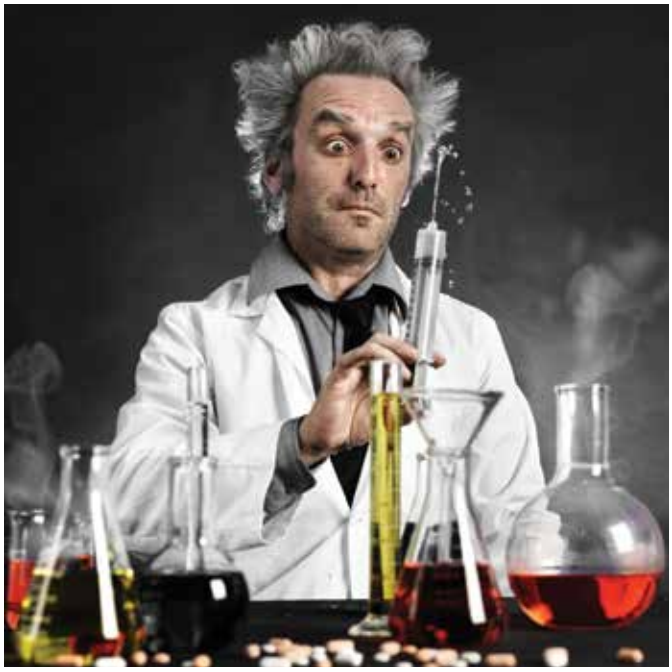
# George's marvellous medicine

**MARIA KITT** wonders whether UK businesses are obtaining as much benefit as they could from the research and development tax relief scheme.



HMRC have recently published the annual statistics for companies claiming research and development (R&D) tax relief. Initial reviews of the figures (see ***R&D Expenditure*** and ***Costs and Claims***) have pointed to a dramatic increase in small and medium-sized companies (SMEs) claiming this relief as the uplifts aimed at them, and which were announced by George Osborne in 2011 and 2012, are absorbed. However, although ***Costs and Claims*** shows that more than £1.3bn was provided in R&D tax reliefs to all UK businesses last year, the wider perspective of ***Incentives and Funding*** shows that indirect funding from European Economic Area (EEA) grants and assistance have provided almost four times this figure over the past five years.

The statistics in ***Costs and Claims*** also show that large company R&D expenditure is static and claims by such businesses have declined slightly. Of even more concern is the fact that many more eligible companies remain unable to unlock the opportunities provided by the relief. Looking more closely at the statistics, it seems as if tax advisers still have some way to go to keep up with the pace of UK innovation. In this article I aim to provide an insight into the figures and what is really going on in the R&D economy.

## KEY POINTS

- Research and development tax relief claims by small and medium-sized businesses have increased significantly.
- Claims processed by HMRC for 2013 reach 15,000, a 30% increase.
- Large company claims are static and the value of the UK's research and development economy is dwindling.
- Tax relief is only part of the picture for UK innovators and is limited to corporates.
- UK companies are still almost absent from the global top 20 companies undertaking R&D work.

## SME activity

To recap, a company is regarded as an SME for R&D relief purposes where it:

- employs fewer than 500 employees;
- has an annual turnover that does not exceed 100m euros; and
- has a maximum balance sheet value of 86m euros.

Generally, those companies may then claim the higher rate of tax relief if they are not performing "subcontracted" activity and have no linked or partner enterprises compromising the above threshold limits in the accounting period of the claim.

## R&D EXPENDITURE

R&D expenditure captured by R&D tax relief schemes*

| *Year* | *SME scheme tax relief* | *Large company scheme tax relief* | *All UK R&D schemes*** |
|---|---|---|---|
| 2001 | £360m | – | £360m |
| 2005 | £1,150m | £5,250m | £6,470m |
| 2010 | £1,740m | £7,990m | £9,980m |
| 2012 | £2,260m | £9,570m | £12,040m |
| 2013 | £2,650m | £10,380m | £13,230m |

* Source: HMRC's *R&D Statistics Report*, 15 August 2014, updated 20 September 2014.
** Includes vaccine research programmes.

## COSTS AND CLAIMS

Cost of R&D tax funding for UK companies (all schemes).

| *Year* | *SME scheme tax relief ** | *Large company scheme tax relief *** | *All UK R&D schemes* | *Number of claims processed* |
|---|---|---|---|---|
| 2001 | £70m | - | £70m | 1,780 |
| 2005 | £190m | £400m | £590m | 6,310 |
| 2010 | £320m | £690m | £1,010m | 9,250 |
| 2012 | £430m | £790m | £1,220m | 12,050 |
| 2013 | £600m (+30%) | £770m (<3%) | £1,370m | 15,120 |

*SME scheme introduced 1 April 2000
**Large company scheme introduced 1 April 2002
Source: *R&D Tax Reliefs*, Maria Kitt, Bloomsbury Professional Press, August 2014

More than 13,000 SME companies filed claims for R&D tax relief last year. Analysis of the statistics shows that, for the first time, the alarming decline in R&D tax credit repayment claims by SMEs has reversed. But the 2013 uplift in companies claiming tax credits (1,220 companies), simply returns the number of businesses surrendering corporate tax losses towards its 2004 level. In the intervening period from 2007 to 2012, fewer than 800 companies were filing annual tax credit claims.

The trend in ***SME Reliefs*** shows an interesting elasticity regarding the changes in the SME tax credit rates before April 2014. But clearly the abolition of the cumbersome PAYE cap and minimum project spends in April 2012 and December 2010 respectively have also had a positive impact. Easing the red tape puts the valuable credit within the reach of more R&D start-up and loss-making companies. The PAYE cap, which limited the claim to the amount of PAYE and NIC paid by the company, was particularly relevant for many "tech" companies where relatively low employee/subcontractor hire is a common feature. Many of my clients were thwarted by the pure nature of their own R&D environment. A bona fide R&D company, while having valid expenditure, was unable to take advantage of the tax credit because there was no PAYE cover. This was because talented personnel were either not on the payroll or were remunerated through share awards. The 2013 trend perhaps confirms the widely-held belief that easing the administrative burdens on R&D performers may be more of a stimulus to some than absolute rate changes.

The benefit of R&D tax relief through a reduction in corporation tax liabilities was claimed by 8,740 SMEs in 2013.

## SME RELIEFS

Decline in the rate of SME tax credit reliefs 2008 to 2014*

| | |
|---|---|
| Pre-July 2008 | 16% |
| August 2008 | 14% |
| April 2011 | 12.5% |
| April 2014 | 14.5% |

*Rate of surrenderable loss

This continues the positive trend that kicked in during 2010 and builds on the patent box regime, positivity reinforcing the low mainstream corporation tax rates regime enjoyed by UK R&D corporates.

## Go large

Clearly, the R&D picture is dominated by large company scheme claimants who claim the lion's share of relief. Such claims accounted for R&D expenditure of £10,380m while SME expenditure accounts for just £2,650m. Of course, the reduced rate of relief (130% of qualifying expenditure for large companies compared with 225% for SMEs) means that the absolute support provided in tax incentives to large company scheme claimants is only slightly above that for SMEs.

The number of large companies claiming R&D relief in the UK remains static, edging just slightly above its 2008 levels. This provides two messages. First, that the level of R&D expenditure has remained insensitive to the "recovery" from the economic crisis in 2007. Second, that the phased transition to the R&D expenditure credit scheme may simply complicate the relief mechanisms further rather than provide an absolute encouragement.

> ***"The abolition of the cumbersome PAYE cap and minimum project spends in April 2012 and December 2010 have had a positive impact."***

Economic data for global R&D investors shows that large company R&D expenditure by UK plcs compares relatively poorly with our global competitors. Only two UK companies (AstraZeneca and GlaxoSmithKline) have maintained a presence in the world "top 20" list of global R&D companies since the R&D tax relief scheme was first introduced. In 2013, just one UK company featured in the top 20 Thomson Reuters index.

Clearly, HMRC remain the "gatekeepers" of the R&D tax relief schemes. With diminished resources caused by the need to accommodate the patent box and creative sector regimes, HMRC R&D units must now review and process about 2,100 claims each year per unit. If the schemes are to continue to work effectively alongside the R&D economy there is significant work for tax advisers in preparing claims fully and keeping the detailed R&D records required.

## Which sectors perform R&D?

The universality of the tax definition of R&D is a strong impetus for companies from all types of industry to look at the potential for the relief. But UK companies continue to delay here, with

the UK tax regime being placed at only middle ranking for companies claiming R&D relief where a tax code provides an incentive. This is more remarkable given that the UK relief code has two clear advantages for R&D performers.

- R&D activities may be performed anywhere in the world.
- No intellectual property restrictions apply or are tied into the R&D activity for a claim to be made.

Of those companies filing R&D tax relief claims, the data is obscured by HMRC's collection of trade classification numbers and only the mainstream pharmaceutical, information technology and manufacturing companies are clearly evident. However, that does not detract from the fact that R&D relief may be found just as much within activity on the factory floor as the laboratory.

## Indirect funding for R&D

The context of R&D tax relief incentives comes within both the wider corporate intangible asset tax relief reforms as well as the indirect EC-based support layers for innovation. As ***Incentives and Funding*** shows, the EC framework programmes alone have dwarfed the value of direct R&D tax relief incentives. To top this, the Horizon 2020 schemes launched in late 2013 have an estimated budget of delivering support for EC innovators of more than 86m euros by 2020.

> ***"Since 2000, the UK's R&D tax relief schemes have stimulated more than 100,000 claims for enhanced corporation tax breaks."***

For me, the clear message is the longevity of all the many types of R&D support now available. The deep pockets of EC support are matched by the technical depth of the UK's R&D support organisations. For example, the work of the Technology Strategy Board and Science Park Associations reinforces this with more than 400 scientific research programmes in progress and 15 core development support strategies in hand. R&D companies may, to an extent, access both support layers to further the commercialisation of R&D and access practical help for excellent research and development activities.

The briefest look at this wider picture is very interesting. ***Incentives and Funding*** shows the eclipse of indirect support for UK businesses conducting R&D since 2006. Further information upon R&D grants and the impact on tax relief is discussed briefly in "Get a grant" (*Taxation*, 20 Mar 2014, page 21)

## INCENTIVES AND FUNDING

A comparison of the costs of UK tax incentives for R&D and EU indirect funding.

***Tax incentives UK R&D tax reliefs***
£0.07 billion a year (2001)
rising to:
£1.3 billion a year (2013)
*Note*. The cost to government of providing R&D tax relief has increased by more than 1,200% since the R&D schemes were first introduced.

***EU funding for R&D***
*6th Framework Programme*:
£1.58 billion provided to the UK between 2002 and 2006.
*7th Framework Programme*:
£4.3bn provided to the UK between 2007 and 2013.
*Note*. The "2020 Horizon" innovation programmes were launched for the period 2014 to 2020. The budgeted estimated cost of these programmes is 80 billion euros.

## Summary

Since its introduction in financial year 2000, the UK's R&D tax relief schemes have stimulated more than 100,000 claims for enhanced corporation tax breaks and have provided more than £9.5bn in tax relief. The most recent statistics show that the administration of the reliefs must keep pace with the needs of innovative UK companies and their excellent work. ■

**Maria Kitt** is the corporate tax partner at Tax Insight UK. More information on R&D tax reliefs and other reliefs for innovative companies is available at www.TaxInsightUK.com and in Maria's book *R&D Tax Reliefs*, published by Bloomsbury Professional Press.