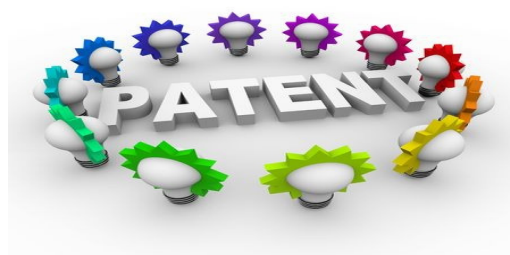


Research & Development and Patents

A guide to what qualifies and what reliefs & allowances are available.



Generous reliefs and allowances are generally available for expenditure on research & development (R&D) and patents.

The main tax breaks are:

- R&D relief
- Capital allowances
- Costs on patents & know-how
- The patent box.

What Constitutes R&D?

The treatment of R&D for accounting & tax purposes can differ, something that complies with UK GAAP does not automatically qualify for tax relief as R&D expenditure. There is a raft of guidelines & legislation which must be met in order to qualify.

Expenditure on R&D includes:-

- Costs incurred to gain new knowledge
- Costs incurred in extending such knowledge
- Costs incurred in the application of such knowledge for commercial purposes.

Consideration needs to be given as to what to include & whether the expenditure is to be treated as revenue or capital. Expenditure does not necessarily need to be conducted by your company, it can be conducted by a third party.

R&D Relief

Expenditure on R&D can qualify for extra relief often known as a 'super-deduction' due to the fact that the relief available exceeds the amount actually spent. The relief is available to any size of company on the proviso that a trade is being carried out or a relevant trade is to be carried out subsequent to the cost being incurred. The R&D must be relevant to the trade being carried out.

The relief available is size dependant. Large companies qualify for an extra 30% relief (130% of costs) & small or medium sized companies (SMEs) qualify for an extra 125% (225% of costs).

Special provisions exist for SMEs whereby they may either claim the relief against profits or if there are no profits then they may be able to surrender the whole or part of any claim in exchange for a cash payment (R&D Tax Credit).

An SME with a £100,000 R&D claim can offset this against profits generating a 20% saving on corporation tax (£20,000) or choose to take an 11% R&D tax credit of £11,000. Obviously it is more tax efficient to offset the claim against profits but if cashflow is an issue it may be prudent to take the cash payment.

Up to March 2016 large companies are allowed to claim the extra relief as a 'super-deduction' or claim an above the line credit. From 1 April 2016 only the latter applies. The rate of credit is 10% for large companies rather than 11%.

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Company A spends £6 million on an R&D project of which £4 million qualifies for R&D relief. As a consequence £10 million of income is generated. The main rate of corporation tax for 2013-14 is 23%.

	Super-deduction	Above-the-line
	£'000	£'000
Turnover	10,000	10,000
R&D Expenditure	(4,000)	(4,000)
Above-the-line credit	0	300
Other expenses	(2,000)	(2,000)
Profit	4,000	4,300
R&D extra tax credit at 30%	(1,200)	0
Taxable profit	3,800	4,300
Tax at 23% on profit	874	989
Above-the-line credit	0	(400)
Tax less credit	874	589

R&D Capital Allowances

All allowable expenditure is eligible for a 100% first year allowance in the year costs are incurred.

Patent & Know-how costs

The cost of acquiring/registering a patent does not fall within the R&D tax relief scheme detailed above but will normally be covered by other tax provisions. You can either acquire your own patent or a licence to use an existing patent.

Know-how excludes the costs of commercial information (client data etc.) but includes industrial information/techniques for manufacturing, agriculture or mining and covers elements such distribution, packaging & marketing. This type of cost is classed as intellectual property and as such costs can be spread over several years, tax treatment generally coincides with the accounting treatment.



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Patent Box

This is a new scheme allowing companies to reduce the tax on income arising from the use of patents including innovations in the fields of botanics & medicine. This scheme is a voluntary option.

The new regime is being rolled out over a 4 year period which commenced 01 April 2013 & is intended to result in corporation tax of effectively 10% being charged on patent derived income.

As always strict rules control what income is eligible for this treatment, certain types of income are expressly exclude:-

- Income that would arise regardless of the existence of the patent
- Value inherent in the brand rather than directly arising due to the existence of the patent (or equivalent)

However what is allowed is quite wide ranging:-

- Income arising from the licensing or sale of patent rights
- Sale of the patent invention itself
- Sales of products which contain the patented item
- Income generated by the use of the item by the company, in the course of it's trade
- Monies received as a result of any infringement of the patent.

The main object of the regime is patents registered either with the UK Intellectual Property Office or it's European equivalent the European Patent Office but is wide enough to include plant variety rights, supplementary protection certificates and those inventions where patents cannot be granted due national security issues. Limited concessions apply where a company holds a licence to utilise third party technologies.

The calculation of eligible profits arising is complex & involves a seven step process, although 'small claims' & 'streaming' elections may apply although the latter may be compulsory in some circumstances. This guide is intended to highlight the existence of this emerging regime, rather than giving details of complex tax laws that apply.