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## R&D Tax Credits White Paper

### What is the R&D Tax Credit potentially worth to companies?

The latest figures published by HMRC in August 2012 show that in the year 2010/11 around 8000 SMEs claimed £340m, making the average SME claim worth about £42,000. From 1<sup>st</sup> April 2011 the rate at which qualifying R&D expenditure is treated for Corporation Tax purposes increased from 175% to 200%, and on 1<sup>st</sup> April 2012 the rate increased again to 225%. On that basis it is reasonable to assume that if the same claims were repeated in this financial year the average SME claim would exceed £55,000. The Labour government should be congratulated for introducing R&D Tax Credits in 2000 and the Coalition government should be congratulated for recognising the importance of the R&D Tax Credit scheme in encouraging large and small companies to invest in R&D. The Dyson report on innovation recognised the importance and said this:

*“Of the various tax instruments available to government, R&D tax credits have the advantage that they seek to help companies that are themselves prepared to invest in R&D. Government does not need to choose sectors or companies, with the result that R&D can be encouraged in the widest possible range of sectors, taking advantage of businesses’ own insights into likely breakthroughs”.*

Given that the number of SMEs in the UK is estimated to be around 4.5m, and the number claiming in the 2010/2011 year is around 8000, it is clear that much less than 1% of SMEs actually claimed R&D tax credits in that year. Is this an accurate reflection of the R&D work actually done by SME? Around 21,000 different SMEs have claimed R&D Tax Credits since the scheme started in 2000. This begs the question “Have a lot of SMEs stopped doing R&D or have many just stopped claiming it?”

At the current rates an SME with £100k of qualifying expenditure would be able to reduce their Corporation Tax bill by £25k, or if they were loss making they could receive a credit in cash of more than £15k. These sums make a significant impact on R&D budgets.

### Why do so few companies claim R&D Tax Credits

Our experience of helping with more than 700 qualifying projects, for more than 200 SME clients, is that many companies and their advising accountants simply do not recognise when they do R&D. Because of this, less than 0.50% of SMEs actually claim R&D Tax Credits. This is a real shame, because those who do claim really do get lots of money, with the average claim in the 2010/11 year being in excess of £42,000.





Why is this?

It can hardly be that companies don't need the money. Is it a blind spot that people have?

Part of it is that people have preconceived ideas about what they do and their own impression of what is R&D in their company. They may feel that they must develop a "world's first" something. This is not correct. We come across people who say things like this "if it is a government scheme the qualifying process will be too much hassle to make the effort worthwhile". Nothing could be further from the truth. We meet people who have asked their accountant, who answered that "you would not qualify". Each person has their own notion of what R&D actually is. This is based on their experience. Comments which have been quoted to us have included, "you are engineers, not scientists, so you would not qualify" or "you only develop web sites so you would not qualify" or "you only develop computer games, so you would not qualify"

In the area of R&D Tax you will hear people talk about the aim of advancing science, and we have never met a company which sets out to do this. More typically, the company will want to adapt science or technology, or develop the capability of science or technology to do something practical, such as make a new product, create a new service, develop a new manufacturing or operational process or create a new material. While the resulting research and development is focussed on resolving technological uncertainty, this work is R&D. Where consumables are used in the process they could qualify as direct R&D expenditure. Where there are indirect R&D costs they may also qualify.

The word "science" can be confusing but it continues to be used in a broad sense denoting "reliable knowledge about a topic" In this sense every industry and every company has its own "science". Where a company adapts or develops that science in a way which is not "readily deducible by a competent professional working in the field" then that work is potentially R&D. What actually happens in practice is that competent professionals working for a company will have an idea to create a new and innovative product, service, process or material based on their current understanding of the related "science" and available "technologies". Technologies are tools which aid the application of the science.

In the product area they will say things like "if we redesign our product using the latest technologies or transform our manufacturing processes we will be more competitive in our marketplace". The working out of how to do this in theory and in practice is often R&D, if there are uncertainties to be resolved. Those uncertainties could be related to the science and technologies in the product and manufacturing processes. Where a service organisation or the service function of an organisation says "we can give better service and reduce costs by improving our processes and systems" they may well embark on a project to see if the goal can be achieved. In large companies they may call this "business process re-engineering" and perhaps this is not often recognised as R&D but it may well be, if it involves the resolution of scientific or technological uncertainties.