Funding multiplication

Large Corporate OMB



01 May 2015

Lisa-Marie Smith and Malcolm Henderson explain the relationship between grant funding and claims made under the R&D tax credit scheme

Key Points

What is the issue?

The relationship between grant funding and R&D tax credit claims

What does it mean for me?

Many claims are incorrectly prepared and submitted due to the complexities of this commonly misunderstood area. This can lead to a drawn-out enquiry and delay in receiving a repayment

What can I take away?

An understanding of the impact of grants on an R&D claim and how to advise clients effectively

Since its establishment in 2000, the research and development (R&D) tax credit scheme has rewarded companies prepared to invest in innovation by granting relief on all qualifying spend. Rates have significantly increased throughout the scheme's lifetime and were boosted further in the chancellor's 2014 autumn statement – testament to its continued success.

In the main, a well-researched and evidenced claim will achieve a successful rebate, but one particular area has caused confusion and has been a stumbling block for a number of companies: namely, the relationship between grant funding for R&D activities and the claiming of relief on R&D spend. The complexity of funding structures involving grants has, in many cases, either significantly diminished the level of relief available or discouraged advisers from claiming on their clients' behalf altogether.

It is possible for a company to receive grant funding and still claim R&D tax credits. However, each grant could have an impact on the amount of R&D tax credits available. This article will explore the complexities of grant-related R&D claims and offer practical advice on overcoming the most common obstacles.

The effect of grants on R&D claims

To understand why grants can affect the level of relief available, the workings of the R&D tax credit scheme need a brief explanation. The scheme has two distinct elements: that for SMEs and that for large companies or, more recently, the research and development expenditure credit (RDEC).

The SME scheme

Meeting the criteria for the first one is the most beneficial financially. To qualify, companies or organisations must have fewer than 500 employees, an annual turnover not exceeding €100 million or gross assets not exceeding €86 million. The

R&D tax claim enhancement is 125% of the qualifying expenditure incurred. So the company can receive up to 32p from HMRC for every £1 it spends on R&D, with this increasing up to 33p for expenditure incurred after 1 April 2015.

Large company scheme

For large companies the rate of relief is far lower – only 30% enhancement. This means that the company will receive up to 7.9p for every £1 spent on R&D activities, increasing up to 8.8p for expenditure incurred after 1 April 2015.

The distinction between the two is important because the presence of notified state aid has a bearing on scheme eligibility and, therefore, the relief available. R&D tax credits are classified as state aid so, if even a penny is received in the form of a grant, that company is automatically excluded, subject to certain exceptions, from claiming under the SME arrangement.

Scheme eligibility

If a company that would normally qualify as an SME receives any non-project-specific grant, it may claim relief only under the large company scheme for all qualifying R&D costs. A project-specific grant will fare slightly better; only project-specific R&D costs will fall under the large company scheme, while all other qualifying costs will fall under the SME arrangement.

If grant funding is received for costs unrelated to R&D, this will not have an impact on an R&D tax relief claim. In this situation, an R&D claim can be made as normal under the SME scheme on the qualifying R&D costs, despite grant funding having been received for non-R&D costs.

However, if a company receives a grant for R&D that is not notified state aid it only falls under the large company scheme for its subsidised costs, while its remaining R&D costs will still fall under the SME alternative.

A profitable SME spending £250,000 on qualifying R&D, therefore, would receive up to £62,000 in R&D tax relief. If that company had accepted notified state aid, the claim could be reduced to as little as £15,000.

This poses the question as to whether the impact of a grant on the relief available makes it worth accepting in the first place. There is not always necessarily a straight choice. Instead the focus is on maximising both sources of aid.

Competition law and grant classification

How can you make a proper assessment of the type of claim that can be made if a company is considering whether to accept a grant? The key lies in understanding the detail of competition law. This prohibits EU member state authorities from granting state aid that distorts competition and trade in the Eurozone, enabling businesses to compete on a level playing field. The starting point for any claim directly involving a grant should be to correctly categorise the funding. The following questions can be used as a basis:

- Is the grant classified as state aid?
- Does it need to be notified?
- If it is state aid, is it covered by an exemption?

In tackling the first point – whether a grant is classified as state aid – a further set of questions can be posed:

- Is the aid provided by a member state or through member state resources?
- Does the aid favour certain undertakings or the production of certain goods?
- Does the aid distort or threaten to distort competition?
- Does the aid affect trade between member states?

If the answer to one or more of the above questions is ‘yes’, the grant is classified as state aid. Hard luck – or possibly not, because not all state aid requires notification to the EU. If it doesn’t, qualifying companies can still take advantage of the SME option for R&D relief.

In which instances, then, might state aid not require notification? The first and simplest example concerns de minimis state aid. Small amounts of funding – under €200,000 over three years (per recipient) – are exempt from notification requirements because the EU considers that minor sums have a negligible impact on trade and competition. If a company receives de minimis state aid, only the amount received in the accounting period will need to be stripped out and enhanced under the R&D large company arrangement, with the remaining qualifying expenditure

falling under SME.

Second, a number of grants can be excluded from the normal notification process through general block exception regulation (GBER), which can be used instead of de minimis for competition law purposes. In 2014, GBER was extended to cover 43 aid measures under 13 chapters, including investment aid for research infrastructures and innovation clusters – designed to give SMEs restriction-free access to vital R&D funding.

Funding programmes

Aside from de minimis and GBER exemptions, some funding programmes provide aid which does not fall under the normal notification rules. Generally, EU-administered grants are exempt from the notification process but, crucially, the conduit for the funding is all-important and requires careful distinction. Centrally-distributed EU funds are not considered to distort competition between member states, and therefore do not require notification but those that are regionally distributed – such as European regional development funding (ERDF) – do require notification and would therefore affect the value of any R&D relief claim made. In effect, this pushes them back into the state aid regime. Most grants available through Innovate UK, a widely used funding programme, are also classified as state aid.

Grants under the EU's Horizon 2020 and sixth and seventh framework programmes are examples of those that are not classified as notified state aid, and therefore do not disqualify companies from using the SME option. Horizon 2020's focus on R&D-related grants makes it an excellent source of funding for companies seeking to innovate and develop quickly, while leaving the door open for tax relief further down the line.

The status of some grants in relation to R&D tax credit scheme compatibility is ever-changing, and keeping on top of the latest developments is one of the key challenges we face. Unfortunately, there is no central source.

Striking the right balance between grants and relief is a difficult process. Whether re-investing cash into commercialisation of products, development of retail platforms, or further innovation and product development, R&D tax and grant funding savings continue to help UK businesses succeed and compete on a global scale.