R&D Tax Relief and Patent Box Update

22 October 2024

SUMER
NORTHERN IRELAND

Background to R&D Tax Relief

- Used to attract more R&D to UK
- Correlation between R&D & Productivity
- Introduced in UK in 2000
- Increasingly more attractive each Budget until 2023
- Investing in New Products & Services Updating existing Products & Services and Processes
- Extra tax relief to incentivise and subsidise R&D spend

Key points

1 Two R&D Tax Relief Schemes

2 SME Scheme

- Introduced 1 April 2000
- 230% rate/186%
- 14.5%/10% repayment

3 LARGE Scheme

- Introduced 1 April 2002
- 130% rate replaced 1 April 2016

4 RDEC Scheme replaced Large Scheme

- 1 April 2016
- 12% rate from 1 January 2018
- 13% rate from 1 April 2020

5 EU Definition of a SME solely for R&D

6 Companies only

7 Two year time limit

8 MERGED Scheme

- Introduced 1 April 2024
- 20% rate

What activities qualify for R&D tax relief?

UK Department for Business, Energy and Industrial Strategy ("BEIS") Guidelines

Corporate Intangibles Research and Development ("CIRD") Manual 81900

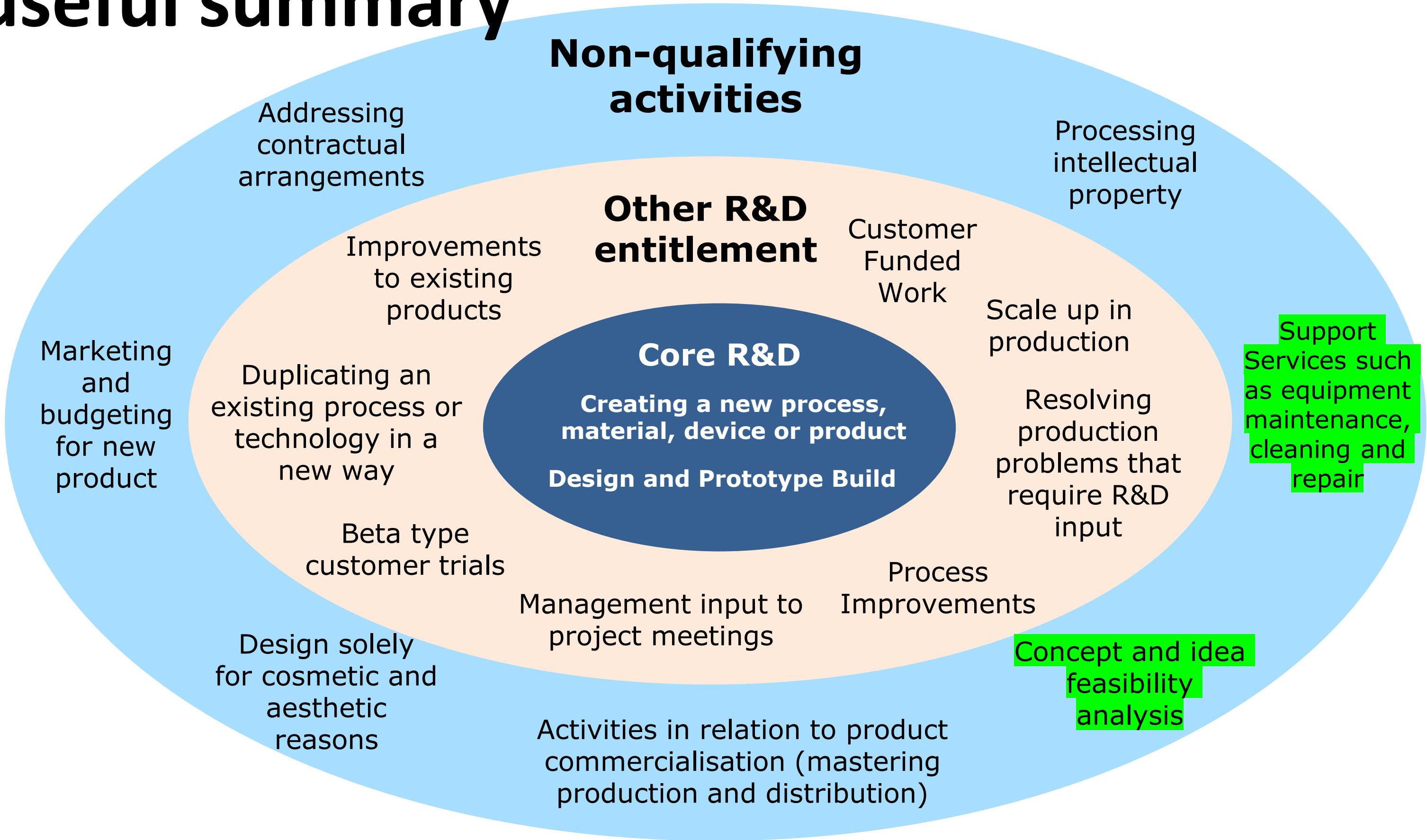
R&D takes place when there is a **PROJECT**

That seeks to achieve an **ADVANCE IN SCIENCE OR TECHNOLOGY**

With activities that **DIRECTLY CONTRIBUTE**

To the resolution of **SCIENTIFIC OR TECHNOLOGICAL UNCERTAINTY**

A useful summary



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Subcontractors And Externally Provided Workers

Qualifying Indirect Activities

Staff Costs, Gross Wages, Salary, Bonus, Employers NIC, & Pension

Consumables/ Materials and Utilities

Software

Qualifying Costs

Recent changes to R&D Legislation

- Accounting periods beginning on or after 1st April 2024 will see the introduction of a single merged R&D scheme with all companies (regardless of size) receiving a credit of 20% in line with the RDEC scheme

- Supposed aim of simplification - however, the 86% enhanced deduction on qualifying R&D expenditure and 14.5% repayable credit for loss-making SMEs will still be available if companies qualify as R&D intensive. For accounting periods beginning on or after 1st April 2024 the R&D intensity threshold will be reduced from 40% to 30%.

- The first accounting periods this will affect are those after YE 31.03.25

Introduction of Merged scheme

- PAYE Cap will be £20,000 plus 300% of the Company's relevant PAYE and NIC Bill
- Subsidised (i.e grant funding) expenditure will not be restricted in the merged scheme
- R&D subcontracted to 3rd parties can be included in the Company’s claim who are making the decision to do the R&D (and who thus bear the risk). However, this is to the detriment of companies that currently undertake contracted R&D for larger businesses, which enable them to still make RDEC claims.

Recent changes to R&D legislation cont.

- Pure maths will now qualify
- The costs of cloud computing and datasets will now be included, long overdue for software companies (reasonable apportionment)
- All claims must be digital with added requirement for named senior officer of the Company and advising agent to be disclosed
- The above reforms along with recent changes such as the introduction of PAYE caps are all steps to try and improve the quality of claims and eradicate the high levels of fraud

Recent changes to R&D legislation cont.

Overseas R&D will be disqualified from 1 April 2024

- **Relief is to be restricted to R&D 'undertaken in the UK' and 'qualifying overseas expenditure'**
- **In practice, externally provided workers (EPWs) must be paid via a UK payroll and eligible activities subcontracted to third parties will need to be carried out in the UK**
- **Nevertheless, eligible activities of UK companies undertaken by their own UK employees, for a period of time overseas, will still qualify for relief**
- **Expenditure on overseas R&D activities that are subcontracted or carried out independently, must be undertaken outside the UK due to necessary geographical, environmental or social conditions, or legal or regulatory requirements**

Recent changes to R&D legislation cont.

Overseas R&D will be disqualified from 1 April 2024 – continued:

- **For example, expenditure on sub-contracted deep ocean research may still qualify, as may certain clinical trials operated by drug development companies**
- **Cost or the availability of workers are specifically excluded as reasons for R&D activities to be carried out overseas**
- **HMRC technical specialists base this new approach on the premise that expenditure carried out overseas must qualify on the basis of 'necessity, rather than convenience or preference'**

Advance Assurance Scheme

- Voluntary scheme for SME corporate businesses making their first claim to R&D tax relief, certain criteria to be met.
- If accepted, HMRC will allow the R&D claim without further enquiries for the first three accounting periods claimed, providing in line with agreed application.
- From 1 April 2024 this will only apply to new R&D Intensive Companies (ERIS)

ERIS

- R&D Relief Regulations 2024 make provision for loss-making, R&D intensive SME's with a registered office in Northern Ireland
- Affected Companies are NOT subject to the restrictions for relief on payments to overseas contractors, or providers of externally provided workers
- Will be able to claim enhanced R&D intensive support (ERIS), subject to a rolling three year limit
- Above this limit, relief is available under the New Merged Scheme
- Limit applies to the net benefit of all claims made under ERIS over any period of three years, on a rolling basis
- Must not exceed £250,000

What moves a company into large scheme?

A Size (Above 500 employees)

B Grants (Invest NI, Innovate UK etc)

C Subcontracted R&D or

D Subsidised Expenditure – Contentious Area

- Bank loan – not subsidised;
- Loan from parent – subsidised;
- Payments from central treasury function – not subsidised;
- Customer funded – Quinn case.

Grants and subsidies

SME Scheme

1. De minimis - €300,000 over a three year rolling period – grant netted off
2. Notified state aid – Company must claim under RDEC

Merged scheme

1. Grants are irrelevant in terms of the calculations, dealt with completely separately

What are the savings?

SME Scheme	Old Rate 130% uplift	New Rate 86% uplift
Qualifying Costs	£100k	£100k
R&D Uplift	£130k	£86k
Additional Tax Deduction-19%	£24.7k	£16.34k
Additional Tax Deduction-25%		£21.5k

What are the savings?

RDEC/Merged Scheme	Old Rate 13% tax credit	New Rate 20% tax credit
Qualifying Costs	£1m	£1m
Tax credit	£130k	£200k
Tax Savings at 19%	£105.3k	£162k
Tax savings at 25%		£150k

What are the savings?

Company A has March Year end and total R&D Expenditure of £100k.

	SME Scheme - 130% Uplift	SME Scheme - 86% Uplift	Merged Scheme - 20% Credit *
Year End	31/03/2023	31/03/2024	31/03/2025
	£	£	£
Qualifying R&D Expenditure	100,000	100,000	100,000
R&D Uplift	130,000	86,000	
R&D Credit			20,000
Additional Tax Deduction - 19%	24,700		
Additional Tax Deduction - 25%		21,500	
Tax Savings at 25%			15,000

*If Company A’s R&D expenditure is at least 30% of its total expenditure, Company A can stay under the SME Scheme rules in 2025 (i.e claim 86% uplift on their R&D expenditure)

Impact of a grant

A company spending £100k on qualifying R&D with a £30k subsidy could make a saving of £62.5k under RDEC and receiving a grant

Net cost of project	£'000	£'000
R&D spend	100	
Less: funding (Subsidy @ 30%)	(30)	
Net cost of project to Company		70
R&D tax relief claim under **RDEC**		
RDEC – additional 20% income to P&L A/c (£20k @ 25%)	5	
Less: RDEC - 20% Credit	(20)	
Tax saved under RDEC		(15)
Plus accounts deduction on spend (£100-30k @ 25%)		(17.5)
Effective cost of £100k R&D Project		**37.5**

Impact of a grant

A company spending £100k on qualifying R&D with a £70k subsidy could make a saving of £92.5k under the merged scheme and receiving a grant

Net Cost of project	£'000	£'0002
R&D Spend	100	
Less: funding (Subsidy @ 70%)	-70	
Net cost of project to Company		30
R&D tax relief under merged scheme		
RDEC - additional 20% subject to CT @25%	5	
Less RDEC Credit	-20	
Tax saved under RDEC		-15
Plus accounts deduction on spend (£100-70k @ 25%)		-7.5
		7.5

R&D Additional Information Form
Project Information

Number of Projects	Project details required
1 to 3	All the projects you're claiming for that cover 100% of the qualifying expenditure
4 to 10	Projects which account for 50% of the total expenditure, with a minimum of three projects described.
11 to 100	Projects that account for at least 50% of the total expenditure, with a minimum of three projects described — if the qualifying expenditure is split across multiple smaller projects, describe the 10 with the most qualifying expenditure

R&D Additional Information Form Requirement

- **As of 8th August 2023, an additional information form must be submitted to HMRC prior to the submission of the Company's Corporation Tax Return**
- **If this is not completed, HMRC will remove the claim from the Corporation Tax Return**
- **Either the company itself or an agent acting on the company's behalf is able to file the new form**
- **The following details are required to complete the form :**
  - UTR, Employer PAYE Reference Number, VAT Registration Number and SIC code
  - Contact details of the main senior internal R&D contact in the company
  - Agent Details
  - Qualifying Expenditure split per project.

R&D Additional Information Narrative Questions

The form includes the following narrative questions:

1. **What is the main field of science or technology?**
2. **What was the baseline level of science or technology that the company planned to advance?**
3. **What advance in that scientific or technological knowledge did the company aim to achieve?**
4. **The scientific or technological uncertainties that the company faced.**
5. **How did your project seek to overcome these uncertainties?**

Advance in Science or Technology

What advance in science or technology is this project seeking to achieve?

- An advance in science or technology means an advance in overall knowledge or capability in a field of science or technology, not a company's own state of knowledge or capability alone
- The advance may also be an appreciable improvement to an application of software provided these changes or adaptations to the scientific or technological characteristics would be generally acknowledged by a competent professional as a genuine non-trivial improvement
- Tangible consequences:
  - a faster process; and
  - a process which involves less risk; or
- More intangible outcomes, i.e. new knowledge or cost improvements

The Importance of Google

What will HMRC find if they research your project's activities or advancements online?

- We can guide them to ensure a fair and accurate benchmark, ensuring comparisons are relevant and industry-appropriate. HMRC might otherwise compare your company to one that isn't directly comparable, which could misrepresent your claim

Anticipating HMRC's likely comparisons:

- We can proactively assess what HMRC might use as a basis for comparison, ensuring that the information aligns closely with your project specifics and industry standards

How does your company appear online concerning R&D capabilities?

- A quick online search should demonstrate your company's competency and involvement in R&D activities, presenting a credible image to HMRC during their assessment

How do SUMER NORTHERN IRELAND support the R&D Claim?

- **Kick-off Meeting:** Initial consultation to understand your business and R&D activities.
- **R&D Discussion:** Deep dive into the projects and activities to identify qualifying R&D work.
- **Qualifying Assessment:** Advise on what costs qualify and what does not, based on HMRC guidelines.
- **Project Summaries:** Compile and summarise technical details through the lens of HMRC's requirements.
- **Claim Preparation:** Pull together all necessary documentation and evidence for the claim submission.
- **End-to-End Management:** Take over administrative and accounting responsibilities to minimise your burden.
- **Ongoing Support:** Provide continued guidance and support on claim in case of HMRC enquiries.

Current R&D Trends

HM Revenue & Customs have post-covid hired hundreds of new inspectors whose primary focus will be to review R&D claims

An increased incidence of R&D claims coming under review by HM Revenue & Customs – enquiry could go one of two ways (named and unnamed)

HM Revenue & Customs' Campaigns Team is intensifying efforts to scrutinise and tackle high-risk R&D claims, ensuring only legitimate reliefs are granted

If HMRC can weed out the nefarious claims gives hope for the future of the tax relief

Real Time Analysis Practical issues to be aware of when making a claim

- Is there any existing documentation we can use to help with a first draft project summary?

- Two massive focuses for HMRC

1. BASELINE – this is much easier to establish at the start when the path is still unclear than at the end when all the uncertainties have been resolved

2. TIMELINE – When does R&D stop and end and how could we better identify this through the time records? <u>FAILURE LOG IS IMPERATIVE</u>

What have we learned from recent HMRC enquiries

Case 1 – Increased scrutiny / increased level of detail:

- First response was over 500 pages
- Second response was over 100 pages
- Formulaic response, repetitive line of questioning, inspector did not have the experience we might have expected
- Agreed the 'Google/Amazon' example the fact that similar technology exists does not preclude our client from claiming – competent professional test
- HMRC used the Google cache function to investigate the timeline – we had never encountered this approach before

What have we learned from recent HMRC enquiries

Case 2 – Stringent Interpretation of the CIRD manual:

- Were fairly intractable in asserting that although they could see there were innovative elements they did not feel it was ‘enough’ of an advance
- They compared our client to industry giants and stated that in a software claim the bar was set at the multinational/super high end level, however our client met all the legislative requirements
- We were able to succeed by initially proving that the advance went above and beyond anything in the software sector even perceived as not ‘racy’ enough
- However we were only able to close the case by engaging with a Phd student in Big Data and a contact in a major software company to explain they would not be able to readily deduce how the advance was achieved and the difficulties they would have in trying to arrive at the same result

What have we learned from recent HMRC enquiries

Case 3 – Massively increased focus on the 'baseline':

- **Another example of the additional need for increased detail in claims**
- **Inspector said that while there were innovative aspects of the activities described it was not considered as an 'advance' in relation to the industry baseline**
- **We had to work with the client to expand the narratives and set out how the advance was the first of its kind in Europe**
- **The experience gained this year has led to us redrafting our project summary as throughout all three enquiries there were two consistent themes - baseline and timeline**

R&D Tax Relief comparison

	SME	ERIS (for APs beginning from 1 April 2024)	RDEC	New RDEC (for APs beginning from 1 April 2024)
Who can claim?	SMEs	Loss making SMEs who meet 30% intensity condition	SME and Large Businesses	Companies of any size
Method of providing relief	Enhanced expenditure (claimable tax credit if loss)	Enhanced expenditure (claimable tax credit if loss)	Taxable credit	Taxable credit
Rate	86% additional deduction, 10% credit rate (14.5% credit rate if 40% intensity condition met)	86% additional deduction, 14.5% credit rate	20%	20%
PAYE cap	£20,000 + 300% PAYE and NIC for all staff	£20,000 + 300% PAYE and NIC for all staff	PAYE and NIC for R&D staff	£20,000 + 300% PAYE and NIC for all staff
Contracting	Allowed	Allowed	Not generally allowed	Allowed
Overseas	Allowed	Restricted	Allowed	Restricted

Conclusion

An extremely generous relief! Worth the investment.

Key Takeaways:

- **A proactive approach to recent scheme changes**
- **Capture time spent on R&D activities on a ‘real-time’ basis**
- **Remain aware of increased HMRC review and the importance of strong project summaries**

Patent Box

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The Burning Question

- How do I pay less tax?
  - No obligation to provide HMRC with a bigger shovel
  - Legitimate tax planning opportunity
  - Cost / benefit analysis
  - Differential now 10-25% rather than just 10-19%
  - Development condition (created or owned patented invention) and
  - Active ownership condition (developed or actively managing)
  - What profits – Sales of patented item/Royalties/infringement income

Some Statistics

- 1,600 companies elected into Patent Box in 22/23
- The value of the relief claimed under Patent Box increased to £1,469 million in 22/23 up from £1,327 million in 21/22
- Of the Companies that elected into Patent Box in 22/23 25% were classified as 'Large' but accounted for a massive 94% of the relief claimed
- There were 65 Northern Ireland Companies who claimed under the Patent Box and we were not the lowest claiming region, Wales and the North East both had less!

Reasons for Low Take-Up

- Corporation tax regime only – sole traders, partnerships and unincorporated entities cannot claim
- Costs and timescales – but corporation tax savings usually outweigh legal and admin costs / also patent box benefits available for 'patent pending' period
- Complexity – calculations are complex could be considered as another admin burden / worry that there would be increased record keeping
- Loss making companies – where a relevant IP loss arises, it is better not to elect into the regime
- Lack of awareness – some companies still unaware of availability of Patent Box

Why to Patent (borrowed from Rosie at EIP)

- Attract & protect investment
- Generate revenue via licensing fees
- Deter competition
- Protect odeas whilst collaborating
- Use as a negotiation tool
- REDUCE UK TAX BILL
- IF THE LATTER WHAT IS THE BEST APPROACH TO SEEKING PATENTS

Election

- Election into Patent Box regime (under CTA 2010 s357A(1)) must be made within two years of the end of an accounting period
- No special form of words for an election – USE REGISTERED POST
- Making a Patent Box claim counts as an election
- No provision for 'late' elections
- Importance of election for late claims (ie. amended CT returns) and also 'patent pending' period
- Election can be revoked, but no re-entry to regime within five years

Patent Pending

- A company holding a qualifying IP right can obtain the benefit of the Patent Box on profits arising from exploiting the right prior to the right being granted

- Profits can only qualify if they relate to periods for which a Patent Box election under s357A(1) has been made

- Further 'right by right' written election required under CTA 2010 s357BM / CTA 2010 s357CQ within twelve months of filing deadline of Corporation Tax Return

- This period is limited to up to six years before the right is granted, but cannot go back earlier than later of date of application for the grant of the right, or 1 April 2013

- Relief for the 'patent pending' period is given by adding relevant IP profits arising before grant of right to relevant IP profits in the accounting period in which the right is granted

Relevant IP Loss

- If elected into regime, full calculation must be performed, even though no Patent Box deduction will arise where there is no relevant IP profit
- If a relevant IP loss is made, better not to be elected into regime
- Relevant IP loss must first reduce relevant IP profit elsewhere in group, or be carried forward against relevant IP profits of the same company
- NB. relevant IP loss not an actual loss
- Where there are relevant IP profits and the patent box deduction results in an actual trading loss, this loss is relieved in the normal way

Where is the 10% Rate on my Corporation Tax Return?

- Mechanism for Patent Box relief is not to have two profits chargeable to Corporation Tax figures to which different tax rates are applied
- Effective 10% rate by adjusting the amount taxed at the normal rate
- Following formula calculates additional deduction required to tax IP profits at 10%:

RP x ((MR-IPR)/MR)

Where RP = relevant IP profits

MR = main CT rate (currently 25%)

IPR = Patent Box rate (currently 10%)

- £100,000 x ((0.25-0.1)/0.25) = £60,000 deduction in CT Return
- £60,000 x 25% = £15,000 Tax saved
- CHECK (£100,000 x 25%)-(£100,000 x 10%) = £15,000

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Example – SME R&D Scheme

Patent applied for at the end of Year 1 and granted during Year 3

	Year 1	Year 2	Year 3	Year 4
Qualifying R&D spend	£500,000	£500,000	£500,000	£500,000
Patent Pending profits	-	£1,000,000	-	-
Patented product profits	-	-	£1,000,000	£1,000,000
Profits qualifying for Patent Box Uplift	-	-	£2,000,000	£1,000,000
Patent Box Deduction	-	-	£947,368	£473,684
R&D Uplift (130%)	£650,000	£650,000	£650,000	£650,000
Tax savings at 19%	£123,500	£123,500	£303,500	£213,500

Step 1: Divide taxable trading income (net of any finance income) between separate streams of **relevant IP income** including, where appropriate, the appropriate share of any **IP-derived income**

Step 2: Divide the relevant IP income stream into separate sub-streams attributable either to specific **IP rights**, specific **IP items** or specific **IP processes**.

Step 3: Allocate trading expenses to the other income stream and each of the relevant IP income sub-streams on a just and reasonable basis.

Step 4: Deduct non-excluded trading expenses & the **routine return** from each relevant IP income sub-stream.

Step 5: Deduct the **marketing assets return** from the step 4 result.

Steps 1 & 2 - Set up streams and allocate income to sub-streams						
			IP Sub-streams			
	Total Income	Relevant IP income stream	Sub-stream 1	Sub-stream 2	Sub-stream 3	Standard income stream
Streaming Method	£	£	£	£	£	£
Turnover	1,200,000	900,000	350,000	300,000	250,000	300,000
Step 3/4/5 - Allocate deductions to sub-streams						
Expenses	(700,000)	(600,000)	(200,000)	(200,000)	(200,000)	(100,000)
Relevant IP Profit	**500,000**	**300,000**	**150,000**	**100,000**	**50,000**	**200,000**
Step 6 - Applying the Nexus Fraction						
Nexus Fraction per sub-stream			1	1	1	
Relevant IP Profit			**150,000**	**100,000**	**50,000**	
Step 7 - Combine the sub-streams						
Total relevant IP profits of the trade		300,000	150,000	100,000	50,000	
Calculation of Patent Box deduction						
		Year ended 31 December 2023				
RIPP = Relevant IP Profit		300,000	150,000	100,000	50,000	
MR = CT at 19% rate for 90 days		0.19	0.19	0.19	0.19	
MR = CT at 25% rate for 275 days		0.25	0.25	0.25	0.25	
Allowable percentage under transitional provisions		1	1	1	1	
RIPP x $\frac{\text{MR - 10\%}}{\text{MR}}$ x allowable percentage		**170,656**	**85,328**	**56,885**	**28,443**	


Question?

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