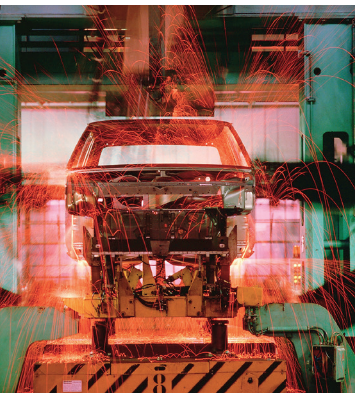

Development brings advantage
R&D incentives for organisations in the manufacturing sector

Faced with increased competition, shorter manufacturing cycles and ever increasing customer and regulatory demands, the UK manufacturing industry is responding by increasing investment in new and improved products and production processes. The good news is that the UK R&D 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, and any development 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, our experience is that many manufacturing companies are missing out on R&D claims for development projects where existing products are being improved, or where process improvement activity is being undertaken and consequently a large portion of the potential benefit is being lost.

Qualifying revenue expenditure includes:

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

Understanding your industry

The product development process presents a wide range of technological challenges: from bids and proposals and the initial concept development phase, through to the initiation of full-scale manufacturing and testing with customers. Many individuals and teams within your company may be contributing directly to these R&D projects, and the time spent by these staff, who are often not in R&D-specific roles, should be included in your R&D claims.

Process improvement work to reduce cost or wastage, adapt to environmental or regulatory constraints, or increase process capability can also meet the eligibility requirements, provided a level of 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 included when an organisation considers R&D incentives.

Our 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 manufacturing industry is vast, but could include:

- Development of improved production technology that increases end product quality, reliability or performance, or reduces the amount of waste generated by the production process.

- Where chemical processes are relocated between sites, significant technical challenges may be faced, even where the same end product is to be produced. The need to accommodate a wider range of processes into an existing line can drive efforts to increase throughput rates for existing procedures, and even small changes to the conditions experienced in the new line can result in significant technical effort being needed to resolve major quality issues.

- For some manufacturing operations, significant time can be required to change over between products. In these situations, technical work to understand how changes to plant design and/or clean-down methodologies can reduce that time, while still achieving target levels of cross contamination, may also meet the eligibility requirements.

Optimising your claim

Businesses can often readily identify activities that fall within the definition of research, since these tend to be picked up 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 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 material with a temperature rating 100°C higher than existing materials would be eligible. Frequently, however, the concurrent expenditure associated with the innovative development of the moulding machine necessary to process this material, so that it can be used in a new product, is not claimed when it could be. This can occur if the machine 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. 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 awards and thought leadership. At a time when HMRC's interpretation of the "R&D v Production" distinction was restrictive, Deloitte 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 on 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. 31470A