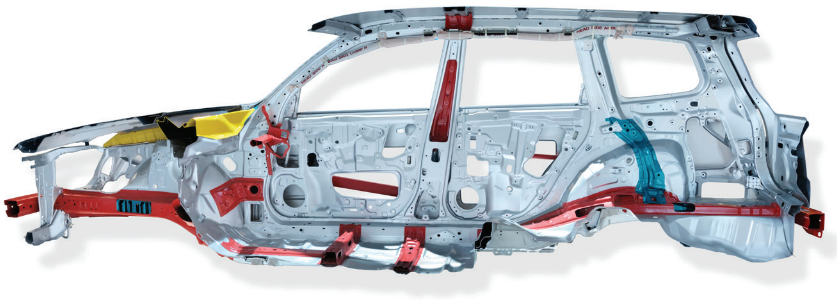
R&D incentives for organisations in the automotive industry
Driving Change



Increasing pressure for fuel-efficiency, 'green' engineering solutions, the need to address operational costs, and suppliers' role in developing new content, continue to transform the UK automotive industry and reshape its research and development programmes. Qualifying R&D activities can be found across a wide range of companies serving the industry, from the OEMs through the tiered supply chain to service companies. The good news is that the UK R&D tax regime provides valuable incentives for companies to encourage these activities. Whether a company claims R&D tax relief (the super-deduction) or the new R&D expenditure credit (RDEC), the eligibility requirements are relatively broad in nature meaning that any work where your personnel face significant technological challenge has the potential to qualify for this valuable benefit.

Although a wide variety of companies are already claiming for new product development activity and obvious areas of technological innovation, our experience is that automotive companies can overlook the extent of their qualifying R&D. Many are missing out on claims for projects where existing products are being improved, or where continuous process improvement activity is being undertaken, and consequently a large portion of the potential benefit may be lost.

Qualifying revenue expenditure includes:

- salary costs (including employer's NI and pension contributions) of engineers, technologists and other employees directly and actively involved in the R&D work, and of those indirectly involved in supporting eligible R&D projects;
- the cost of consumable items employed in the R&D process;
- 65% of contract staff costs; and
- the cost of software licences, and power, fuel and water used in the R&D projects.

Under the R&D scheme for large companies, claims can be made for activities contracted to the claimant company, but not for R&D work which has been subcontracted to a corporate third party. R&D subcontracted to individuals, universities or other qualifying bodies, however, can be claimed.

In contrast, the R&D relief for small and medium sized enterprises (SME relief) allows claimants to include 65% of the costs of R&D subcontracted to corporate third parties. R&D performed by an SME which is funded, subsidised or contracted to the company, however, cannot be claimed under the SME regime. In these circumstances, the SME can generally make claims under the large company scheme for the excluded expenditure.

In addition, all companies can claim 100% accelerated capital allowances on capital expenditure incurred on carrying out R&D activities or providing facilities for carrying out R&D.

Understanding your industry

As your engineers, technologists and scientists will be well aware, the product development process presents a wide range of technological challenges: from the initial concept development phase, clay or digital models, through to 'body in white' and the initiation of full scale manufacturing and testing with regulatory authorities before final release to customers. Many individuals and teams within your company may be directly and indirectly contributing to these R&D projects, and the time spent by these staff, who are often in non-R&D specific roles, should be included in your R&D claims.

Continuous process improvement work to reduce cost or wastage, modifying designs to environmental or regulatory constraints, increasing process capability or improving the recycling opportunities at the vehicle's 'end of life' can also meet the eligibility requirements, provided a level of scientific or technological challenge exists. These projects are often performed by teams outside the R&D department, and all too often this type of development is not considered when an organisation identifies activities for R&D tax relief.

Our team of R&D specialists have practical experience directly relevant to your industry and are able to assist your lead technical staff in identifying the full range of R&D activities taking place and mapping these activities across your organisation to manage your claims efficiently.

The range of potentially qualifying activities across the automotive industry is vast, but could include:

- Design and development of new, lighter weight composite material products that integrate with traditional steel and aluminium body shell parts to offer enhanced safety, environmental performance, reliability and durability at a reduced cost.
- Developing manufacturing and assembly strategies and techniques through "scaling up" of engineering prototype designs to enable production at full rate.
- Conducting experimental production trials on hybrid engine, gearbox and final drive system prototypes to advance fuel economy and demonstrate technical feasibility (including field evaluation).
- Devising new tools or software technologies to advance simulation and prediction capability that allows the limitation and control of vehicle panel deformation in crash scenarios.

Optimising your claim

Businesses can often readily identify activities that fall within the definition of research, since these tend to be in specific departments and account codes. However, developmental activities are much more difficult to define and identify as, typically, they are spread across several departments. Companies with traditional R&D or engineering departments can often overlook other areas of eligibility because the activities are not thought of as R&D in the traditional sense.

Many organisations would correctly consider that the development of a new composite body panel with the ability to resist accident impact loads at a rate higher than existing materials would be eligible. Frequently, however, the concurrent expenditure associated with the innovative development of the machine process to form the panel, so that the new material can be used in a new product, is not claimed. This can occur if the machine process development work occurs in a different department or division or if the equipment development is outsourced.

In other cases, a product development requirement may lead to the first use of a material for a particular application. Follow-up work to develop a wider range of parts using this material may continue to fulfil the eligibility requirements provided technological challenges persist in this work. Defining the appropriate end of an R&D project for tax purposes can require careful consideration in this type of situation.

The Deloitte Touch

Deloitte's Innovation tax team has a history of winning awards and publishing thought leadership. At a time when HMRC's interpretation of the "R&D v Production" distinction was restrictive, Deloitte, with others, used the industry knowledge of our experienced engineers to agree principles with HMRC such that costs associated with the outputs of R&D in the production environment which were sold, or capable of being sold, could be included in claims. Our understanding of the boundaries of R&D in a manufacturing environment, efficiency in approach and unrivalled experience in testing and agreeing these boundaries with HMRC have meant that the scope of R&D activity in a manufacturing environment for tax purposes has been redrawn. Combined with our leading-edge costing, technical and project management skills, Deloitte's Innovation tax team is the clear choice to partner manufacturers in optimising R&D claims.

Working with you

Our service model offers a range of bespoke solutions allowing us to work with you on a co-source basis wherever we can add most value. This may involve assisting you to manage your claims upon HMRC enquiry, carrying out a review and providing advice on the suitability of systems and processes for claim preparation, a review of claims prepared in-house or the provision of training for your staff.

In addition, as a member firm of our global network, we can access in-country experience and the ability to advise across the large number of jurisdictions that now offer tax based R&D incentives.

For further information contact:

Brian White
0118 322 2220
bhwhite@deloitte.co.uk

Carmen Aquerreta
020 7007 3928
caquerreta@deloitte.co.uk

Kylie Gregge
020 7007 0264
kgregge@deloitte.co.uk

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. 34546A