Research and Development

TAX SAVING OPPORTUNITIES

November 2020

In the current difficult economic climate due to the COVID-19 pandemic, many businesses are seeking funding to assist cash flow.

Research and Development (R&D) tax credits can provide a substantial cash injection within 28 days of making a claim to HMRC.

Many companies in the agricultural and farming sector are undertaking activities which could qualify as R&D for these purposes, but they may not realise this.

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.

Examples of work in agriculture and farming that could qualify for R&D tax credits include:

- Analysis of the effects of introducing different feed to livestock;
- Testing the reduction of antibiotic usage on livestock;
- Methods to reduce the stress of livestock;
- Trials to investigate the feasibility of growing different crop varieties in particular soil or climate conditions;
- Examination of the effectiveness of different methods of pest control;
- Developing ways to extend the length of the crop growing season;
- Development of new labour-saving equipment;
- Studies to establish the effect of different combinations of nutrients on the quality of land

HOW DOES IT WORK?

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

- identifying eligible R&D projects / activities;
- identifying eligible costs associated with those activities; 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.

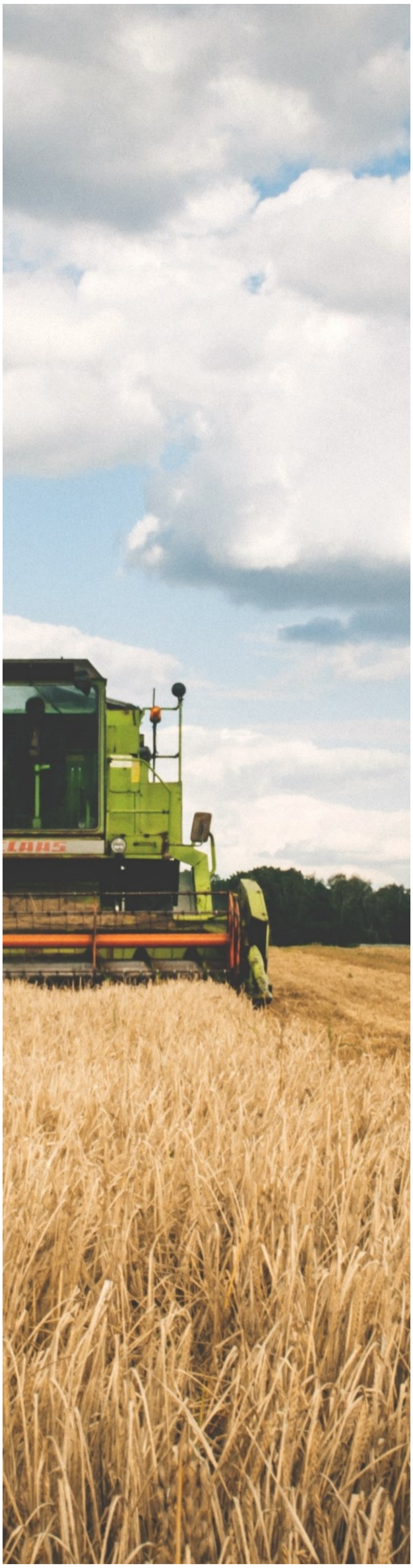
SME scheme:	**2019/20**	**2018/19**
Profitable companies		
→ Additional tax relief on qualifying expenditure*	130%	130%
→ Corporation tax rate	19%	19%
→ Effective cash value of additional tax relief	24.7%	24.7%
Loss-making companies		
→ Enhanced R&D expenditure	230%	230%
→ R&D 'surrender rate' for loss-making 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:	**2019/20**	**2018/19**
→ R&D Expenditure Credit (RDEC) – pre tax	12%	12%
→ Corporation tax rate	19%	19%
→ Effective cash value of RDEC post tax	9.72%	9.72%
* RDEC rate increased from 12% to 13% with effect from 1 April 2020.		

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 2020 must file its claim by 30 June 2022.

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 2019 can still file an R&D claim for that period provided that the amended return is filed with HMRC by 30 June 2021.

Should you incorporate your farming business?



Incorporating a business to save or defer tax or to enable a claim for R&D may be appealing, especially when profits are being retained by the business to fund future growth. However, care should be taken to consider both the commercial and the tax issues of incorporation.

HOW MUCH TAX WILL I SAVE?

The possible tax savings will depend on your current circumstances and future projections. There will be savings for many because:

- the rate of corporation tax is 19% as opposed to rates up to 45% for unincorporated businesses;
- the personal allowance for those with income over £100,000 now tapers off to zero; and
- Self-employed individuals pay National Insurance Contributions (NIC) .

Any savings you can make will depend on your specific circumstances and will need to be balanced against matters such as extra administrative costs and the company's accounts being on public record.

WHAT ARE THE MAIN ADVANTAGES?

As well as the possible tax savings other advantages include:

- dividend income can be received by family members not involved in the business;
- it may be easier to obtain finance from banks since a company can give a fixed and floating charge over its assets whereas this is not an option for individuals;
- directors/shareholders have limited liability and as such are protected against trade creditors; and
- the ability to access R&D incentives.

However, this limited liability is restricted, for example:

- Directors will be liable for losses to creditors resulting from illegal trading;
- Directors/shareholders may be required to give a personal guarantee for borrowings; and
- Liabilities outstanding at the time of incorporation will remain liabilities of the partnership/sole trader.

WHAT ARE THE MAIN DISADVANTAGES?

- The additional compliance costs of preparing statutory accounts. Also, these accounts are available to the public including competitors (although there is limited disclosure for small companies);
- There is potentially a double tax charge if the company sells assets and the shareholders wish to extract the funds from the company. This is because the company is liable to corporation tax on the sale of its assets and the shareholders have a tax liability on any funds paid out to them; and
- There are more PAYE and benefit in kind formalities with directors and employees of a company. Assets held by sole traders and partners may need a different, and more costly, tax treatment if owned by the company. Deciding what should be held outside the company is key.

CAPITAL TAXES

Farming businesses often trade as family partnerships. This gives flexibility and generally allows the farming assets to pass down generations tax efficiently. Where limited companies are introduced care is required to ensure that the reliefs available for capital gains tax and inheritance tax are considered.

CONCLUSION

There can be significant tax benefits from incorporating all or part of your farming business, especially where you are heavily involved with R&D projects. However, there are many aspects to consider and you should always seek expert advice before incorporating.

MEET THE TEAM

99%
of clients would recommend us

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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.

LUCIE HAMMOND Partner

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Lucie joined the Hazlewoods team in April 2017 and advises owner-managed businesses, private clients and trustees on business and taxation matters. She likes to work with clients to gain an understanding of the drivers of both their business and family. By taking this holistic approach, she can help the business and family work towards achieving their goals.

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I am a Chartered Tax Adviser, and joined Hazlewoods after previously being Head of Tax at a Cardiff firm and prior to that working at PricewaterhouseCoopers. From a farming background, I provide tax advice to many farmers, land owners and agribusinesses. This includes income and corporation tax planning, capital gains tax planning and inheritance tax planning.

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