



Research & Development Tax Reliefs

The tax treatment of Research and Development, Goodwill, and other intangibles in companies

Introduction

The world of business has become ever more technical with even the smallest of businesses investing in new technology, innovation and intangible assets of one form or another. Government has responded to this change in the way businesses operate with changes in the tax systems dealing with these areas.



What are we talking about?

This help sheet looks at the tax reliefs which deal with Research and Development (R&D) and the cost of acquiring or creating intangible assets, such as goodwill, patents, etc.

Research and Development

R&D is defined by reference to the Accounting Standard SSAP13 and the tax rules follow the accounting treatment. Expenditure can be either capital in nature, i.e. plant, buildings, etc, or revenue in nature, i.e. salaries and consumable items.

The definition of R&D is a difficult one requiring the exercise of professional judgement. Revenue & Customs appear to give particular weight to the fact that the standard requires there to be a significant element of innovation for R&D to be present. Therefore simply modifying or improving an existing product may not be R&D for these purposes although it is clearly product development.

In cases where R&D was not in point other forms of tax relief should be available but the R&D enhancement will not be available.

Capital expenditure on R&D assets is dealt with by way of a capital allowance previously known as Scientific Research Allowance. The allowance is given at 100% and includes expenditure on buildings used for R&D, but not generally expenditure on land and dwelling houses.

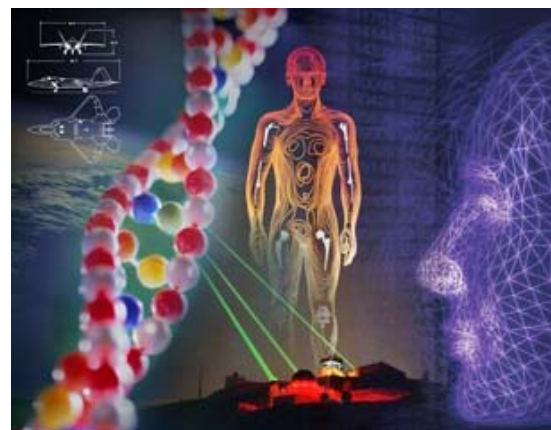
Revenue expenditure is given as a deduction from profits and may be enhanced by 50% or 25% depending on the size of the company concerned. Only 'small and medium sized enterprises' qualify for the 50% enhancement. This 50% enhancement is increased to 75% for expenditure incurred after 1 August 2008. Large

enterprises qualify for a 25% enhancement, which has been increased to 30% for expenditure incurred after 1 April 2008.

The revenue expenditure must fall within the following categories.

- Staff costs in relation to staff working directly on the R&D activities
- Consumable stores, i.e. those materials which are used up in the R&D process
- Subcontracted costs, that is where the R&D work is outsourced to certain other persons such as a university or research establishment
- Certain prototype construction costs

In the case of SME's the intellectual property created must belong to the company claiming the relief. In the case of large companies the R&D relief can be claimed by subcontractors working for a large company.



R&D Tax credits

A special extension of the R&D relief is designed to help start up companies who may not be making any profits in early years of the business when the products are still being developed but is equally applicable to anyone who wishes to claim it. The basic relief simply allows the expenditure to be deducted from profits for tax purposes. In a period when there is a loss this simply increases the loss and is of limited benefit.

To help alleviate this problem the company may claim a tax refund based on the R&D expenditure allowed although this is restricted by two factors. Firstly the tax refund is only allowed at 16% (compared with the Corporation Tax Rate of 20%, rising to 21% from 1st April 2008) and secondly the tax refund cannot exceed the amount of PAYE and NIC paid by the company on its R&D staff.



Goodwill and Intangibles

The Finance Act 2002 provides a tax deduction for expenditure in acquiring intangibles. The legislation is detailed and complex, but the following is a brief summary of the main concepts of the new relief.

The purchase or cost of creation of an intangible asset is a capital cost. In the past this would attract no tax relief against profits but would be charged to Capital Gains Tax if the asset was sold.

With effect from 1st April 2002 tax relief will be given for the amortisation of intangible assets acquired or created on or after that date in accordance with the amounts charged in the company accounts.

Therefore where a company purchases an intangible asset, say goodwill, the accounting policy adopted for writing it off will also determine the speed at which that expenditure is allowed for tax.

Where intangibles are sold the profit on sale will now be taxable income, although there is a restricted form of roll-over relief where a certain type of replacement asset is acquired.



Further Information

Monahans can assist you with all aspects of starting your business.

For further advice and assistance please contact **Geoff Don** in our Bath office who will be pleased to help on **01225 472800** or e-mail geoffd@monahans.co.uk