Research and Development

TAX SAVING OPPORTUNITIES

April 2018

As you are no doubt aware, the government's economic strategy focuses heavily on supporting UK innovation and Research & Development ('R&D'), including redoubling efforts to increase awareness of R&D tax incentives among small and medium-sized companies. This seems an opportune time, therefore, for veterinary practices to take another look at these potentially valuable tax incentives.

WHAT IS R&D FOR TAX PURPOSES?

R&D tax incentives provide an opportunity for companies to claim additional corporation tax relief for certain R&D costs in order to reduce their taxable profits and their corporation tax liability, or, in certain circumstances, to claim a cash payment from HM Revenue and Customs ('HMRC') as a 'payable R&D tax credit' or an 'R&D Expenditure Credit'.

In simple terms, a project should qualify for R&D tax credits if:

- It aims to extend existing knowledge or capability, or to 'appreciably improve' existing processes, products, devices, materials or services through scientific or technological changes;
- There is no readily available knowledge regarding its technical feasibility or whether it can be turned into something which is cost-effective, reliable and reproducible in practice; and
- A 'competent professional' would not easily be able to resolve the technical issues involved.

Adapting existing knowledge and capability from other fields for new uses in order to generate improvements can also involve R&D that qualifies for tax relief and credits.

DAVID CLIFT Partner

Staverton Office Tel. 01242 680000 Email: david.clift@hazlewoods.co.uk

David works in the Corporate Tax team and also leads the Hazlewoods Innovation team. He specialises in R&D tax reliefs, an area that he has been involved in since 2001, following their introduction in 2000. In our last financial year, the Hazlewoods Innovation team identified qualifying R&D expenditure approaching £28.5 million for our clients, successfully generating tax savings of over £4.1 million.

Examples of veterinary work that could qualify for R&D tax credits include:

- Investigating whether developments in human medicine and surgery might be capable of adaptation for the treatment of animals, and other comparative medicine;
- Development of new methods and techniques for the control of animal disease;
- Development of new veterinary vaccines, drugs and technologies;
- Investigation of new animal surgery techniques and procedures;
- Studies to understand the physiological effects of different treatment methods; and
- Studies to understand the behaviour of emerging pathogens and diseases.

HOW DOES IT WORK?

In principle, it is not as complicated as you might think. The process essentially involves:

- identifying eligible R&D projects;
- identifying eligible costs associated with those projects; and
- adjusting the tax computations to claim extra tax relief on the eligible costs.

The main scheme of R&D tax incentives is aimed at 'Small and Medium-Sized Entities' ('SMEs'); for these purposes SMEs are companies with fewer than 500 employees and either turnover less than €100 million or gross assets less than $86 million. Under this scheme:

- companies which have taxable profits see a reduction in those profits as a result of the claim for additional tax relief on R&D expenditure, and consequently a reduction in their tax liability. Each £100 of eligible R&D expenditure reduces the tax liability by around £25.
- companies which have tax losses can 'cash in' losses relating to their enhanced R&D expenditure. Each £100 of eligible R&D expenditure could be cashed in with HMRC for a payment around £33.35.

WHAT EXPENDITURE QUALIFIES FOR THE CLAIM?

Expenditure that can be included in the claim comprises:

- **Staffing costs**, relating to the proportion of time spent by employees on qualifying R&D activities and also reimbursed expenses relating to R&D;
- **Consumable items** used up in the R&D activities, including water, fuel and power, and expenditure on R&D prototypes;
- **Software**, to the extent that it is used for qualifying R&D activities;
- Payments for '**externally provided workers**', such as agency staff involved in the R&D activities; and
- Payments to **subcontractors** engaged to undertake qualifying R&D on the company's behalf.

It is important to ensure that the claim includes only expenditure in the above categories: one of the most common errors giving rise to HMRC enquiries is the inclusion of expenditure that does not qualify, such as rent and rates, apportioned overheads, capital expenditure and hire of equipment.

SME scheme:	2017/18	2016/17
Profitable companies		
→ Additional tax relief on qualifying expenditure*	130%	130%
→ Corporation tax rate	19%	20%
→ Effective cash value of additional tax relief	24.7%	26%
Loss-making companies		
→ Enhanced R&D expenditure	230%	230%
→ R&D 'surrender rate' for loss-making companies	14.5%	14.5%
→ Effective cash value of R&D losses surrendered**	33.35%	33.35%

* In addition to 'normal' 100% deduction of costs.

** Assumes full surrender of R&D tax losses.

Large companies scheme:	2017/18	2016/17
→ R&D Expenditure Credit (RDEC) – pre tax	11/12%	
→ Corporation tax rate	19%	
→ Effective cash value of RDEC post tax	8.91/9.72%	

* RDEC rate changed with effect from 1 Jan 2018 as announced in the Autumn Budget on 22 November 2017.

WHAT ACCOUNTING PERIODS CAN BE CLAIMED FOR?

The claim must be made within two years after the end of the company's accounting period. So, for example, a company with a period ending 30 June 2018 must file its claim by 30 June 2020.

It is possible to 'reopen' and amend tax returns that have already been filed with HM Revenue and Customs to include an R&D claim. For example, a company with a period ended 30 June 2016 can still file an R&D claim for that period provided that the amended return is filed with HMRC by 30 June 2018.

SOME IMPORTANT POINTS TO NOTE, PARTICULARLY RELEVANT TO VETERINARY BUSINESSES

There are a number of points that veterinary companies in particular need to bear in mind in considering a possible R&D tax credits claim:

Advance in science or technology

As noted above, a project must seek to extend existing knowledge or capability in order to qualify as R&D for tax purposes.

This means that the objective must be to advance *overall* knowledge in the relevant field, not just to advance the knowledge of, for example, the particular veterinary practice or practitioner. If the knowledge or capability is already available and the company is seeking only to 'bring itself up to speed', this does not qualify for R&D tax credits.

So, for example, a veterinary surgeon's time spent in familiarising themselves with a new procedure which has already been investigated by others, and for which knowledge is readily available, will not of itself be R&D. The veterinary surgeon would need to be doing something to enhance the knowledge in the public domain in order for the activity to qualify as R&D.

Partnership structures

The R&D tax incentives apply only to companies and bodies subject to corporation tax, not to partnerships, LLPs or sole traders.

Some veterinary businesses comprise a combination of a partnership and one or more limited companies. In such structures, it may be possible to claim R&D tax incentives, but this involves some complexity; specialist professional advice should be taken to ensure that eligibility for R&D tax credits is not compromised.

Owner-managers' remuneration planning

In many owner-managed businesses, the owner's reward comprises a combination of salary and dividends. Often the salary is relatively modest, whilst the dividends can often be much greater.

For R&D tax incentives, it is important to note that 'staffing costs' refer only to salaries and other employment reward, not to dividends. It is not uncommon, therefore, that in situations where the main individual involved in the R&D activities is the owner-manager, the expenditure qualifying for R&D tax incentives may be quite low, unless of course other staff are also involved in the R&D activities.

Payments to R&D consultants

As noted above, payments to 'externally provided workers' involved in qualifying R&D activities are eligible for R&D tax incentives. For these purposes, the payment must be made to a 'staff provider' who must be separate from the worker themselves i.e. there must be three parties to the arrangement: the claimant company, the R&D worker and the staff provider.

Payments to R&D consultants can therefore be problematic:

- If the consultant provides his services through an agency or his / her personal service company, the costs should be eligible as payments for an externally provided worker.
- However, if the consultant is self-employed and the company's payments for the consultant's services are made directly to the individual, the costs cannot be claimed as an 'externally provided worker' as there is no 'staff provider' involved in the arrangement. In these circumstances, it would be necessary to consider whether the arrangements are such that the company has subcontracted some of its R&D activities out to the consultant, in which case the costs might be eligible for R&D tax incentives on that basis.

R&D undertaken for others

An SME company undertaking R&D on a subcontract basis for other organisations will not qualify for R&D tax incentives under the main 'SME' scheme, but it may qualify under a different scheme (R&D Expenditure Credits, or 'RDEC') if the contracting party is not another UK SME. A claim under the RDEC scheme is not as beneficial; the cash effect of an RDEC claim is around 9% to 10% of qualifying expenditure, so the commercial viability of a claim in these circumstances could potentially be impaired.

Whether or not R&D is undertaken on a subcontract basis can often be difficult to determine, and requires consideration of the specific arrangements, commercial risks etc. Specialist professional advice should be taken in this regard.

Grants for R&D

If grant funding has been received for the qualifying R&D projects, this will affect the scheme under which R&D tax incentives may be claimed. Depending on whether the grant is a 'Notified State Aid', some or all of the claim will need to be made under the less beneficial RDEC scheme. Due to the increased complexity in these circumstances, specialist professional advice should be taken.

WHAT SHOULD YOU DO IF YOU THINK YOU MIGHT BE ELIGIBLE FOR R&D TAX CREDITS?

Simple – please contact us to discuss it!

We are happy to have a 'no cost' conversation with you to see whether you are likely to qualify and, if so, how much tax saving or repayment you might be entitled to. We can then help you to prepare the claim documentation and file it with HM Revenue and Customs on your behalf.

At Hazlewoods, we have our own specialist R&D partner, David Clift. David is based in our Staverton office. We pride ourselves in adopting a professional approach to R&D, as we do with all of our service. In this regard, we will give you a cost benefit analysis in terms of whether to progress a claim.

UPCOMING EVENTS

SEPTEMBER 2018

We will be attending 2018 BEVA Congress, taking place on 12-15 September at the ICC in Birmingham. Mark Harwood will be speaking on ‘Benchmarking and measuring KPIs’.

NOV 2018

We will be exhibiting at London Vet Show on 15-16 November 2018 at Excel, London.

2018

We are planning to hold another of our ever popular practice management days in 2018, which in 2017 included guest speaker Carolyne Crow. Watch this space!

MEET THE TEAM

MARK HARWOOD Partner

Staverton Office Tel. 01242 680000 Email: mark.harwood@hazlewoods.co.uk

Mark has been with Hazlewoods since 2003 and works solely with veterinary practices. Mark advises on a whole range of matters including profit improvement, tax planning, valuations, ownership change and buying and selling practices.

Mark regularly writes for the veterinary press and presents to the profession.

PHIL SWAN Partner

Staverton Office Tel. 01242 680000 Email: phil.swan@hazlewoods.co.uk

Phil has been a partner at Hazlewoods since the early 1990s when he formed the veterinary team. Virtually all his clients are vets and he specialises in offering the profession a wide range of advice. This includes profit improvement, pricing strategy, overhead management, practice efficiency, tax planning, incorporations and practice change. The latter area includes advising vets on goodwill valuations, company valuations, new owners, mergers/demergers and succession planning.

SUZANNE HEADINGTON Partner

Staverton Office Tel. 01242 680000 Email: suzanne.headington@hazlewoods.co.uk

Suzanne joined Hazlewoods Vet Team in January 2005 and is a Chartered Accountant and Chartered Tax Adviser. She specialises in working with veterinary practices to help improve profits, advise on pricing strategies, practice efficiency and tax planning. She also advises on practice valuations for both internal and external sales and has been involved in a number of large veterinary sales in recent years.

SIGN UP TO RECEIVE OUR BUSINESS UPDATES

Hazlewoods LLP and Hazlewoods Financial Planning LLP produce regular updates, using our expert commentary to provide you with information about our services, events and topical premium business news.

SIGN UP/UPDATE ONLINE: http://bit.ly/hazlewoods

Staverton Court, Staverton, Cheltenham, GL51 0UX
Tel. 01242 680000 Fax. 01242 680857

www.hazlewoods.co.uk / @Hazlewoods

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

Member of HLB International