

SMEs and tax relief for research and development expenditure

This newsletter provides an overview of tax relief available to SMEs for research and development expenditure, in light of a recent decision by the First-tier Tribunal (Tax Chamber)

The First-tier Tri has held that debt restructurings, such as debt-for-equity swaps, should not lead to a loss of research and development (R&D) relief for a small or medium-sized enterprise (SME), as long as the investor leaves the day-to-day management of the business in the hands of the existing management team.

In a recent case, a company remained entitled to R&D relief as a SME despite a banking group being a substantial shareholder. While the group's shareholding was such that, absent any exemption, the group's balance sheet would have to be taken into account in applying the SME limits (leading the company to lose SME status), the group was an "institutional investor" and was therefore ignored for these purposes as it was not involved in the day-to-day running of the company, and did not provide the company with financial strength or advantage exceeding that of other SMEs.

SME R&D relief

SME R&D relief is given by allowing a company to deduct an enhanced percentage of its qualifying expenditure when calculating profits or losses for tax purposes. For expenditure incurred after 1 April 2015, the percentage is 230%. If the SME is loss-making, the additional loss arising from R&D relief can be surrendered in exchange for an immediate repayment from HMRC.

Qualifying expenditure

The expenditure that qualifies for R&D relief must:

- Be revenue expenditure attributable to R&D, which is related to the trade of the SME and is done by the SME or on its behalf.
- Relate to:
 - the cost of qualifying staff involved (qualifying staff are those who are directly and actively involved in the R&D including researchers or managers who plan, organise and carry out or support the R&D activity);

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The information in this newsletter is not meant as a substitute for advice on particular issues and is written in general terms. You should seek specific advice before taking any action based on the information in this newsletter.

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*This newsletter outlines the law as it stands at the date of writing in
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- consumable stores used (consumable stores include supplies directly employed in the R&D activity, essentially materials and equipment, but only where the equipment has a short useful life);
- certain subcontractor costs; or
- payments to clinical trials volunteers.

There is no geographical restriction on the R&D activities qualifying for relief. For example, there is no requirement that any proportion of the activities take place in the UK.

