dti

# APPLYING FOR R&D TAX CREDITS

## Case studies of companies’ experiences

HM TREASURY

HM Revenue & Customs

# Introduction

Thousands of companies every year use the UK's research and development (R&D) tax credits to help them develop and improve technology that reduces costs, raises quality or leads to new or improved products or services. These companies, which between them have made nearly 22,000 claims for R&D tax credit, have been able to claim almost £1.8 billion of Government support since the tax credits were introduced in 2000.

We asked some of these companies to share their experience of R&D tax credits through these case studies. As far as possible, we have passed on their comments in their own words, with some additional information we think may be helpful. We hope the lessons they've learned about claiming the credits and the difference the credits have made to their businesses will also be relevant to you, whether you're exploring the subject for the first time or are just looking for tips to make a future claim easier.

The case studies in this folder cover a wide variety of companies, sectors, and sizes. The featured firms describe how they've learned to:-

- Look for technological development across the business – not just in a special R&D department;
- Make a successful claim;
- Use the tax credits to achieve key goals for the business – growth, sales, etc by accelerating the business plan.

We are very grateful to the companies who've taken the time and trouble to provide information for the case studies, and we hope their experience will encourage you and help you to use R&D tax credits to make important changes in your business. We would welcome hearing about your experiences with the R&D tax credits, feedback on how useful these case studies were to you and also if you would like your company to be included as a case study in a future edition of this brochure. Contact details are at the end of this pack.

### What do R&D tax credits do, and can I get them?

The R&D tax credit works by allowing companies to deduct up to 150% of qualifying expenditure on R&D activities when calculating their profit for tax purposes. Small and medium size companies (SMEs) can, in certain circumstances, surrender this tax relief to claim payable tax credits in cash from HM Revenue & Customs. There are some detailed rules about how this works that you need to check before claiming. For example, only certain types of costs qualify, and there's a minimum spend of £10,000 a year. Most importantly, to qualify for relief your work should be trying to achieve an advance in science or technology through the resolution of scientific or technological uncertainty. Just catching up with what lots of other companies can do isn't R&D: the work needs to be a genuine advance (though not necessarily a huge one).

# Some useful sources of further information

- For a quick check on whether your company may be eligible for the R&D tax credits, use the R&D tax credit toolkit, at **http://www.businesslink.gov.uk/r_dtool**
- For more information see the new guide to R&D tax credits for SME companies and their advisers, at **http://www.hmrc.gov.uk/randd/intro.htm**
- This includes information on how the R&D tax credits scheme works, what can be claimed and how to claim. This guide compliments the DTI's guidelines on the meaning of R&D for tax purposes at **http://www.dti.gov.uk/innovation/randd/ randd-tax-credits/RandD-Tax-Guidelines/page14094.html**
- The R&D pages on the HMRC website (at **http://www.hmrc.gov.uk/randd/)** contain full details of the R&D tax credit legislation and also the HMRC's Corporate Intangibles Research and Development (CIRD) manual, which has the instructions that HMRC gives to their staff for examining R&D tax credit claims. See **http://www.hmrc.gov.uk/manuals/ cirdmanual/index.htm**
- The DTI's R&D Scoreboard gives information and analysis on the world's top active R&D companies. The 2006 R&D Scoreboard shows that R&D pays dividends for business. The Scoreboard can be accessed at **www.dti.gov.uk** (follow the route: Home > Innovation > Research & Development > R&D Scoreboard).
- DTI's benchmarking tools can help a business to understand what the right level of investment might be and include a simple on-line calculator which enables any company to calculate the wealth it creates – its 'value added'. This can then be compared with that of the leading companies listed in the DTI's Value Added Scoreboard at **www.dti.gov.uk** (follow the route Home > Innovation > Benchmarking Innovation Performance).
- To give feedback about these case studies, contact: **andrew.culley@dti.gsi.gov.uk** **Tel: 020 7215 3674.**

This brochure is available free of charge from **publications@dti.gsi.gov.uk** or by calling DTI Publications Orderline on **0845 015 0010** or fax **0845 015 0020**. The brochure may be ordered as a pack quoting Unique Reference Number (URN) 06/1930 or by individual case study quoting the respective URN shown at the foot of each case study. Web version is at **http://www.dti.gov.uk/innovation/randd/randd-tax-credits/page11350.html**

For general DTI enquiries ring **020 7215 5000**

# Endorsement

The following organisations have kindly agreed to endorse the brochure as a source of information for companies and their shareholders when considering the investments needed to grow and develop the business as part of business strategy: –

BCC
THE BRITISH CHAMBERS OF COMMERCE

CBI
THE VOICE OF BUSINESS

Design Council

eef
The manufacturers' organisation

Business Link

# Research whether the company qualifies for R&D tax credits

**AVIDEX LTD.**

Biotechnology spin-out
Abingdon, Cambridgeshire
41 staff
2005 Turnover £3.4k
2005 R&D £4.5m
**www.avidex.com**

**KEY ISSUES IN THIS CASE STUDY**

- Finding out if you're eligible for R&D tax credits
- The costs that qualify for tax relief
- Benefits to cash flow for a SME

## The company

Based in Abingdon, Avidex Ltd is a spin-out firm from Oxford University employing 41 people. Avidex was founded in March 1999 with an investment of £0.2m from Oxford Technology Venture Capital Trust, the University of Oxford and two business angels. Its principal activity is the research and development of novel small molecule and protein therapeutics.

Avidex carries out research into novel ways of using soluble T cell receptors in the treatment of cancer, autoimmune disease, diabetes and allergy. The company has a development compound, RhuDex®, which has successfully completed two phase 1 studies and is being developed as a potential oral drug for a variety of autoimmune diseases including rheumatoid arthritis.

The company report ending December 2005 showed a turnover of £3.4k with an R&D expenditure of £4.5m.

## Making a tax credits claim

Avidex found out that they were eligible for R&D tax credits by reading the Finance Bill 2000 legislation on Research and Development. This gave guidance on research and development for tax purposes.

Julie Singleton, Company Accountant, said: "Using the HMRC website helped our company to establish the criteria required of a SME to qualify for the R&D tax relief. It also helped us to identify exactly which costs qualify for the tax credit under the SME scheme. The area that was most difficult in the claiming process was understanding exactly what types of costs were included in the 'Consumable stores' definition."*

"Using the HMRC website helped our company to establish the criteria required"

***Technical Note: Definition of 'Consumable stores'**
As a result of consultation with business, the definition of "consumable stores" was changed to "consumable items" with effect from 1 April 2004. The term 'consumable items' covers consumable or transformable items. This includes water, fuel and power of any kind.

## Our experience

Julie continued: “Our R&D tax credit claims using the SME scheme have been successful. The only claim that went to appeal was the claim for the tax year 2002-3.

This was due to further clarification on the exact costs included under “Consumable Stores”. This covers consumable or transformable items, including water, fuel and power of any kind. We were notified by the HMRC that a number of items would not be accepted as part of the claim without further evidence. We put forward a revised claim for those items we felt satisfied the requirements of schedule 20 Finance Act 2000 of consumable stores. Following some correspondence, an agreement was reached and the R&D tax credit was amended and payment made.

Through our experience of claiming the R&D tax credits, we learnt that we should review the HMRC guidelines on R&D tax credits every year prior to making a claim, to ensure that the qualifying cost definitions have not altered in any way and that the company still meets the qualifying criteria.”

“R&D tax credits have benefited our company by improving cash-flow and... allowed us to increase the amount of research carried out.”

## The benefits

Avidex was, at the time, loss-making, and so was able to surrender part of the loss attributable to qualifying R&D, in return for a cash payment of £1m for 2004/05. Julie further said: “The R&D tax credits have benefited our company by improving cash-flow and this, in turn, allowed us to increase the amount of research carried out at the company.”

Avidex is aware that they can claim 100% capital allowances for R&D – based capital expenditure. They have not claimed for these yet as this expenditure has not been significant.

## Advice to newcomers

“Our advice to newcomers is to research whether the company qualifies for R&D tax credits using the HMRC website and then identify which costs qualify. I would recommend, particularly to small R&D companies, to claim the R&D tax credit, especially as cash-flow is extremely important to the survival of small companies.”

“Research whether the company qualifies for R&D tax credits using the HMRC website and then identify which costs qualify.”

– Julie Singleton, Company Accountant, Avidex Ltd.

# A good scheme for biotech companies

**CAMBRIDGE ANTIBODY TECHNOLOGY**

Pharmaceuticals and Biotechnology
Granta Park, Cambridge and
Palo Alto, California
300 staff
2005 Turnover £49.2m
2005 R&D £37m
**http://www.cambridgeantibody.com/html/**

**KEY ISSUES IN THIS CASE STUDY**

- Tax credits help fund early-stage loss-making Biotech companies
- Handling transition from SME to larger company R&D tax credit scheme [see Sidenote]

## The company

Cambridge Antibody Technology (CAT) is a biopharmaceutical company committed to developing human monoclonal antibody therapeutics to bring improvements to seriously ill patients' lives.

For example, the rheumatoid arthritis treatment HUMIRA®, licensed to Abbott and isolated and optimised in collaboration with Abbott is already approved and marketed in 57 countries worldwide and nine further human monoclonal antibodies originating from CAT are in clinical trials.

CAT develops products independently and in collaboration with partners. It also licenses its technologies to enable other organisations to develop new medicines. Based near Cambridge, and with a new site in Palo Alto, California, CAT currently employs 300 people.

In the summer of 2006 CAT was acquired by AstraZeneca, following a successful collaboration between the two companies for the development of antibody medicines, initially in the area of respiratory and inflammation, which commenced in 2004.

For the company's financial year ending 30 September 2005, turnover was £49.2m with an R&D expenditure of £37.0m. The R&D as % of sales was 75%.

CAT found out that they were eligible for R&D tax credits from Budget publicity. They established which of their costs would be eligible through the study of the legislation and with input from specialist tax advisors.

## The benefits

### "… additional cash for a cash consuming business is very beneficial"

John Aston, Chief Finance Officer, said: "Our R&D tax credit claims are successful. We transparently disclose the amounts of tax credit received in our annual reports. Using the SME scheme, we obtained £3.6m in 2002 and £2.6m in 2003. With continuing growth in the company, we were ineligible after 2003 for the SME scheme. The receipt of additional cash for a cash consuming business is very beneficial."

**Technical Note: Definition of SME**

For accounting periods ending on or after 1 January 2005, there is a new definition of Small or Medium Enterprise. Such a company must have:

(i) fewer than 250 employees, and

(ii) either annual turnover of less than 50m Euros or an annual balance sheet total of less than 43m Euros.

Where an enterprise is not autonomous it may be necessary to take account of the headcount, turnover and balance sheet totals of other enterprises to which it has connections.

## Advice to newcomers

### "a good scheme for biotech companies"

John said: "Our advice to newcomers to the R&D tax credits is that the SME scheme is a good scheme for biotech companies in that it provides cash back. The larger company scheme was less relevant to us as we did not have taxable profits against which to offset the enhanced losses available. We would recommend other companies who qualify as SMEs to look closely at the cash benefits available from R&D tax credits."

**Technical Note: R&D tax credits where large and small company schemes interact**

For a growing company there is normally a year of grace before it loses its SME status. For the first accounting period in which it goes over the employee or financial thresholds at the closing balance sheet date, it will normally still qualify as a SME over the whole period. But it will not do so for the next accounting period if the thresholds are also exceeded at the end of that period. This year of grace does not apply if the company loses its SME status because it is taken over by a large company, although it will qualify for the accounting period in which the takeover happens.


DTI/PUB 8433/10K/10/06/NP. URN 06/1933

dti HM TREASURY HM Revenue & Customs

# Technology design work may qualify for R&D Tax Credits

**CREACTIVE DESIGN**

Design Consultancy
Leamington Spa, Warwickshire
15 Staff
2005-06 Turnover £2.3m
2005-06 R&D £0.2m
**www.creactive-design.co.uk**

**KEY ISSUES IN THIS CASE STUDY**

- Belief that R&D in high value products is the future
- Not all design meets R&D definition
- Product development via aerodynamics and thermodynamics was eligible.

## The company

Creactive is an award-winning product design consultancy, based in Leamington Spa. It was founded in 1989 and currently employs 15 people.

The company's approach is based on the belief that product design should be an integral part of a cohesive marketing strategy and they work with their clients to produce solutions that meet specific commercial, strategic and manufacturing requirements. They have an in-depth knowledge of design trends, materials and production processes gained from projects undertaken for clients working in diverse industrial sectors, ranging from toys to telecommunications and from consumer goods to architectural hardware.

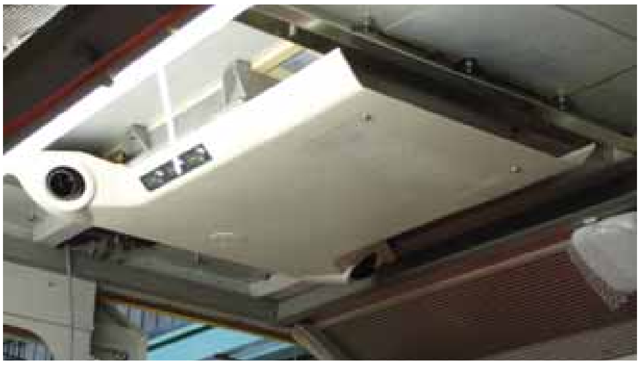
The Creactive team has won numerous awards for product design including IF Design Award, DBA Design Effectiveness Award, Minerva Award and British Design Award.

## Why R&D matters

"….R & D in high-value complex products is the future for us"

Tony Hume, Director, said: " Our company is using R & D to generate our own product range so that we become less reliant on the design consultancy marketplace which is being affected by the large increase in Far East activity and large investment in design education. I believe that R & D in high-value complex products is the future for us, allowing growth of spin-off businesses specialising in each product sector selected."

The company report ending April 2006 showed a turnover of £2.3 million with an R&D expenditure of £0.2 million. The R&D as % of sales was 10%.



## Making a tax credits claim

### “identify exactly which costs qualify”

Tony said: “ We found out that we were eligible to apply for the R&D tax credits by reading our accountants’ newsletter. We asked our accountant to help us identify exactly which costs qualify for the tax credit under the SME scheme. The area that was most difficult in the claiming process was deciding what qualifies as R&D for taxation purposes and convincing HMRC that our project was eligible for the tax credit.”

## Our experience

### “The R&D combined the study of aerodynamics and thermodynamics.”

Tony said: “Our main R&D tax credit claim using the SME scheme was successful but claims for other smaller projects were not considered by HMRC to meet the R&D definition as they were not innovative.

“The successful project was to research and develop a product that would cool train drivers/operators directly using streams of chilled air but with very low energy consumption. The R&D combined the study of aerodynamics and thermodynamics to provide a viable solution to the product design. The final product is an electrically powered cab air-cooling system. Apart from the air blowers it has no moving parts, no refrigerants and virtually no maintenance with 10% of the energy consumption of a traditional cab air conditioning system. Cooled air is produced using electronic devices and the cooled air is carefully ducted to the driver’s preferred location.

“The main lesson we learnt was the fact that the definition of R&D for taxation purposes is different from the more widely used definitions in industry. We benefited from the R&D tax credit as it allowed us to invest more money in R&D and this, in turn, strengthened our product range.”

Creactive was not aware that they can claim 100% capital allowances for R&D based capital expenditure, however, they rely on their accountant to be fully informed.

## Advice to newcomers

“My advice to newcomers: don’t assume that your project will qualify for the R&D tax credits; check first with your accountant and with HMRC. I would recommend other small companies to claim the R&D tax credit especially as cash-flow is important to the survival of small companies.”

**Technical Note: Definition of R&D**

R&D for tax purposes takes place when a project seeks to achieve an advance in science or technology. The activities that directly contribute to achieving this advance in science or technology through the resolution of scientific or technological uncertainty are R&D. Activities which do not directly contribute to the resolution of the project’s scientific or technological uncertainty are not normally R&D. An advance in science or technology means an advance in overall knowledge or capability in a field of science or technology (not a company’s own state of knowledge or capability alone). A more detailed explanation of some of these concepts is available in the 2004 DTI guidelines available at: http://www.dti.gov.uk/innovation/randd/randd-tax-credits/RandD-Tax-Guidelines/page14094.html

# R&D in high performance engineering

**CROMPTON TECHNOLOGY GROUP LTD**

Design and manufacture of products based on advanced composite material technology
Banbury, Oxfordshire
60 staff
2005 Turnover £5.2m
R&D £0.4m
**www.ctgltd.co.uk**

**KEY ISSUES IN THIS CASE STUDY**

- Its about resolving technical uncertainty, not just "men in white coats"
- Increasing process output could be eligible R&D
- Acceleration of business plan, based on improved cash flow
- Use experienced accountants and liase with HMRC

## The company

Crompton Technology is a high performance engineering company specialising in design and manufacture of products based on advanced composite material technology. They are a specialist in the development and production of advanced composite components for a number of sectors including magnetic resonance imaging scanning (MRI), aerospace and defence, performance automotive, subsea and turbo machinery. In addition to the development and manufacturing technologies, the company have in-house test facilities that enables them to accelerate the introduction of their products into their chosen marketplace.

Based in Banbury, this small company employs 60 people. It was set up 5 years ago from management buy-in of Crompton Plastics (which was founded in 1969).

The objective of the company's R&D is focused on developing new products based on composites, particularly filament winding technology so that they can bring new innovative products to the market as soon as they possibly can.

The company report ending December 2005 showed a turnover of £5.2 million with an R&D expenditure of £0.4m. The R&D as % of sales was about 8%.

## Eligible costs

Scott Roberts, Managing Director, said: "We have an external professional accountancy firm who gives us expert advice and they told us that we were eligible. In discussion with our accountants, we drew up a spreadsheet and identified all the employees who work on R&D, the % time spent on these activities, how much they cost the business, spend on materials, etc. Our accountants did an audit of our company and scrutinised our spreadsheet."

## Making a tax credits claim

"My company philosophy is that we must do more R&D to bring more new products into the market and quickly"

Scott said: "I found the claiming process to be incredibly straightforward. I am a company director; I know how to run my business. I am not an accountant but I work with my accountants on the basis that they are experts in accountancy. It is for my accountants to ensure that our figures are correct, to submit our corporation tax return to HMRC and to understand the intricacies of the R&D tax credit relief. But, I sit down with the accountant so that he can explain in plain language what the implications are to my business.

"I also attended a number of presentations given by HMRC staff that spoke about the R&D tax credits and the process of making a claim. They explained how the R&D tax credit was introduced by the Chancellor to incentivise companies to spend more money on R&D and thus help increase the UK's competitiveness in the global marketplace.

"My company philosophy is that we must do more R&D to bring more new products into the market and quickly. And the more R&D we do, the more tax relief we can claim.

"We have claimed the R&D tax credits since the beginning of 2003 and our claims are successful".

# Our experience

"It is about being innovative, resolving a technical uncertainty."

Scott further added: "I have personally learnt that if you get the right help by appointing a professional accountancy firm, the claiming process is easy. If I want my company to develop new products, penetrate new markets, then we

must innovate and do more R&D. I learnt what R&D meant as far as taxation is concerned. This is crucial – R&D is not about pure research or even about scientists in white coats working in laboratories. The definition of R&D for taxation purposes to us means we can develop new products based on composite materials. It is about being innovative, resolving a technical uncertainty."

**Increasing process output could be eligible R&D**

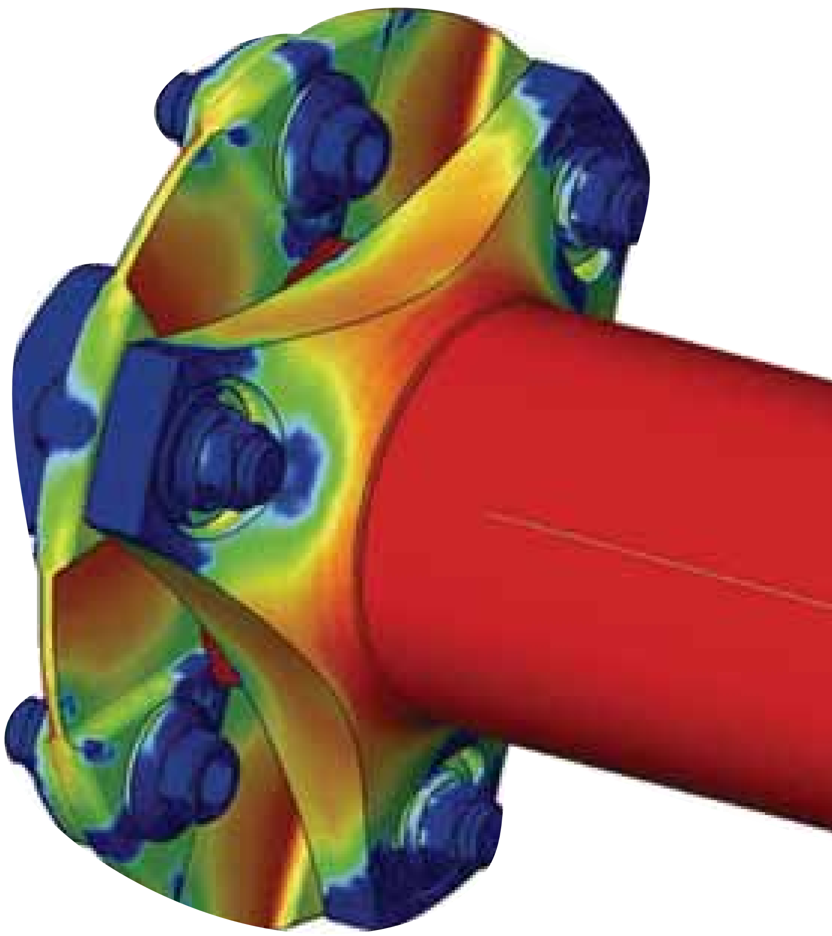
"So, if you have a machine and it makes a product but its output is only 10,000 and you have an opportunity to export 100,000 overseas, then you have to adapt your machine to greatly increase its efficiency. This is a step-change in the way you manufacture and this is development you may be able to claim tax relief for."

**Level and amount of tax credit received**

Crompton Technology claim the R&D tax credit using the SME scheme and they outlined that in:

- 2003, their R&D spend was £185k and this meant they could claim 150% or an extra £93k as a deduction from the company's taxable profits.
- 2004, their R&D spend was £223k and they successfully claimed an extra £112k as a deduction from taxable profits;
- the 2005 claim will be based on an R&D spend of £396k.

Scott said: "We spend substantial amounts of money on development activities. We have introduced some new products into the aerospace and defence sector which has enabled us to grow from one or two contracts to winning some significant contracts within the last 18 months."

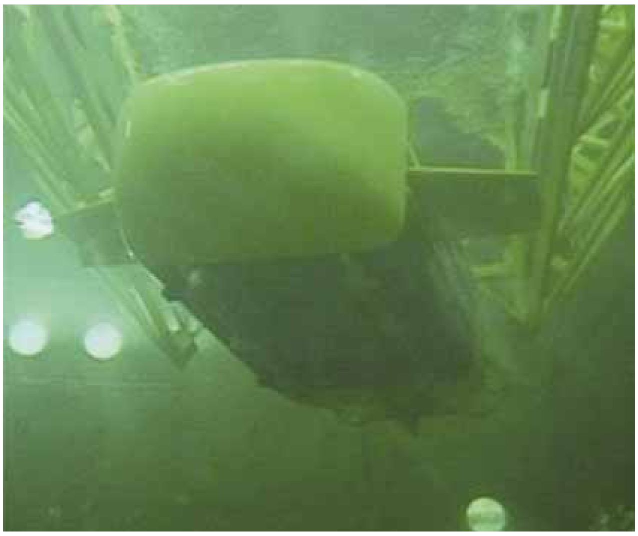


## The benefits

### "This allows me to accelerate my business plan."

Scott said: "My business strategy incorporates the fact that I want my business to grow, year on year. Undertaking R&D activities helps us to develop the technology into new products using new robust manufacturing procedures. The more R&D I do, the more tax relief I can gain. And the more relief that we get, the less tax we pay. I have gone the extra step: if you are confident then you can predict what tax relief you will get at the start of the financial year, based on previous years' experience, this gives you the benefit of being able to forecast your cashflow. This allows me to accelerate my business plan – I can employ more staff, buy new machines and develop new technologies and bring new products and penetrate markets more quickly. So, the R&D tax relief is an excellent incentive – a small stimulation from Government makes a big difference to my company and our growth rate."

Crompton Technology claims 100% capital allowances for R&D based capital expenditure.



## Advice to newcomers

### "get an expert you can trust and rely on."

Scott said: "

- Get an accountant who has experience of helping companies access the R&D tax relief, and knows what the process involves.
- Sit down with the accountant with the ethos that – this is my business and I know how to run it. You are an accountant. You deal with the HMRC, it's your job to find out about the rules and the intricacies of applying them. He should have the ability to explain in plain language what the implications are for your business.
- Don't try and become an expert in accountancy or taxation if you are running your business – get an expert you can trust and rely on."

## Recommend other companies to apply

### "Do it as ...part of your growth strategy".

Scott said: "Yes, I would recommend others to apply. But, before you become all excited – this is my advice. Don't just go through the process of making a claim. Do it as part of your business strategy, as part of your growth strategy. Understand how you will use the tax relief to grow your business. If making a tax claim on the R&D activities is incorporated in your business plan, you will go through the process of claiming it anyway. But, the tax relief that you get is an extra bonus. Ask and understand through your accountant what the R&D tax credit is all about and use the relief that you gain to grow your company."


DTI/PUB 8425/10K/10/06/NP. URN 06/1935

dti HM TREASURY HM Revenue & Customs

# Long-established knife manufacturer uses R&D

**HARRISON FISHER & CO LTD**

Knives Manufacturer
Sheffield
90 staff
2005 Turnover £4.6m
2005 R&D £0.1m
**www.harrison-fisher.co.uk**

**KEY ISSUES IN THIS CASE STUDY**

- Relief for Design costs which resolved technological uncertainty
- Small claims worth the effort
- Use finance professionals in the first instance

## The company

Harrison Fisher & Co Ltd operates under the trading name of Taylor's Eye Witness, founded by John Taylor in the early years of the 19th Century. Harrison Fisher manufactures and distributes kitchen knives, gadgets, pens and scissors.

The trademark, "Eye Witness", was first registered in 1838. The inspiration for the choice of "Eye Witness" as a trademark is believed to be Shakespeare's line in Henry IV – "No eye hath seen better". Today Harrison Fisher's products are sold in many countries across the world, often as private label programs for leading retailers.

This Sheffield-based small firm employs 90 people. The company report ending December 2005 showed a turnover of £4.6million with an R&D expenditure of £110k. The R&D as % of sales was about 2%. (See footnote 1)

Harrison Fisher found out that they were eligible for the R&D tax credits from various government reports and circulars. Their auditors were also able to provide further clarifications.

**Technical Note: Minimum spend on R&D**

To qualify for relief, a company must spend more than £10,000 on qualifying R&D expenditure in a 12-month accounting period. The £10,000 is adjusted proportionately if the accounting period is not 12 months long.

## Making a tax credits claim

### Relief for design costs which resolved technological uncertainty

Robert Waller, Financial Controller, said: "Our auditors have helped us in developing our understanding of the claiming process. We have had problems deciding which costs should be classified as R&D as defined under the taxation rules and which costs fall within our normal product development. We have occasionally asked for assistance from our auditors and they have claimed for the R&D tax credits, as part of submitting our corporation tax return to HMRC. The experience taught us that it is worth educating some key employees on the process of claiming in order to obtain a lower tax bill. Our claims have been successful. We obtained R & D tax relief to cover certain design costs which directly contributed to resolving technological uncertainty of using new materials and processes."

### Small claims are worth the effort

"We applied for tax relief using the SME scheme and the tax claims have been in the order of £10k each year. Robert said: " This small sum of tax relief per year equates to the rates charged for our main premises in Sheffield. So, in effect, we have occupied rates-free premises for the past few years, which is helpful."

Harrison Fisher is aware that they can claim 100% capital allowances for R&D based capital expenditure. However, to-date they have not claimed for these yet as this expenditure has not been significant.

## Advice to newcomers

### Use finance professionals in the first instance

Robert said: "My advice to newcomers: use your auditors or professional accountancy advisors in the first instance at least. I would recommend other small companies to claim the R&D tax credit because once the original groundwork has been done it is fairly straightforward. Why waste the chance of a lower tax bill for the sake of a little planning and recording of work done?"

Disclaimer- please see accompanying folder (URN 06/1930)

DTI/PUB 8431/10K/10/06/NP. URN 06/1936

dti HM TREASURY HM Revenue & Customs

# Healthcare company's R&D tax credits help cash flow

**INTERCYTEX LTD**

Healthcare
Manchester
68 Staff
2005 Turnover £0
2005 R&D £3.4m
**www.intercytex.com**

**KEY ISSUES IN THIS CASE STUDY**

- Straightforward calculation and application process
- Value of claims far outweighed extra cost of claiming
- Reduces time from research to market

## The company

Intercytex is an emerging healthcare company developing cell therapy products for the woundcare and aesthetic medicine markets. Intercytex has proprietary expertise in cell therapy, which is being applied to create products that harness the innate ability of human cells to regenerate and repair the body. Intecytex was founded in 1999 by Dr. Paul Kemp who was closely involved in the development of one of the first generation of cell therapy products approved for the woundcare market. Intercytex is applying its expertise in this area to develop a second generation of products, which are expected to deliver improved performance in terms of ease of manufacture, cost of goods, storage and ease of use in the hands of clinicians. This proprietary experience and expertise is also being used to bring the benefits of cell therapy to the field of aesthetic medicine.

The Company has a broad patent base protecting its product portfolio comprising both inventions generated in-house and those in-licensed or acquired from third parties.

Intercytex has four products in development, all of which are derived from unmodified human cells, relating to the active stimulation of repair in chronic wounds, hair regeneration, facial rejuvenation and a durable and robust skin replacement.

From 1999 to 2005 Intercytex was a venture capital funded company. In January 2006 the Company successfully floated on the Alternative Investment Market. Based in Manchester, it employs 68 people.

The Company report ending December 2005 showed zero turnover, with an eligible expenditure for the R&D tax credit claim of £3.4 million.

## Making a tax credits claim

### "straightforward"

Mike Panteli, Finance Controller, said: "We found out from accountancy journals and the Financial Times that we were eligible for the R&D tax credits. We established which of our costs were eligible using the HMRC's guidelines and advice from tax professionals. The calculation to claim the R&D tax credit is straightforward, however we also rely on a firm of tax advisers to complete our corporation tax returns."

## The benefits

### "value of the claims far outweigh [the cost of] any additional calculations"

Mike said: "Our R&D tax credit claims are successful. We have had queries from the HMRC; however, these have been straightforward to deal with. Our experience of claiming the R&D tax credits shows that it does add to the admin burden; however, in our case the value of the claims far outweigh any additional calculations, form filling and professional fees".

Intercytex has claimed the R&D tax credit under the SME scheme; their 2004 claim, which has been settled was for £0.6 million in cash (under the payable credit) and the provisional calculation for the 2005 claim is for £0.7 million.

Mike said: "As an R&D company, we depend heavily on non-trading cash flows to enhance our product development and the R&D tax credits contribute towards this. It assists the company in recruiting the best available research staff, development of new and innovative products and reduces the timeline from pure research to marketing of products".

Mike said: "We claim the 100% capital allowances for our R&D-based capital expenditure."

## Advice to newcomers

### "Reduces timeline from research to market"

Mike's advice to newcomers to R&D tax credits is "No matter what the size of your R&D eligible spend, claim the credit! Because as you grow so will the R&D tax credit. I would strongly recommend R&D tax credits to similar business. Why:

- Straightforward calculation and application process.
- Enhances R&D process.
- Reduces timeline from research to market."


DTI/PUB 8422/10K/10/06/NP. URN 06/1937

dti HM TREASURY HM Revenue & Customs

# Developing analytical services can qualify for R&D tax credits

**KERNOW ANALYTICAL TECHNOLOGY**

Laboratory analytical services
North Petherwin, Cornwall
7 Staff
2005 Turnover £0.5m
2005 R&D £0.08m
**www.kat-lab.com**

**KEY ISSUES IN THIS CASE STUDY**

- Grants – when SME R&D tax credit relief cannot be claimed
- Detailed project logs make it easy to define R&D spend
- R&D tax credits mean the company can compete effectively with much larger overseas organisations

## The company

Since its formation in 1996, Kernow Analytical Technology, KAT, has developed a portfolio of highly specialised non-routine laboratory analytical services, primarily serving global upstream oil and gas industries.

KAT is a small company based in North Petherwin, Cornwall, and employs 7 people. They have a wide range of testing services, and highly innovative, specialist capital testing equipment. It also has the ability to design and build bespoke test configurations to meet customer requirements. Their longer-term objective is to become recognised as a worldwide leader in advanced instrumentation and test protocols for flow assurance measurements.

The company report ending October 2005 showed a turnover of £0.5 million, with an R&D expenditure of £80k (including staff costs); the R&D as % of sales was 17%.

## Eligibility

KAT and its sister company, Kernow Instrument Technology (KIT), have both received DTI SMART awards. The possibility of claiming tax credits for other R&D work was highlighted in the process of applying for the initial grant.

**Technical Note: Grant for Research and Development**

The Grant for Research and Development was introduced on 1 June 2003 as a replacement for the former Smart scheme. It is a DTI product delivered by the Regional Development Agencies. The grant encourages small and medium-sized businesses to research and develop technologically innovative products and processes by sharing some of the costs and risks associated with R&D projects and fostering recognition of the importance of undertaking R&D.

# Making a tax credits claim

## Importance of keeping detailed project logs

Dr Neil Chilcott, Managing Director, said: "With the guidance notes issued by HMRC, we can identify projects that clearly fall within the definition of legitimate R&D spend for the purpose of claiming tax credits. As part of our normal administration, we routinely keep detailed logs of staff time spent on a project, consumables purchased, etc. It is therefore quite easy for us to derive and quantify R&D spend for any given project.

"We submit the details of our R&D spend at the end of our financial year to our accountant who then sends the information off with our corporation tax return.

"The fact that our R&D activities are quite clearly defined along with our other management procedures make it a relatively painless exercise to claim for R&D tax credits."

# The benefits

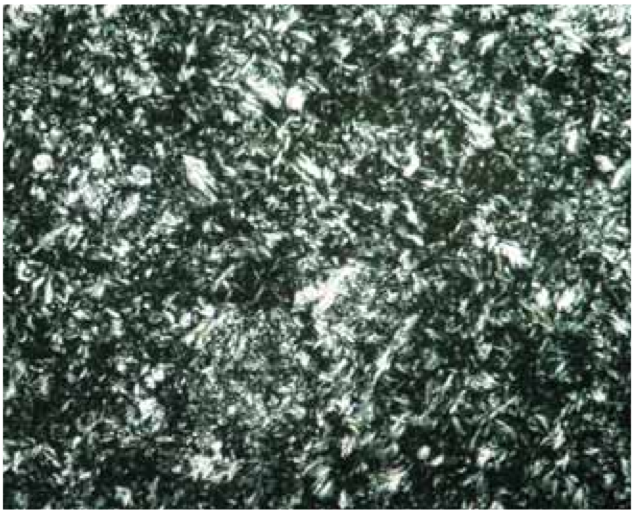
- the company can compete effectively with much larger overseas organisations

Neil points out that KAT has remained competitive against much larger organisations, in Europe and the USA, by the continual development of high quality, technologically innovative flow assurance test solutions. Neil said: "Without the support of the SME R&D tax credits, it would have been economically impossible for the company to make the necessary investment in such development."

Neil said: "I am aware that we can claim 100% capital allowance for R&D-based capital expenditure; however, the opportunity to claim this has not yet arisen."

# Recommend other companies to claim

"The simplicity of claiming for R&D tax credits makes it such an attractive scheme and based on our experiences, to date, we would wholeheartedly encourage any company in a similar position to ourselves to explore the scheme further and, if appropriate, take advantage of the opportunities available."



Wax crystals seen through a microscope with cross-polar filters, used by KAT for determining the wax appearance temperature of crude oils and gas condensates

**Technical Note: most grants and other cases when SME R&D tax credit relief cannot be claimed**

The SME scheme for R&D tax relief is sufficiently generous that it is considered by the European Union to be a notifiable State Aid. Where an R&D project has received funding which is another notified State aid then no expenditure by the company on that project can qualify for the R&D SME relief. Notified state aids are usually government-funded grants such as the Grant for Research and Development (which replaced the SMART award in June 2003). But not all government grants are notified State aids – for example, some funding under the SMART label (e.g. grants for feasibility studies and micro-enterprise award was not). If clarification of the status of a grant is needed, the body that has provided or arranged the funds should be able to help. Where the company has benefited from a state aid for a project which disbars it from claiming the R&D relief under the SME scheme it can, for expenditure incurred in accounting periods beginning on or after 9 April 2003, claim under the large company scheme for that project.


DTI/PUB 8430/10K/10/06/NP. URN 06/1938

# Software company receives R&D tax credit

**NONLINEAR DYNAMICS LIMITED**

Software
Newcastle
42 Staff
2004–05 Turnover £3.0m
2004–05 R&D £0.9m
**www.nonlinear.com**

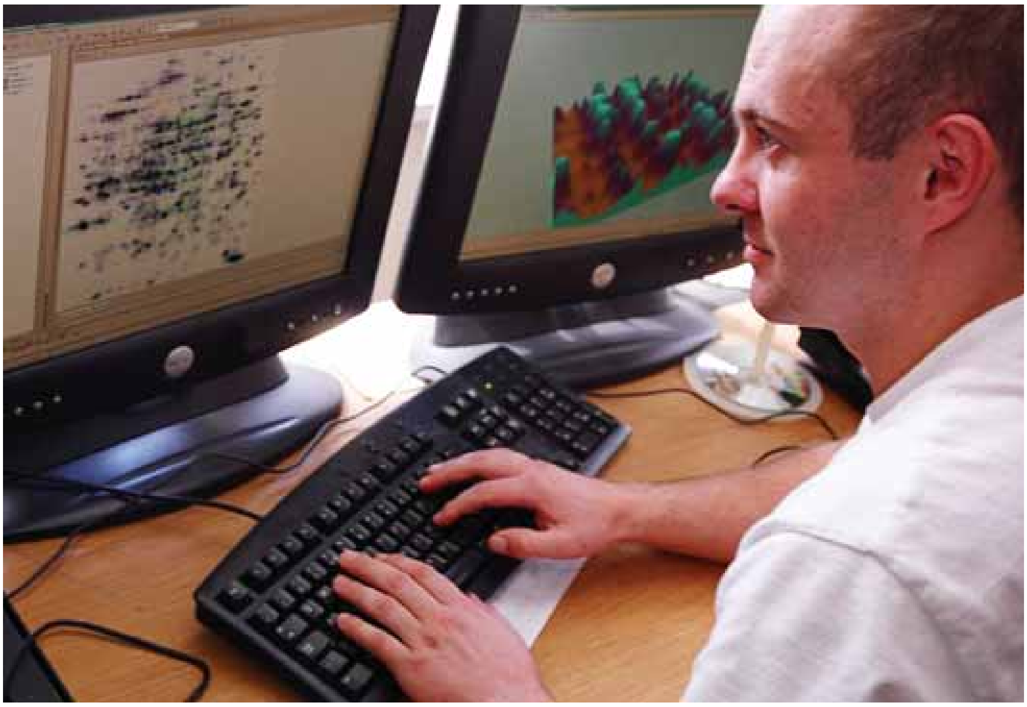
**KEY ISSUES IN THIS CASE STUDY**

- Need for good management information systems
- Cash payment from HMRC at 24% of qualifying R&D costs
- Claiming shows that a company is very "commercially aware"

## The company

Nonlinear Dynamics Ltd, based in Newcastle Upon Tyne, is a leading provider of bioinformatics software. Bioinformatics – managing and analysing biological data using advanced computing techniques – is one of the important technologies for the drug discovery, clinical diagnostics and medical research industries, and hence is of growing importance to life science firms. The software products directly support proteomics (study of proteins) and genomics (study of genes).

Founded in 1989, Nonlinear Dynamics' business model relies on quality products and excellent service. They are a small company employing 42 people.



A software engineer testing a new release of software code prior to it being released to customers.

The company report ending March 2005 showed a turnover of £3 million with an R&D expenditure of £0.9 million, well above industry average level. The R&D as % of sales was 30%.

The company directors and their external tax advisors have both been aware of the R&D tax credits and taken advantage of the tax credits since they were introduced.

# Making a tax credits claim

## Completing subsequent claims should be straightforward

Nonlinear Dynamics undertook an exercise with their external tax advisors based on their understanding and interpretation of the legislation. Duncan Barrie, Finance Director, said: "The whole process of making a claim has been relatively straightforward. Clearly the first year is the most onerous – establishing the basis for the claim and processing all the required information. However, once that was set up the nature of our business hasn't changed dramatically so the process has been one of broadly repeating this exercise and ensuring continued compliance."

# The benefits

## £ CASH PAYMENT

Duncan said: "Our R&D tax credit claims are very successful and a great motivation to continue to invest in R&D. At the operational level, the information required to claim the R&D tax credits reinforced the need for robust audit trails and good management information within our company."

Duncan pointed out that, with the weighting allowed, the company has claimed approximately £1.4m of R&D tax credit, under the SME scheme. Duncan said: "As we unfortunately made a taxable loss last year we were able to use the R&D tax credit claim to obtain a cash refund for previously paid tax by surrendering the loss, albeit at 24%."

Duncan said: "We are aware that we can claim 100% capital allowance for our R&D – based capital expenditure; we along with our tax advisors are currently pursuing this as it has become a material item this year."

# Advice to newcomers

Duncan's advice to newcomers is: "Obtain good external advice and utilise the tax credit scheme. It is relatively simple and a major benefit to R&D–intensive qualifying companies and well worth the investment of time to pursue."

# Definitely recommend others to apply

## Claiming shows that a company is very "commercially aware"

We would definitely recommend other companies to claim the R&D tax credits. There is a tangible benefit and it shows to external investors that the company is very commercially–aware."


DTI/PUB 8429/10K/10/06/NP. URN 06/1939

dti HM TREASURY HM Revenue & Customs

# R&D in nanomaterials design and application

**OXONICA PLC**

Nanomaterials
Kidlington, Oxfordshire
58 staff
2005 Turnover £1.2m
2005 R&D £1m
**www.oxonica.com**

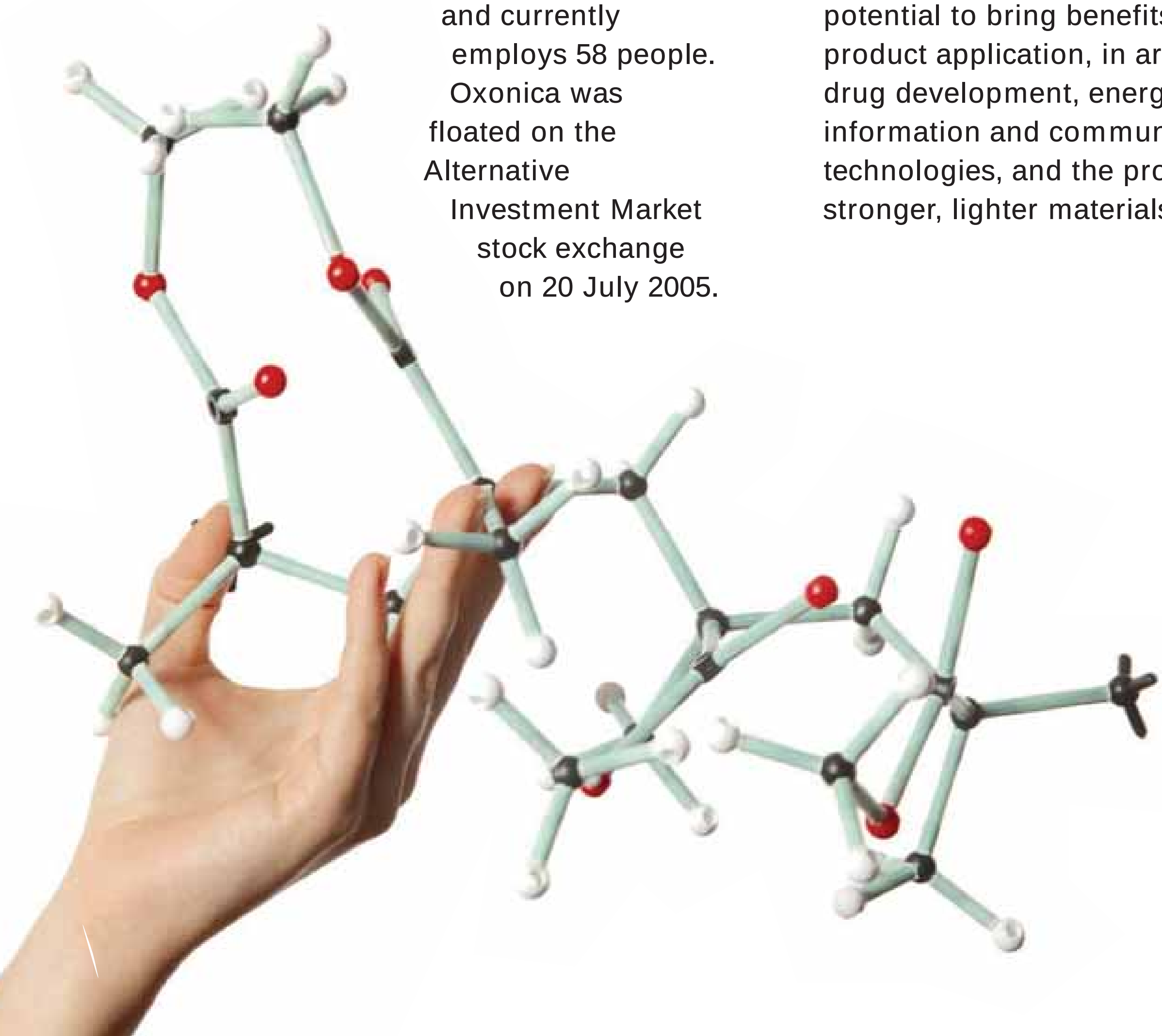
**KEY ISSUES IN THIS CASE STUDY**

- External accountant was the influencer
- Cash refund good for cash flow and incentive to invest

## The company

Oxonica is one of the leading European nanomaterials groups, with products already launched into international markets. It was spun out from Oxford University in 1999 and currently employs 58 people. Oxonica was floated on the Alternative Investment Market stock exchange on 20 July 2005.

The Group's mission is to develop innovative commercial solutions for international markets using their expertise in the design and application of nanomaterials. Nanotechnology is widely seen as having potential to bring benefits to many areas of product application, in areas as diverse as drug development, energy and environment, information and communication technologies, and the production of stronger, lighter materials.



## Business Model

Oxonica's business model is to focus on its strength in identifying market opportunities, securing intellectual property and introducing new technology to market. They have three operating divisions covering energy, healthcare and materials. Their commercial products include:

- a fuel–borne nanocatalyst for diesel engines which reduces fuel consumption by savings of 5–10% and reduces particulate emissions by up to 15%;
- a photostable UV absorber that provides enhanced and longer lasting protection against UVA in sun–care and anti–ageing products.

In addition, Oxonica is working to generate a range of future product applications. These include additional fuel saving additives, marker technology for the clinical and life science diagnostics markets, further UV protection applications and new products for plastics and coatings, transparent conducting films and security markers.

The company's report for the year ending December 2005 showed a turnover of £1.2 million with an R&D expenditure of £1m; the R&D as % of sales was 83%.

## Making a tax credits claim

### Influenced by external accountant

Nicola Slater, Financial Accountant, said: "We found out that we were eligible for the R&D tax credits through our external accountant and with their guidance put together a claim for all our eligible costs."

## Our experience

Nicola said: "Our R&D tax credits claims are successful. One of the lessons the company learnt was to identify what activities qualified for the claim and being able to determine the eligible costs of R&D activities for taxation purposes."

## The benefits

Oxonica has claimed the R&D tax credits using the SME scheme and Nicola said: "Our company benefits from the R&D tax credit scheme as we obtain a cash refund which is good for our cashflow. Our advice to newcomers to R&D tax credits is obtain advice from an accountant before applying."

Nicola said: "We already claim for the 100% capital allowance for our R&D–based capital expenditure."

## Recommend other companies to apply

### Cash refund good for cash flow and incentive to invest

"We would recommend that other companies make a claim for the R&D tax credit, where possible. It provides a much – needed cash incentive for new research companies like ourselves who automatically invest heavily in R&D activities".

Disclaimer- please see accompanying folder (URN 06/1930)
Department of Trade and Industry. www.dti.gov.uk 
DTI/PUB 8428/10K/10/06/NP. URN 06/1940

# Credits funded development work on electronics process

**PELIKON LIMITED**

Electronics
Caerphilly and Cambridge
46 staff
2005 Turnover £1m
2005 R&D £0.5m
**www.electronicstalk.com/news**

**KEY ISSUES IN THIS CASE STUDY**

- Three successful years of claims, received in timely fashion
- Engaging an external advisor helped identify all qualifying activity, and smoothed process
- Make detailed record, at the time of activity

## The company

Pelikon is a UK pioneer in the design and manufacture of printed segmented electroluminescent touch displays, backlights and specialised driver electronics that can be used in a broad range of applications. Pelikon pSEL(tm) Intuitive Touch Displays make complex consumer appliances and electronics devices easier to use.

Pelikon Ltd. was founded in September 2000 backed with an initial financing of £3m led by Advent Venture Partners. In 2001 the advanced displays team from Cambridge Consultants Ltd (CCL) joined Pelikon and worked on a new type of flexible display. In 2005, Pelikon raised a further £5m in preparation for a prepared IPO flotation.

This small firm employs 46 people and has its manufacturing, finance & administrative functions in Caerphilly while its R&D, sales & marketing functions are located in Cambridge.

The Pelikon Intuitive Touch Display, a printed flexible electroluminescent display panel

## Objective for R&D

Pelikon's objective for undertaking R&D was to define, develop and implement an automated process that can reliably and consistently produce a printed ink multi-layer display assembly with:

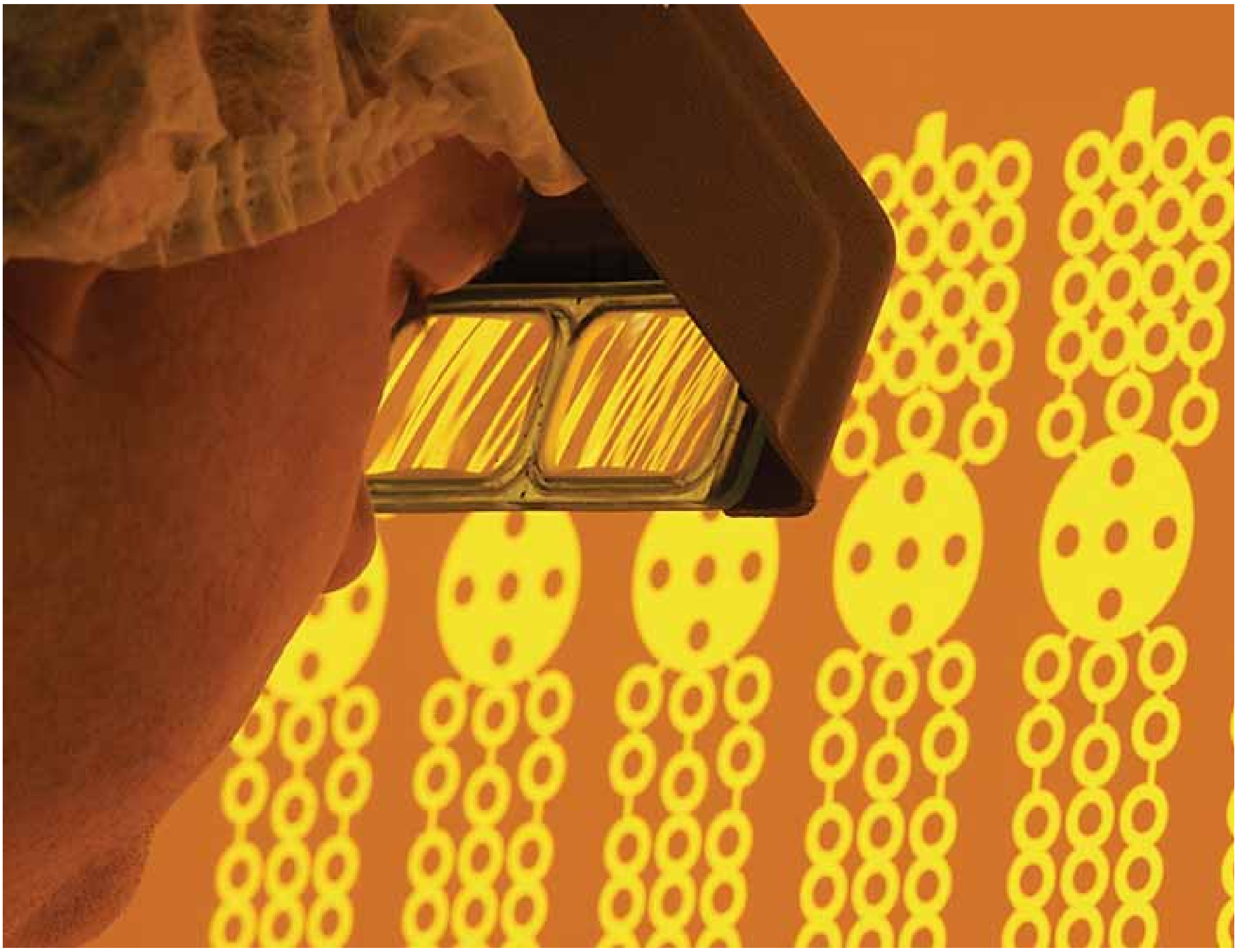
- new display driving electronics
- new market, technology and specification compliant material
- the ability to reliably verify the display performance characteristics by fully automating the test.

The company report ending December 2005 showed a turnover of £1.0m with an R&D expenditure as disclosed in their Financial Statements of £0.5m, well above industry average level. The R&D as % of sales was 50%.

Simon O'Sullivan, Finance Director said: "We were made aware that we were eligible for the R&D tax credits by the Venture Capitalist backers of Pelikon Limited. We referred to the published HMRC guidelines which gave us an indication of the extent to which various costs would be eligible.

Establishing that we perform R&D, which is eligible for a tax claim, was reasonably straightforward; matching the costs incurred by that R&D activity was slightly more problematic. Engaging an external professional tax advisor for the last 3 claims meant we could identify and tie all the qualifying costs with the associated R&D activities."

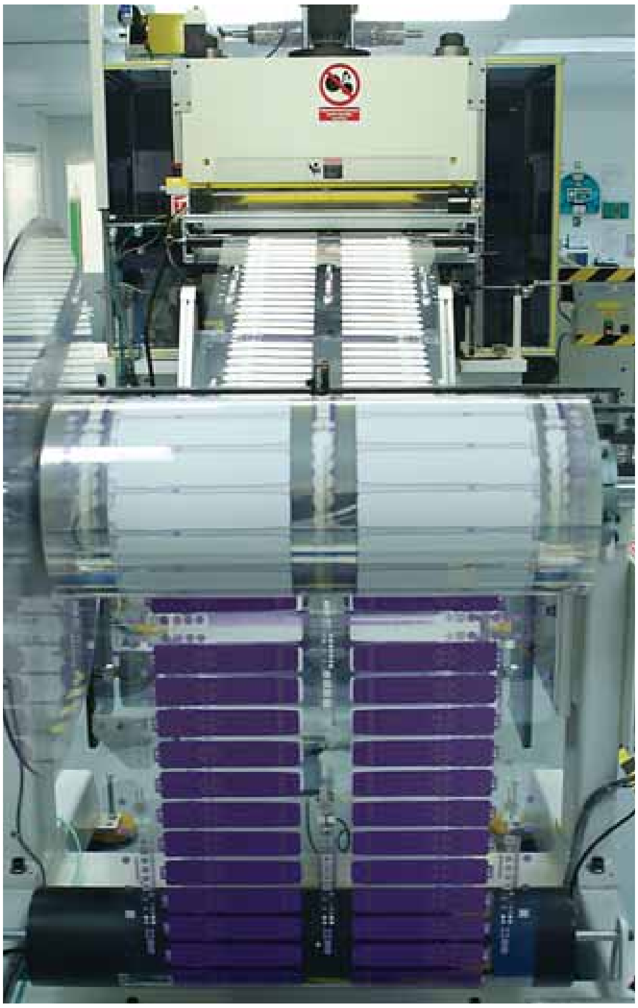
"Establishing that we perform R&D .... eligible for a tax claim was reasonably straightforward"



Final inspection of Pelikon Backlites off the print line

## Making a tax credits claim

"The claiming process itself was straightforward. The only unknown was the commitment from HMRC in dealing with the claim, though in any event they have, to date, been dealt with in a timely fashion."



Sheets of Pelikon Backlites ready to go through die-cut process

## The benefits

### Three successful years of claims

Using the SME scheme, Pelikon received payable credit:

- £13.5k year/ending Dec 2001
- £0.2m for years ending Dec 2002 and 2003
- £0.3m for the year ending Dec 2004
- a draft claim of £0.2m for the year ending Dec 2005 has been made; HMRC is currently awaiting signed Financial Statements from the period.

Simon said: "We would definitely state that our R&D tax credit claims have been successful so far."

"Our experience of claiming R&D tax credits for 2003, 04 & 05 was a smooth process. The time resource internally was kept to a minimum by involving only those people at Pelikon absolutely necessary to contribute to the claim compilation."

### Engaging an external advisor helped identify all qualifying activity, and smoothed process

"We benefited from engaging an external advisor. Their experience & technological understanding certainly helped us identify all the R&D activity. They were able to help us tie together the view of what constitutes R&D with the eligible costs associated through each project".

## Helped us minimise risk of claim being declined

"Their experience gave us confidence that we were claiming for all eligible costs and not making any common errors with the claim that would have caused it to be declined. There will have been learning from the smaller, perhaps understated 2001 claim which was submitted without any external advice."

Simon said: "We are aware that we can claim 100% capital allowances for our R&D-based capital expenditure but have not claimed thus far as this has not been a substantial expenditure."

## Advice to newcomers

### Make detailed record, at the time, of activity

"Our advice to newcomers to R&D tax credits would be:

- seek clarification on what constitutes R&D for claiming the tax credits
- identify at the conception of a project whether it will be eligible
- make notes at each stage of the project to ensure that all information on resources allocated to the project is identified and recorded. With staff turnover, the history of a project can become skewed with undue time being spent on finding information from files as opposed to keeping a log along the way
- use external advisors with a proven track record, to put the claim together."

## Recommend others to claim

"We would recommend other companies to claim the R&D tax credits. The significance of the cash injection cannot be emphasised enough. It allows further R&D to be carried out."


DTI/PUB 8424/10K/10/06/NP. URN 06/1941

dti HM TREASURY HM Revenue & Customs

# R&D in advanced surveillance systems and products

**SYSTEMS ENGINEERING & ASSESSMENT LTD**

Advanced surveillance systems
Frome, Somerset
200 staff
2004-05 Turnover £19.0m
2004-05 R&D £2m
**www.sea.co.uk**

**KEY ISSUES IN THIS CASE STUDY**

- Time-consuming to assess which activities, on which projects, are allowable
- Can claim some time of staff who only work part time on R&D
- Worth the time, effort required from technical experts as well as finance staff, towards preparing claims

## The company

SEA is a UK-based systems company delivering advanced surveillance systems and products for demanding environments. The Company, which was founded in 1988, remains independent and continues to enjoy substantial year-on-year growth.

Activities are focused on the Defence, Aerospace and Public Sector markets and it has a reputation for innovation, high-quality and cost-effective solutions. The company employs 200 people and maintains and develops its knowledge and skills base to match the expanding boundaries of technology and operational demands.

The company report ending March 2005 showed a turnover of £19m with an R&D expenditure of £2m. The R&D as % of sales was 11%.

Development testing of the Planck spacecraft cooling system at SEA's laboratory facilities.

# Making a tax credits claim

## Time-consuming

Tim Marvell, Finance Director, said: "We found out that we were eligible for the R&D tax credits by reading about it in the accounting press. We established which of our costs were eligible through discussions with our external financial advisors and various HMRC and DTI guides / technical papers that they provided us. There are some parts of the claiming process which we did not find straightforward, including:

- the assessment of which activities on which projects are allowable is time consuming and involves bringing in technical experts (diverting staff from their day to day jobs);
- the rules have now changed but for the first few years the calculation of the 20% / 80% allowable salary cost was quite complicated.

The rest of the process is OK."

**Technical Note: Can claim some time of staff who only work part time on R&D**

This 80:20 arrangement was designed to simplify record keeping for those staff with only a small amount of their time needing to be examined critically. It was abandoned as a result of representations from companies that these requirements were not compatible with the way their accounting system interacted with the staffing records. The rule now is that an appropriate proportion of the staffing cost can be qualifying expenditure if the director or employee is only partly involved in relevant R&D.

# The benefits

## Worthwhile although time and effort required in identifying and separating costs

SEA reported that their R&D tax credit claims were successful. Tim said: "This is a worthwhile exercise but it takes time and effort. We have benefited from the R&D tax credits because the reduction of corporation tax payable benefits our cashflow and makes it much cheaper for us to carry out R&D activities."

SEA has claimed the R&D tax credit using the SME scheme. The level of R&D expenditure they will claim for 2005/06 will be approximately £2m.

Tim said: "We are aware that we can claim 100% capital allowances for your R&D-based capital expenditure. However, there were no significant items of capital expenditure dedicated to R&D activities and to date, we have not made a claim."

# Recommend others to claim

## Claiming worth the significant effort required from both technical experts and finance staff

"Our advice to newcomers to R&D tax credits is that it is well worth pursuing but don't underestimate the effort involved. Significant effort is required from technical experts as well as the finance department. I would recommend this scheme to other companies due to its impact on reducing the corporation tax liability and making more R&D projects viable."

# Construction sector missing out on substantial benefits?

**TERRAPIN INTERNATIONAL LTD**

Construction
Milton Keynes and Nottingham
180 Staff
2005 Turnover £31m
2005 R&D £ 0.3m
**www.terrapin-ltd.co.uk**

**KEY ISSUES IN THIS CASE STUDY**

- Effective coding important for identifying qualifying costs
- Helped company to view R&D as an investment, rather than a cost
- Increased R&D would make sector less "vulnerable" to overseas intervention

## The company

Terrapin is a leading company in the construction sector, involved in modern methods of construction especially modular and panel design, manufacture and construction. The objective of its R&D is to improve products, processes and technologies associated with the business.

Employing 180 people, Terrapin's principal location is in Milton Keynes; however, the R&D is split between Chilwell, Nottingham and R&D workshops at Milton Keynes.

The company report ending October 2005 showed a turnover of £31m with an R&D expenditure of £0.3m. The R&D as % of sales is approx. 1%.

Illustrating how tiles are placed quickly and accurately prior to pointing

Denbigh School, Milton Keynes, providing quick robust construction

## Eligibility

### Importance of clear R&D cost coding

Nick Whitehouse, Managing Director said: "Our initial awareness of the R&D tax credits came from the technical press. Through discussion with our financial auditors and tax advisers and through our internal cost coding, which had been in place for many years, the R&D expenditure is kept separately from product development. Therefore finding out which costs were eligible for the R&D tax credit was relatively simple. Terrapin found the process of making an R&D tax credit relatively straightforward."

## The benefits

### R&D an investment, not a cost

Nick said: "The R&D tax credit claims have been successful for us. We have used the SME scheme.
The experience has reinforced our discipline of separate cost coding. We have benefited from applying for the R&D tax credits. We have reduced our tax bill and it has encouraged an internal culture for R&D which does not view R&D as a short-term cost to the organisation but as an investment for the future." Examples of R&D in this construction sector are presented at the end of this case study.

Nick said: "We are aware that we can claim 100% capital allowances for our R&D-based capital expenditure and we do so."

Corium "Stack bonded" innovative brick tile facade

## We would recommend other companies to claim

### Important that construction companies invest in more R&D

"We would advise newcomers to submit claims and to keep discrete cost coding. We would recommend other companies to claim. It may reduce companies' tax payments. It may encourage investment in R&D or for more R&D to be undertaken. In the construction sector, there is not a strong culture for R&D work which in turn makes the sector vulnerable to overseas intervention."


Cardinal Newman College, showing stack bonded tiles

## Examples of R&D in the construction sector

Terrapin has over 58 years of experience in offsite manufacture and has established a reputation for innovation and product quality. This innovation has been achieved by employing a continuous policy of R&D. The company has pioneered and developed many of the technology initiatives that have progressed this sector of the construction industry.

Terrapin has always kept records of its R&D activities of new processes, products and technologies separate from its product support utilising different departments and cost codes.

Recently there have been two examples of third party recognition of the output from Terrapin's R&D. Corium was designed as a cladding system which could replicate the appearance of brickwork but which would also have features suited to modern methods of construction:

- Mechanical fixing rather than wet mortar or adhesive
- Construction capability in all weathers
- Removal of vulnerability to skill shortages
- Potential for off-site fabrication
- Durable and robust with a good fire resistance
- Suited to fast track construction
- Versatility to provide visually exciting facades.

The route to market was critical to the business model and partners expert in the relevant sector were part of the development process after the initial research and patents had been completed. The team consisted of Terrapin, Baggeridge Brick and Corus, with Terrapin owning the product patents and Baggeridge producing the product under licence.

Baggeridge have achieved considerable commercial success with the product on a range of building types from housing to hospitals. Currently, there is also considerable export interest and Baggeridge are in the process of negotiating a sub-licence in North America.

## Innovative development

The product was the result of many years' work developing a new and innovative solution to a very traditional and well-proven trade. Terrapin's product had to be designed in such a way so as to match and exceed the qualities of the traditional methods including life expectancy, robustness, fire performance and durability. Many hours of innovative development work were devoted to this product by the R&D team before it could be finalised and receive appropriate Building Research Establishment Certification.

Nick Whitehouse said: "Our Finance department, who maintain the detailed overhead cost records, operate a comprehensive analysis of expenditure, consequently the preparation of our claim for R&D tax credits from this cost code analysis was a relatively straightforward exercise. This data was formulated by our external tax advisors, into a format acceptable to HMRC and submitted with our annual Corporation Tax computation. The resultant credit generated a very useful reduction in the total Corporation Tax payable by the Company."


DTI/PUB 8426/10K/10/06/NP. URN 06/1943

# R&D tax credits support engineering and design in long established industry

**VT GROUP PLC**

Support services and shipbuilding
Hampshire
13,000 staff worldwide
2005–06 Turnover £800m
2005–06 R&D £1m
**www.vtplc.com**

**KEY ISSUES IN THIS CASE STUDY**

- Involved HM Revenue and Customs during entire claims process, to address potential contentious areas
- World's largest single–masted yacht needed very significant qualifying R&D
- Use own engineering and design staff to identify significant technological advances

## The company

The VT Group, based in Hampshire, is a major support services and shipbuilding group supplying services and products to governments, government agencies and businesses worldwide.

The VT Group has its roots in two shipbuilders, Vosper and Thornycroft; both started out in the 19th Century. The two companies merged in 1966, and 22 years later Vosper Thornycroft was floated on the London Stock Exchange.

In 2002 the company changed its name to become VT Group plc – a move driven by its diversification programme. The VT Group now employs over 13,000 people worldwide.

The annual report ending 31 March 2006 showed a turnover of over £800m with an R&D expenditure of £1m. The R&D as a % of group sales was approximately 1% due to the level of support services income generated by the Group. The main area for the R&D claim is the Shipbuilding division. This division offers a total solutions approach, including vessel design and development, systems' integration, and construction in state–of–the–art facilities.

## Making a tax credits claim

Stuart Hellyar, Head of Taxation, commented: "We found out that we were eligible for the R&D tax credits through media coverage, budget announcements, publication of the Finance Bill and presentations by external professional advisors. We…

- performed a review of our largest contracts
- split these contracts into internally funded R&D and externally funded R&D
- looked at VT's role in each of the contracts from design, construction, support, project management etc and determined whether we were the prime contractor or sub contractor."

## Ensure correct costs coding

"The external professional advisors provided us with guidance in collating all the necessary information. Provided that costs are correctly coded for each project it was a fairly simple process capturing the R&D information on the qualifying projects."

### Involve HMRC throughout claim process

We have involved HM Revenue & Customs (HMRC) during the entire claim process. We invited HMRC to visit our sites and presentations were made to the Inspectors by the technical, operational and finance teams during the claim process to ensure that any contentious areas were addressed as they arose.

Given the size and complexity of the VT Group, presentations were held with each of the divisional heads of finance to ensure that going forward the correct means of data capture was in place and to draw their attention to the benefits of enhanced R&D tax relief."

## The benefits

"The VT Group qualifies for R&D tax relief under the large company scheme. Not all historic R&D claims for the Group were submitted with the annual tax return as we wanted to take the time to get the claim right. The largest R&D claim prepared is for the periods ended 31 March 2003 and 2004 in respect of the new "Mirabella V" which is the largest single masted yacht in the world and is recognised as representing a major advance in boat building technology. The claim totals some £12m of qualifying R&D spend. This claim is worth approximately £0.9m to the VT Group as a direct reduction in its liability to corporation tax."

### Capital allowances often overlooked

The VT Group is fully aware that it can claim 100% capital allowances for its R&D based capital expenditure. Stuart added: "I understand this is often an area that is overlooked by other companies, but it is an important area in managing cash–flow by optimising the temporary differences on R&D fixed assets."

## Advice to newcomers

Stuart's advice to newcomers is: "Identify those projects which may qualify for R&D tax relief at an early stage. Code the expenditure correctly so that the costs can be collated at a later stage (even if after further analysis it becomes apparent that the costs do not qualify for R&D tax relief). It is easier to have coded the costs for data capture as they are incurred rather than locating where the costs have been coded at a later date when the project might be complete and the individuals involved are focusing on new challenges."

## Recommendations to other companies

### Use own staff to identify technological advances

The VT group would encourage all companies which incur qualifying R&D expenditure to make a claim on their tax return. Stuart suggested: "Speak to your engineering and design department to get their views on the design process. Is the work making a significant advance in your industry, is it new to the world or ground–breaking? If so, capture these costs and any other costs associated with the process that are not incurred by the engineering and design department. Produce a summary schedule explaining the types of projects the company is undertaking."


DTI/PUB 8421/10K/10/06/NP. URN 06/1944

dti HM TREASURY HM Revenue & Customs

# Tax credit cash helped start-up to profitable growth

**WOLFSON MICROELECTRONICS PLC**

Microelectronics
Edinburgh
300 Staff
2005 Turnover £91m
2005 R&D £12m
www.wolfsonmicro.com

**KEY ISSUES IN THIS CASE STUDY**

- Involve … staff from the technical departments early
- Produce a short report for HMRC to highlight the advance in technology aspects of R&D projects, to accompany corporation tax return
- Qualifying R&D activity may not be obvious or recognised as such, particularly in some sectors

## The company

Wolfson Microelectronics plc designs, develops and sells a range of proprietary high performance integrated circuits combining analogue and digital technology, known as mixed-signal integrated circuits. They outsource the manufacturing process which allows them to focus their resources on product development and marketing activities.

Their analogue-intensive mixed-signal integrated circuits provide the user interface to digital information, by converting between real world analogue signals such as sound and light to the digital format used in electronic equipment. The features and performance characteristics of their mixed-signal integrated circuits play a crucial part in determining the functionality and usability of a wide range of digital electronic products such as MP3 players, games consoles, mobile phones, scanners and printing equipment, DVD players and flat screen TVs and other applications.

"Substantial investment in R&D ……critical to future success"

The markets for their products are characterised by rapid technological changes and advances and the company believes that a continuing substantial investment in R&D is therefore critical to their future success. Their R&D activities focus on the definition, design and development of innovative proprietary products; this involves the exploitation of existing intellectual property and the generation of new intellectual property in circuit design, algorithm development and system architectures.

This Edinburgh-based company employs 300 people. The company report ending December 2005 showed a turnover of £91m with an R&D expenditure of £12m. The R&D expenditure as % of sales was 13%.

## Awareness

Jill Goldsmith, Corporate Compliance Manager said: “We originally became aware of the R&D tax credits through reading commentary on the Budget and the financial press.” The company’s eligibility for R&D tax credits was identified from a review of the legislation and related guidance and from discussions with their tax advisers regarding their understanding of the rules and their application in practice.

## Identifying which costs are eligible

### Establish procedures to collect and analyse expenditure by project

Jill said: “The total R&D costs incurred by our company are reported separately on the profit and loss account in the financial statements. We focussed on identifying, from an analysis of these total costs, which categories of expenditure contained costs that could be eligible for inclusion in the R&D tax credit claim.

As a significant proportion of the company’s R&D expenditure relates to staff costs, we firstly identified the R&D activities on which the employees spent their time. The project time and cost records were used for this purpose.

### Review, Review, Review

The specific objectives, activities and status of each project were reviewed, with the technical project managers, and then assessed for eligibility for R&D tax credits by reference to the relevant sections of the DTI’s “Guidelines on the Meaning of Research and Development for Tax Purposes”.

Those members of staff not formally assigned but still directly contributing, to the R&D activities were then considered firstly by gaining an understanding, from the employees themselves or their managers, of the nature of their involvement in those eligible R&D projects.

Other costs (such as materials and consumables) incurred for the purposes of the eligible projects were then reviewed and considered in terms of the R&D tax credit criteria.

The analyses of total R&D costs incurred for the financial year were then reviewed again to assess whether any other remaining items of expenditure would be eligible to include in the R&D tax credit claim in view of the rules and guidelines.”

## Making a tax credits claim

### Straightforward aspects of claiming

Jill said: "The aspects of the claiming process which we found straightforward were:

- identifying those R&D projects which met the criteria for being eligible for R&D tax credits;
- collecting the details and analyses of the costs associated with those projects (staff costs, consumables, etc); and
- specific items of capital expenditure used for R&D purposes which met qualifying criteria for 100% capital allowances.

### More difficult aspects of claiming

The aspects of the claiming process which we found more difficult were:

- identifying any eligible "qualifying indirect activity" and the costs associated with this which could be included in the claim for R&D tax credits; (See Technical Note)
- interpreting the qualifying criteria for the "consumable stores" category of expenditure;
- considering the eligibility of those costs which are not directly incurred on R&D projects but were included in the R&D costs category in the profit and loss account."

## Our R&D tax credit claims are successful

**Profitable**

Jill said: "Wolfson Microelectronics started claiming the R&D tax credits in respect of the year ended 31 December 2000 when the company's operations and sales were much smaller (annual sales £8.7m) and the company was loss-making. The availability of the R&D tax credits at that time helped to support the funding of some of the R&D activities which otherwise might have been delayed. The investment in R&D was extremely important to the future growth and development of the company."

"In the years since then, our company has grown its sales revenue by over 900% and the investment on R&D in total has remained at around 12 to 15% of sales over those years."

**Technical Note: Treatment of qualifying indirect activities**

Although the 2004 DTI guidelines say that some qualifying indirect activities may be R&D for general tax purposes, this does not necessarily mean they will qualify for relief under the R&D tax credits scheme. For example, in the case of staff costs, the directors or employees must be directly and actively involved in relevant R&D. 'Directly and actively engaged' refers to hands on work. Staffing costs in respect of clerical or administrative staff engaged in those activities are not qualifying expenditure. In the case of managers, time they spend directing the technical course of, or providing direct technical input into, the ongoing R&D activities can be considered as direct engagement in R&D."

"The availability of R&D tax credits in more recent years has reduced the company's total tax charge and, as a result, has reduced the net (after tax) costs of qualifying R&D projects."

## What we learned from the experience

### "Involve ... staff from the technical departments early"

Jill said: "It is important to involve members of staff from the technical departments early in the financial period to review the profile, objectives and activities involved in R&D projects which are in progress or planned for the rest of the year."

"We have found, in the last few years, that the availability of a greater amount of guidance and commentary regarding R&D tax credits has assisted with the process."

### prepare short report for HMRC to highlight technology advances

"In recent years we have compiled a short report which summarises the R&D activities conducted by the company, the identification of qualifying costs and an outline of the qualifying R&D projects to highlight the 'advance in technology' aspects of these projects. This report has then been appended to our corporation tax computation and submitted with the corporation tax return to HMRC."

### Level and amount of tax credit received

As reported in the Company's Annual Report and Accounts 2005 and 2004, the amount of R&D tax credit received was approximately £230k (2004: £185k). The company applied for the SME scheme in earlier years. As a result of the growth in the company's operations, they now apply for the Large Company scheme.

## The benefits

In the earlier years in which Wolfson claimed R&D tax credits, when the company was loss-making, Jill said: "We were able to undertake some R&D projects which otherwise might have been delayed. It should be noted that, at that time, the company was also eligible for "SPUR" grant funding which assisted with the costs of a particular R&D project. As a result of the grant funding all of the costs of that project were, however, not eligible for R&D tax credits."

"In the more recent years as Wolfson has grown and is profitable, R&D tax credits have benefited our company by reducing the net (after tax) cost of some of its R&D activities. Since the company's shares are now listed on the London Stock Exchange its financial results are more regularly and more closely monitored by external stakeholders and the financial results (after tax) are an important measure for many of these stakeholders."

**Technical Note: Grant for Research and Development**

Grant for Research and Development was introduced on 1 June 2003 as a replacement for the former Smart scheme. It is a DTI product delivered by the RDAs. The grant encourages small and medium-sized businesses to research and develop technologically innovative products and processes by sharing some of the costs and risks associated with R&D projects and fostering recognition of the importance of undertaking R&D. The grant is only available in England. Scotland, Wales and Northern Ireland run their own (SMART and SPUR) schemes.

## Advice to newcomers

Jill said that "our advice to newcomers would be:

- Read the guidance available on HMRC and DTI websites regarding R&D tax credits and any relevant publications and commentary issued by business advisers on the subject. All of these sources of information may help to indicate aspects of the organisation's activities which may be eligible for R&D tax credits

"Ensure that the technical manager(s) in your organisation who co-ordinate R&D activities are familiar with at least the main points of the rules and the guidance regarding R&D tax credits"

- Consult your tax advisers regarding any questions or clarifications arising from your interpretation of the legislation and the Guidelines relating to R&D tax credits.
- It may be beneficial to ask Trade Associations your company belongs to for advice or practical guidance or experience of identifying qualifying R&D expenditure (particularly if eligibility for R&D tax credits is not immediately obvious from the company's operations);
- Ensure that you have established procedures to collect and analyse expenditure on R&D that can be identified by project. This level of expenditure analysis is extremely helpful in the process of compiling, reviewing and supporting the R&D tax credit claim
- Document the process used to identify eligible costs for R&D tax credits and ensure there are copies of supporting documentation and analyses retained in one place as a point of reference. This will assist during the review of the claim before it is submitted to HMRC and in case there are any subsequent questions regarding the claim
- Prepare a summary of: the process used to identify qualifying R&D expenditure; the types of expenditure included; and the features of the R&D activities which meet the qualifying criteria for R&D tax credits. Ensure that this summary is reviewed by both technical manager(s) within the company and also by the company's tax manager or tax adviser. This summary may then be appended to the corporation tax computation to be filed with HMRC along with the corporation tax return
- Review afresh each financial year the R&D activities conducted by the company as the nature, extent and expenditure profile of the activities may have changed which could result in more or less expenditure being eligible for R&D tax credits compared to the prior year".

**Technical Note: most grants and other cases when SME R&D tax credit relief cannot be claimed**

The SME scheme for R&D tax relief is sufficiently generous that it is considered by the European Union to be a notifiable State Aid. Where an R&D project has received funding which is another notified State aid then no expenditure by the company on that project can qualify for the R&D SME relief. Notified state aids are usually government-funded grants such as the Grant for Research and Development (which replaced the SMART award in June 2003). But not all government grants are notified State aids - for example, some funding under the SMART label (e.g. grants for feasibility studies and micro-enterprise awards was not). If clarification of the status of a grant is needed, the body that has provided or arranged the funds should be able to help. Where the company has benefited from a state aid for a project which disbars it from claiming the R&D relief under the SME scheme it can, for expenditure incurred in accounting periods beginning on or after 9 April 2003, claim under the large company scheme for that project.

## Recommend others to claim

**Qualifying R&D activity may not be obvious or recognised as such, particularly in some sectors**

"Whilst a significant element of our company's activities relates to R&D it may not be obvious to companies in other sectors that they may conduct some activities which qualify for R&D tax credits. It is worth considering this each year and at least ensuring that those personnel responsible for tax compliance and those personnel involved in technical activities within the company are aware of the relevant criteria for R&D tax credits."

Jill said: "We would recommend that companies do claim, where eligible, R&D tax credits as this can be beneficial while a company is in its phase of establishing products and / or services and a customer base. It is also beneficial through the time a company is expanding its product portfolio, and later by reducing the effective total tax charge when a company is generating taxable profits but at the same time continuing to invest in innovative work to sustain or grow its product and / or service portfolio."


DTI/PUB 8427/10K/10/06/NP. URN 06/1945

dti HM TREASURY HM Revenue & Customs