

R&D TAX CREDIT GUIDELINES FOR THE MOTORSPORT INDUSTRY

THE UK RESEARCH AND DEVELOPMENT TAX CREDIT SCHEME
A GUIDE FOR THE MOTORSPORT AND HIGH PERFORMANCE ENGINEERING INDUSTRY



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The Motorsport Industry Association (MIA) is the world's leading, and by far the largest, trade association for motorsport's performance engineering, entertainment, services and tuning industry. It represents the specialised needs of this highly successful Industry which, although extending throughout the world and rapidly expanding in developing nations, is largely centred here in the UK.

Companies within MIA membership embrace a wide variety of disciplines including; motorsport and performance engineering, race and rally teams, governing bodies, motorsport services, research organisations, race circuits, legal and financial, sponsorship and marketing, universities and colleges amongst many others.

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This guide has been created to provide advice to those involved in research and development within the UK motorsport and performance engineering industry. It will answer these questions:

- What is the R&D Tax Credit Scheme in the UK?
- How can it deliver significant benefits to companies in the industry?
- Which companies does it apply to?
- How can a UK business begin the process of making a claim?
- How to maximise the value of future claims.

The R&D Tax Credit scheme may, at first, seem complex and difficult to understand which may, sadly, deter some companies from claiming their entitled tax relief - this guide aims to address this problem.

Over the past year the MIA, generously supported by our professional partners, has delivered a programme of face-to-face workshops to guide companies through the R&D Tax Credit scheme. Knowledge from this programme has led to this specialised guide for the industry.

This guide will explain, in clear terms and illustrated by relevant, real industry examples, how this valuable and popular scheme works and how UK motorsport companies can take full advantage of it.

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A WELCOME MESSAGE FROM THE MIA

I have long said that if your company operates in the engineering world of motorsport, in some way, then you are very likely to qualify for a R&D Tax Credit, so get claiming. Why just one in three motorsport and high performance engineering companies claim these credits completely baffles me!

Our companies continually make the world's best products as a direct result of endless R&D - we 'race prototypes' for heaven's sake!

I am pleased the MIA has created, with our professional partners, this useful guide to the world of R&D Tax Credits, as they relate to our industry. I know you will find this of real value as it helps you along the potentially profitable road of securing a tax credit for your business.

Check this latest information to maximise your current claims or before you start on the process - an unbeatable wealth of relevant knowledge from the best R&D professional advisers, with specific motorsport knowledge, is included.

These tax credits have, literally, changed the fortunes of many enlightened people in motorsport. Collectively millions of pounds have been re-invested in R&D as a direct result, making all those who claim ever more competitive in a tough world. If you haven't yet claimed - large or small - please make 2016 the year you get onto this scheme and you can claim for all qualifying R&D undertaken over the past two years.

The UK is one of the most pro-active countries in regard to such tax credits and the offer from our government is amongst the most generous in the world. Their aim is simple - to encourage innovation and increased spending on R&D activities by UK companies and, in recent years, the rates have increased significantly to further incentivise companies to claim. Make sure you are one of them, please.

The MIA team, together with all our professional R&D tax partners, are here to help you gain the maximum benefit from your R&D Tax Credit claim, so please make full use of our offer.

It will be our pleasure to secure your success.

Good luck and best regards,

Chris Aylett, Chief Executive
Motorsport Industry Association (MIA)

UK R&D TAX CREDIT SCHEME - FACTS AND FIGURES

The UK's single largest funding source for business research and development
£11.4 billion successfully claimed by UK companies between 2000 and 2014

Corporation Tax relief or rebate of up to 30% of relevant costs

An average of £46,000 in annual claims for SME companies

1. UNDERSTANDING THE R&D TAX CREDIT SCHEME

If your business is liable for UK Corporation Tax...then you could be missing out on this relief

WHAT IS THE R&D TAX CREDIT SCHEME?

Each year the R&D Tax Credit scheme from HM Revenue & Customs (HMRC) provides some £1.75 billion in tax incentives to encourage investment in innovation and increased R&D spending by UK companies. It is one of the most competitive of such schemes in the world.

The more investment is made in research, development and technology, the greater the benefits to individual companies and the wider UK economy. Investment brings added value to businesses helping them to remain competitive and so makes an invaluable contribution to economic growth.

Put simply, the R&D Tax Credit system encourages and rewards investment in research, development and innovation by allowing costs, including those of staff, on relevant projects to be claimed back as relief for Corporation Tax. This can result in substantial savings for the company involved.

The UK R&D Tax Credit scheme, which began in 2000, continues to enjoy strong government support. In the March 2015 Budget, for example, the government announced increases in tax relief under the scheme for small and medium-sized enterprises (SMEs) applying to R&D spending from 1 April 2015. Through ongoing consultation with business and tax professionals, HMRC continues to consider ways to improve the efficiency and effectiveness of the scheme.

The UK motorsport and high performance engineering industry is among the most innovative in the world. Surprisingly, this outstanding position is not reflected by the relatively low level of take up of the R&D Tax Credit scheme. Less than one in three companies from this sector have taken advantage of the benefits under the scheme¹ meaning there is huge future potential for more to do so.

The scheme will not apply to all those in this industry but as the 'end product' of much of the engineering work is in creating and racing 'prototype' solutions the figure should be far higher. It seems many who could benefit are unnecessarily ruling out what is, currently, the UK government's single largest area of financial support for business.

As with any tax scheme, the criteria for eligibility and the process for claiming tax credits can seem complex. This guide is not a blueprint for securing tax credits - but it should help you to understand the scheme, assess whether it could be worthwhile for your business and, if so, get the process started.

HOW MUCH IS THE R&D TAX CREDIT SCHEME WORTH?

Since the R&D Tax Credit scheme was first introduced in the UK in 2000, some 42,000 companies across the UK have benefited from nearly £11.5 billion in tax relief. The scheme is increasingly becoming part of future investment planning for many companies in the wider economy.

The amount of savings to be made from R&D Tax Credits will depend on the size of your business. There are two schemes for claiming relief:

- The SME Scheme applies to companies with under 500 employees and either of the following: an annual turnover not exceeding €100 million or a balance sheet not exceeding €86 million
- The Large Company Scheme has, since April 2013, been further developed as the R&D Expenditure Credit (RDEC).

Whilst other factors may come into play, broadly speaking businesses which qualify as an SME can expect to see a net cash saving of up to 30% of relevant costs, and larger businesses a saving of up to 11%.

Each year, around 30% of claims come from those making a claim for the first time and the average claim for SMEs currently stands at around £46,000. Those SMEs making claims in subsequent years do even better, e.g. **companies making six or more claims have an average annual claim of £61,000².**



¹ 'Renewing the Evidence Base of Britain's Motorsport Valley' 2013; published by Motorsport Research Associates 2013

² HM Revenue & Customs, 2015. Working Paper 17 - An evaluation of research and development tax credit. [online] Available at: <http://www.the-mia.com/assets/hmrc-evaluationofrdtaxcreditworkingpaper17.pdf> [Accessed 3 December 2015]

Claims can be made for costs incurred on projects undertaken, and included in the accounts, over the previous two financial years. For projects undertaken from 1 April 2012, there is no minimum spend on the amount of research and development before your business can claim tax relief.

HOW IS R&D TAX RELIEF CALCULATED FOR AN SME?

Under the SME scheme, Corporation Tax relief is given via an additional deduction in the tax computation. For qualifying expenditure on /after 1 April 2015 an additional deduction of 130% of the eligible expenditure is allowed. At a Corporation Tax rate of 20%, this results in a saving of £26 for every £100 of qualifying expenditure (NB for expenditure between 1 April 2012 and 31 March 2015 the enhancement is 125%). For loss-makers, the loss can be surrendered for a cash back.

LARGE COMPANY SCHEME

Under the Large Company scheme, Corporation Tax relief is given via an additional deduction in the tax computation. For qualifying expenditure incurred on /after 1 April 2015 an additional deduction of 30% of the eligible expenditure is allowed, at a Corporation Tax rate of 20% - this results in a tax saving of £6 for every £100 of qualifying R&D expenditure.

Note below that the Large Company scheme is currently transitioning to the R&D Expenditure Credit (RDEC) and will no longer be available for expenditure on /after 1 April 2016.

R&D EXPENDITURE CREDIT (RDEC)

RDEC was introduced for expenditure arising on /after 1 April 2013 to gradually replace the Large Company scheme, described above. For expenditure up until 31 March 2016, large companies can choose to elect into either the Large Company scheme or RDEC. Once RDEC claims are made, companies cannot then revert to the Large Company scheme.

RDEC is available to both companies with taxable profits, as well as those in a loss making position. From 1 April 2015, this provides for an 11% P&L credit payable on qualifying expenditure (between 1 April 2013 and 31 March 2015: 10%). This credit also applies to projects which are subsidised, grant funded or sub-contracted, whatever the size of the business (see Section 6).

RDEC is treated in the P&L (and Corporation Tax Return) as income receivable (enhancing EBITDA*) and is taxable. After tax (2015: 20%) the net cash tax value is 8.8% and is, therefore, slightly more advantageous than the Large Company scheme.

RDEC can either be claimed as an offset against a tax liability, or can be repaid to a company with no such liabilities (subject to meeting further detailed requirements, for example a PAYE cap).

WHAT'S HOLDING THE INDUSTRY BACK FROM MAKING R&D TAX CREDIT CLAIMS?

1. Lack of knowledge of R&D activity - what constitutes an 'advance' /R&D
2. Lack of knowledge of R&D Tax Credit scheme - definitions, process, work /time /effort required
3. Motorsport businesses are 'time poor' - no time to investigate claiming /preparing claims and so unable to make an informed 'risk /reward' decision
4. Past experience of HMRC - businesses are reticent about 'opening up' to HMRC, fearing further investigation into company affairs.



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* Earnings Before Interest, Taxes, Depreciation and Amortisation

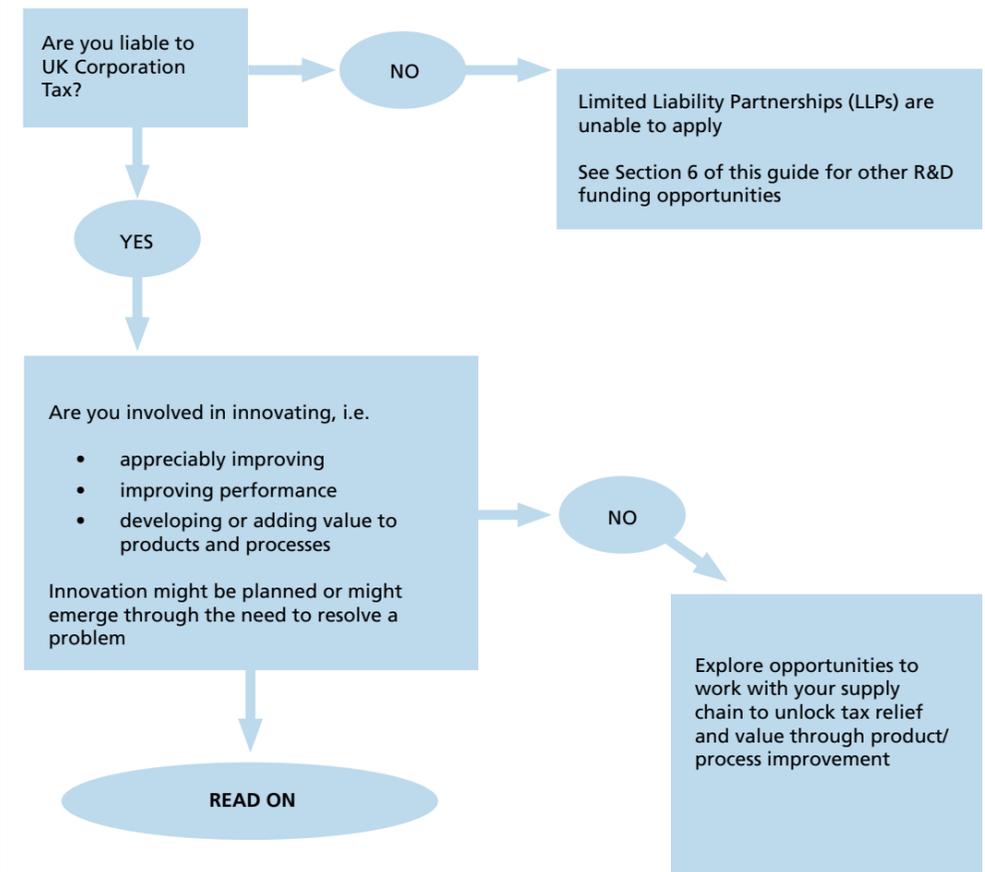
WILL YOUR BUSINESS QUALIFY FOR R&D TAX CREDITS?

Before reading on and going into the R&D Tax Credit scheme in more detail, you should work out whether the scheme applies to your company.

It will only apply if your company is liable to UK Corporation Tax (although you do not have to be actually paying UK tax). It's important to note that a payable credit is available for both large and SME companies which have made losses in the period.

If your company is not liable to Corporation Tax and you are not directly involved in innovation then the R&D Tax Credit scheme may not seem relevant. However, it could still be very worthwhile for you to consider how the scheme could benefit those with whom you collaborate including your supply chain. By ensuring they claim full relief then you could improve their competitive offer to your company.

You should also take the time to check out other sources of funding which support innovation and opportunities to cultivate new ideas (see Section 6).



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2. DEFINING RESEARCH AND DEVELOPMENT

For tax purposes, the definition of 'research and development' is broad and it can, in some circumstances, apply to what might otherwise be seen as normal day-to-day business.

According to HMRC guidelines, research and development takes place when a project, or a component of a larger project, seeks to achieve an advance in science or technology, through the resolution of scientific or technological uncertainties that are not readily deducible by a competent professional.

ANY activity, which directly contributes to seeking an advance through the resolution of a scientific or technological uncertainty, can be classified as 'research and development' for tax purposes.

WHAT THE OFFICIAL GUIDELINES SAY

HMRC uses a comprehensive set of [guidelines](#) compiled by the Department of Trade and Industry (DTI) in 2004.³ The BIS (formerly DTI) Guidelines (2004) are amplified as part of the [HMRC Corporate Intangibles Research and Development Manual](#).⁴

What the motorsport industry needs to know can be put more simply, but it is most important to be clear as to what is meant by the words - 'advance', 'uncertainty' and 'directly contribute'.

PRINCIPLE	BIS DEFINITION ³
ADVANCE	<p>Create or appreciably improve a process, product or service which incorporates or represents an increase in overall knowledge or capability in a field of science or technology</p> <p>There are no absolute indicators of 'appreciable improvement'; however, (hypothetic) recognition of 'appreciable improvement' by a 'competent professional' is regarded as a good starting point</p>
UNCERTAINTY	<p>Where knowledge of whether something is scientifically possible or technologically feasible, or how to achieve it in practice, is not readily available or deducible by a 'competent professional' working within the sector</p> <p>Includes system uncertainty; scientific or technological uncertainty will often arise when translating something already established as scientifically feasible into a cost-effective, reliable and reproducible process, material, device, product or service</p>



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WHAT IS AN 'ADVANCE'?

This must represent an advance in the overall knowledge or capability in a field of science or technology, not a company's own state of knowledge or capability alone. An advance can be an appreciable improvement to an existing product, process etc.

For example, a race team developing a race car from a road car, found that in high speed corners, the standard engine suffered oil surges resulting in oil starvation in some cylinders. Existing baffle designs in the sump failed to cure the problem. New baffles were designed to retain sufficient oil in the sump to allow a constant quantity of oil flow to the oil pump, so preventing oil shortages in cylinders.

WHAT IS MEANT BY 'SCIENCE AND TECHNOLOGY'?

It is crucial for a business to determine whether past, current or future activities can be classified as science or technology. The BIS Guidelines (2004) set out these specific definitions:

- Science is the systematic study of the nature and behaviour of the physical and material universe. Work in the arts, humanities and social sciences, including economics, is not science for the purpose of these guidelines. Mathematical techniques are frequently used in science, but mathematical advances, in and of themselves, are not science unless they are advances in representing the nature and behaviour of the physical and material universe
- Technology is the practical application of scientific principles and knowledge, where 'scientific' is based on the definition of science above. These guidelines apply equally to work in any branch or field of technology.

Businesses need to assess whether their work has, in itself, directly contributed to an 'advance in science or technology'. Work that is just a precursor to R&D activities to be carried out by other organisations, further along the project timeline, does not qualify under the R&D Tax Credit scheme.

There is, intentionally, no official, definitive list of activities which could be regarded as scientific and/or technological. In doing so this avoids the R&D Tax Credit scheme from being overly prescriptive.

Some activities are, however, more likely to fall within the category of 'science and technology' than others. Some of these may include:

- The development of new products or production processes for customer projects or for the company's own purposes
- The improvement, or adaptation, of existing products or production processes for customer projects or for the company's own purposes.

This is not an exhaustive list but will give you an idea of the types of work that could well be eligible for R&D Tax Credits. It also demonstrates that many of the appropriate criteria apply to the kinds of research and development work which the UK motorsport industry undertakes.

WHEN DOES DESIGN BECOME RESEARCH AND DEVELOPMENT?

For many projects, companies provide a range of services around the design of a product which does not require innovation or research and development. However when such designs, developed by the companies, are innovative and can be shown to 'advance science and/or technology' then their potential for qualifying for R&D Tax Credits should be explored.

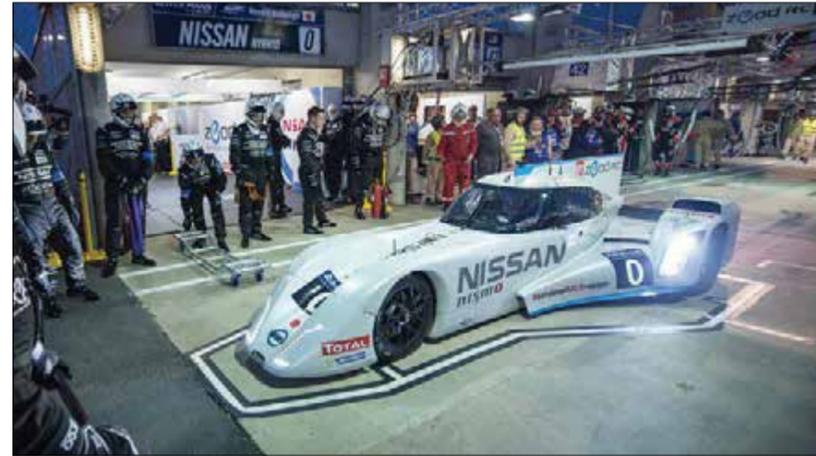


³ Department of Trade and Industry, 2004. CIRDB1900 - R&D Tax Relief: conditions to be satisfied: BIS Guidelines (formerly DTI Guidelines) [2004] - text. [online] Available at: www.hmrc.gov.uk/manuals/cirdmanual/CIRDB1900.htm [Accessed 3 December 2015]

⁴ HM Revenue & Customs, 2012. Corporate Intangibles Research and Development Manual [CIRD 00500, 10000, 60000, 70000, 75000, 80000]. [online] Available at www.hmrc.gov.uk/manuals/cirdmanual/index.htm [Accessed 3 December 2015]

The BIS Guidelines (2004) make clear that when, to achieve a design objective, a scientific or technological uncertainty within a particular project needs to be resolved, then the activities needed to do this would qualify as ‘research and development.’ Design activities that do not directly contribute to the resolution of a scientific or technological uncertainty within a project, on the other hand, would not count as ‘research and development’ under these terms.

What is important, then, is to demonstrate how design activities have directly contributed to achieving an advance in science and technology. The design stage must involve some resolution of uncertainty to comply, or perhaps be a precursor to subsequent analysis and testing of the design, provided that this work is undertaken by the same company.



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* One company connected with another, under common control (ICTA88 S.839)

WHICH COSTS QUALIFY FOR R&D TAX RELIEF?

The main source of costs for research and development eligible for a claim for R&D Tax Credit relief are:

- **Staff:** costs of staff (including salary, bonuses, employers’ NIC, pension contributions, but not benefits in kind) directly contributing to the resolution of the uncertainty in question. For example: technical planning; design; testing; analysis; and /or other ‘non-routine’ activities; all calculated based on a percentage of time spent on the relevant R&D activity. Time spent on Qualifying Indirect Activities (QIA) can also qualify for claim purposes (see paragraph 5 of the BIS Guidelines 2004)
- **Sub-contracted services:** costs for sub-contracted services. For example, where a discrete part of the project is given to a third party, such as testing, then relief can be claimed on up to 65% of the payment made to the subcontractor
- **Externally provided workers:** where an externally provided worker is brought in to work alongside the company’s staff, generally 65% of the cost can be claimed (or 100% for connected parties*)
- **Consumable items:** revenue expenditure on consumable or transformable materials, including water, fuel and power, used directly in undertaking research and development. Note the Autumn Statement 2014 clarified that you cannot claim for any R&D materials that are included in a product that is sold
- **Software costs:** where revenue expenditure is incurred on software employed directly in R&D, including QIA. If software is only partly employed in direct R&D an appropriate apportionment of the expenditure should be made.

Special rules may apply if the expenditure is subsidised by way of a grant or subsidy (see section 6).

THE ‘WHOLE CAR’ CONCEPT

Companies shouldn’t fall into the trap of assuming a ‘whole race car’ will qualify for R&D Tax Credits throughout its lifetime. Any claim must be based on individual projects in accordance with legislation.

Section 13 of the BIS Guidelines (2004) defines ‘what is technological uncertainty’, but refined by Section 14 which states that ‘improvements, optimisations and fine-tuning, which do not materially affect the underlying science or technology, do not constitute work to resolve a scientific or technological uncertainty’.

Preparing a car to achieve optimum performance for each motorsport event is considered to be covered by Section 14 above. Similarly, stripping down a car after each event is not related to a specific project and as a result would be non-qualifying.

For example, when developing a new motorsport car the following costs can normally be claimed:

- **Design:** new innovations such as new body shape to reduce drag or a new chassis design to optimise performance. However, not cockpit ergonomics, nor design using already known technology such as seats, front wing, etc., but this may vary for each project
- **Development:** taking a car from CAD to prototype is mainly eligible for a claim as is any necessary element to test the R&D design
- **Testing** the prototype normally qualifies as R&D testing
- **Building a car** is where R&D usually ends, but there may be some ‘spikes’ of R&D activity where new technological problems arise and need to be resolved

The following costs would not normally qualify:

- **Ineligible R&D costs,** such as rent and leasing tracks for testing
- **Routine project activities,** e.g. when an existing problem has known ways to overcome
- **Material costs** which are sold, for example within cars sold to customers
- **Commercial and marketing work,** unless directly supporting the R&D part of the activities
- **Changing car specifications** for each circuit or event, unless new innovations are included which require testing.

We strongly recommend obtaining advice from HMRC or your advisers to establish, in advance, which costs qualify in each case, which will depend on their purpose and use in the proposed R&D activities.



Courtesy of RML Group

DOES TESTING QUALIFY FOR R&D TAX RELIEF?

Companies need to be careful when claiming for expenses in respect of testing. Testing, in itself, is not a qualifying R&D cost unless a new and novel testing programme has had to be developed. Qualifying expenditure relates solely to testing an advance in science or technology, not general testing.

Furthermore, it is only considered to be qualifying R&D if the testing is undertaken by the same business which designed the prototype or if an SME subcontracts testing out to another company, rather than just hiring a track. In principle, the hire of a venue is not an eligible expense for either the circuit or the company using the facilities. However, in certain circumstances, where the testing relates to testing a 'technical advance' then the time spent testing on the track may be eligible as an R&D expense.

For example, if a company hires a track for testing, then time spent at the track by company employees can be claimed, but payments to the track cannot, as hire costs are not an eligible cost.

If a company pays the track to test a car (i.e. the track does the test work) then as all the test work is being undertaken by the track and its employees, this is 'subcontracted R&D' by the company and, as such, the costs may be claimed by the company at 65%, if an SME (but not for large companies).

If a track or circuit is requested to develop a test programme for a car and then tests and develops the car to the required specifications then...

- If the circuit takes the commercial risk of the programme, being only paid if successful, it could claim R&D Tax Relief
- If this test programme is 'subcontracted R&D' from the company to the circuit, then the costs can be claimed by the company at 65% if an SME, or by the circuit if the company is 'large'.

RESEARCH & DEVELOPMENT ALLOWANCE FOR CAPITAL EXPENDITURE

The R&D Allowance gives relief, at a rate of 100%, for Capital Expenditure incurred on R&D activity which is directly undertaken by a trader, provided the R&D is related to the trade carried on.

SME PAYABLE TAX CREDIT FOR LOSS MAKING COMPANIES

Where an SME company has made losses in the period it is still possible to make a claim for a 'payable tax credit'. This would be for the lesser of the enhanced R&D expenditure (e.g. at 130%) and the unrelieved trading loss for the period. The rate of the 'payable tax credit' depends upon the dates within which the expenditure was incurred, as follows:

1 April 2011 - 31 March 2012	12.5%
1 April 2012 - 31 March 2014	11%
From 1 April 2014	14.5%



Courtesy of Sigmatech

VOLUNTARY ADVANCED ASSURANCE FOR SMALLER BUSINESSES

From November 2015, HMRC have introduced an entirely voluntary scheme, Advance Assurance. This will help small companies who want to claim R&D Tax Relief for the first time, and has to be completed any time before they first claim for R&D Tax Relief.

The benefit is that for the first THREE accounting periods after claiming for R&D Tax Relief for the first time, HMRC will allow a claim from those on the Advance Assurance scheme, without further enquiries.

Any company can, of course, apply for R&D Tax Relief without volunteering for Advance Assurance.

Advantages of Advance Assurance

When applying for Advance Assurance, an HMRC specialist will help the company understand and comply with the R&D Tax Relief conditions⁵. Once given Advance Assurance, the company can then concentrate on their business, rather than on R&D tax claims. In addition, Advance Assurance gives proof that the company will get R&D Tax Relief which may help secure funding.

Who can apply for Advance Assurance?

Any company can apply for Advance Assurance if it's planning to carry out, or has previously carried out R&D, and can meet certain conditions at the date of application, which are that:

- It hasn't claimed R&D Tax Relief before
- Its annual turnover is £2 million or less
- It has less than 50 employees.

These conditions may apply even if a company is part of a group of companies, but it is best to check [who can't apply for Advance Assurance](#)⁵ to be certain.

If the company plans to carry out more R&D in the future, then HMRC will make contact, after the first claim is submitted, to check future R&D matches the details given in the Advance Assurance application.

Professional agents can apply for Advance Assurance on the company's behalf.

When [HMRC contacts you to discuss your application](#)⁵, they'll need to talk to a company director or an employee (for example, research manager), however your agent will be able to contribute.



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⁵ HM Revenue & Customs, 2015. Corporation Tax: Research and Development (R&D) Relief: Advance Assurance [online] Available at www.gov.uk/guidance/research-and-development-tax-relief/advance-assurance [Accessed 3 December 2015]