

# R&D Tax Relief for small and medium sized enterprises



**R&D Tax Relief for SMEs is a very generous corporation tax relief aimed at innovative companies that are pushing the fields of science and technology forwards. It has the potential to reduce a company's corporation tax liability or even entitle a company to receive a cash tax credit.**

R&D tax relief has undergone a significant overhaul in recent years. This factsheet covers R&D relief for SMEs as it exists for accounting periods **beginning before 1 April 2024**. You may also be aware of the R&D Expenditure Credit scheme (RDEC) scheme – this is covered in a separate factsheet and will be superseded by the merged scheme.

For accounting periods beginning **on or after 1 April 2024**, there are two new R&D tax relief schemes:

1. The merged scheme R&D expenditure credit (new RDEC)
2. Enhanced R&D intensive support (ERIS) for R&D Intensive companies

These schemes as well as the old RDEC scheme are covered under separate factsheets as is the Patent Box scheme.

## Research and development for tax purposes

Research and development for tax purposes takes place when a project seeks an advance in knowledge or capability in a field of science or technology. The project must aim to achieve an advance in the field – not just for the company – although if a particular advance has already been made, but it is a trade secret, work to achieve that advance can still qualify for R&D relief. Only activities that directly contribute to this advance through the resolution of scientific or technological uncertainty are classified as R&D.

## Relief for SMEs

Tax relief for SMEs works by giving a company an extra deduction of 86% (previously 130% up to 31 March 2023) of certain expenditure from its taxable profit.

If the company is loss making, or if this extra deduction turns a taxable profit into a loss, the company may claim an R&D tax credit in cash from HMRC. The amount paid is up to 10% (or 14.5% up to 31 March 2023 for all qualifying companies, and for R&D intensive companies after this date) of the lower of:

- The whole deduction made in respect of R&D costs.
- The taxable trading loss for that accounting period.

Claiming the payable R&D tax credit will not always be the best choice for a company. If the losses are carried forward to future years, the rate of tax relief when they are used may be greater than the effective “cash back rate” of 10% (or 14.5%).

For many companies, the cash flow advantage that the payable R&D tax credit claim brings will outweigh any future tax advantage.



### Example 1

A loss-making company, with qualifying expenditure of £200,000 for the year ended 31 March 2024, could receive a tax credit for the year under the SME scheme of £37,200 if the company is not R&D intensive, (or £53,940 if the company is R&D intensive. Broadly, an R&D intensive company for that period was a company that spent at least 40% of its total expenditure on R&D)



### Example 2

A profitable company, paying tax at the main rate (25%), with qualifying expenditure of £200,000 for the year ended 31 March 2024, could save additional corporation tax under the SME scheme of £43,000.

### What is a SME?

A SME must have fewer than 500 employees, and have either:

- An annual turnover not exceeding €100 million.
- A balance sheet total not exceeding €86 million.

The thresholds do not look at the company in isolation – and where the company is part of a group, or there are external investors, it can get complicated to establish if these thresholds have been exceeded and therefore professional advice should always be sought to determine whether SME R&D relief is available.

SME R&D relief is not available in respect of projects in receipt of notifiable state aid, for example funding from Innovate UK, or where the R&D has been subcontracted to the company, but these projects may qualify for relief under the RDEC scheme.

A company may only claim this relief if it is a going concern at the time the claim is made.

### Which costs qualify for R&D relief?

Qualifying expenditure is revenue **expenditure** (whether expensed or capitalised as an intangible asset) on R&D in the following areas:

**Staffing costs:** salary costs, employer's National Insurance contributions and employer's pension contributions.



**Externally provided R&D workers** (externally provided workers must be paid through a UK payroll, with very limited exceptions)



**Consumable items:** Actual physical materials that are consumed in R&D.



**Water, fuel and power** used directly in carrying out R&D.



**Software** used in R&D.



**Data licensing and cloud computing costs.**



**R&D subcontracted to third parties**



**Clinical trial volunteers:** Any payments made to them as part of the R&D project.



### Cap to the tax credit

A company's SME R&D payable tax credit can be subject to a cap, set at a level of £20,000 plus three times the company's PAYE and NIC liability for the period.

There is an exemption from the cap, which requires a company to meet **both** of the following conditions:

**Condition A** requires the company to be creating or preparing to create intellectual property or managing intellectual property which it holds. These activities must be wholly or mainly undertaken by employees of the company, and the company must have the right (alone or with others) to exploit the intellectual property.

**Condition B** requires that the total of the company's qualifying expenditure with connected persons on EPWs and on subcontracting R&D activities is no more than 15 per cent of its qualifying expenditure.

The cap applies to the cash credit only so any excess R&D losses would be carried forward to potentially offset against future profits.

### Future changes to R&D relief

As mentioned at the start of the factsheet, for accounting periods beginning on or after 1 April 2024, the R&D relief for SMEs will be replaced by two new schemes: the merged scheme and the ERIS scheme.

### HMRC scrutiny

HMRC are currently checking more than 20% of R&D claims (over 1 in 5 claims), up from less than 1% a few years ago. Any R&D claim made is therefore at high risk of HMRC enquiry. An HMRC enquiry can be both expensive and time consuming, diverting your resources away from where they are really needed within your company.

We can help you to prepare a robust claim and support you through any HMRC enquiry.

### Our team of specialist advisors

We recognise how important R&D relief can be for your company, and we are here to help and support you. For further information on R&D relief, please contact one of our specialist advisors using the contact details below:



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