2021 update
  - 15 April 2021 – Making Tax Digital and tax system transformation

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