Wylie + Bisset

Chartered Accountants, Business & Tax Advisers

SME QUARTERLY

SPRING **2018**

Contact us...

Our specialists are here to help and answer any queries that you may have.

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Welcome to the Spring Edition of Wylie & Bisset LLP's quarterly SME newsletter.

Since our Winter newsletter, there have been some interesting developments with the ratifying of the Scottish Budget. The main talking point was the introduction of two new tax bands in Scotland, which has resulted in a fairly substantial deviation between Scottish tax payers and those paying tax in the rest of the UK. The main changes are summarised in this newsletter but further information on the budget can be found in the 'Wylie & Bisset News' section of our website.

In the Winter edition of our SME newsletter, we discussed cloud accounting, the importance of cyber security, and possible tax planning opportunities. In this issue, we build on the possible tax planning opportunities, by exploring the availability of additional Research & Development tax relief for companies, and the associated accounting issues faced by reporting Research & Development expenditure. We also look at how tax relief is given for capital expenditure, which is relevant to both incorporated and unincorporated entities.

Working together as a team to bring success and growth to our clients.

Meet the team...

Get to know our team with each quarterly issue.

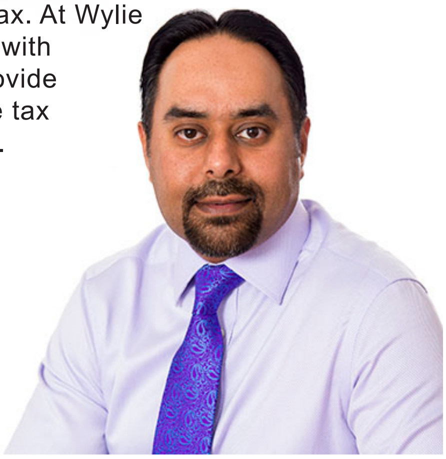
This issue meet...

Claire Dalrymple
- Senior Audit Manager

Claire re-joined Wylie & Bisset in February 2017 as a senior audit manager, having previously trained with the firm. Prior to her return Claire worked for a top 10 UK accounting practice for 13 years and more recently spent 2 years working for one of the big four. Claire specialises in providing audit services and business advice that covers a variety of business sectors. Claire's client base and experience is in large/medium groups, which includes the consolidation process, group reporting and financial statement compliance. Her main area of expertise is within the SME sector. Her main focus is to provide a high quality service that is tailored to her individual client needs.

Shehzad Ashaq
- Senior Tax Manager

Shehzad joined Wylie & Bisset in February 2016 as Senior Tax Manager. Prior to joining the firm he worked for a top 10 UK accountancy practice for 17 years. Shehzad qualified as a Chartered Accountant in 2001 and had obtained Chartered Tax Adviser status by 2002. Shehzad has a broad range of experience in both corporate and personal tax. He worked with some of the largest owner-managed business clients of his previous firm and brings a wealth of experience, specialising in corporate tax. At Wylie & Bisset he works closely with Catherine McManus to provide a full and robust corporate tax service for our client base.



Scottish Budget

The Scottish draft budget was announced on 14 December 2017 and has since been ratified on 22 February 2018. The big change affecting SMEs and their owners is the introduction of new income tax rates and bands for Scottish tax payers for "Non-Savings Income". The personal allowance has been kept in line with the rest of the UK at £11,850, but Scottish tax payers will now pay tax at the following rates on taxable non-savings income:

£0 - £2,000	**19%**
£2,001 - £12,150	**20%**
£12,151 - £31,580	**21%**
£31,581 - £150,000	**41%**
£150,000+	**46%**

This is assuming the tax payer is entitled to the full personal allowance. However, this is reduced by £1 for every £2 earned over £100,000. Non-savings income will cover employment income, self-employed income, rental income, pension income, and taxable state benefits. This means that UK rates and bands will still apply to other income such as dividend and interest income. In most circumstances it will be easy to tell if you are a Scottish tax payer; if you live in Scotland, you pay the Scottish rates. Employers will be notified to process the individual as a Scottish tax payer through their tax code; a letter 'S' will be included at the start of the code. If you have slightly more complicated circumstances, please contact us for more information.

It was also announced that from 2019/20 half of the VAT from Scottish receipts will be assigned to Revenue Scotland. Currently there has been no further information as to the precise method of assignment

Spring Statement

The Chancellor Philip Hammond presented his first Spring Statement on Tuesday 13 March 2018. As the Autumn Statement has now been moved to Spring, and the main budget is in October, there was little in the way of new announcements. The statement was focused around growth and borrowing forecasts and environmental issues. There was, however, some consultation requested on proposals for how to ensure digital businesses are paying their fair share of VAT, and on extending tax relief for both employed and self-employed individuals that fund their own training and skill development.

Capital allowances

In the Winter Edition of this newsletter, we explained the benefits of being proactive and seeking advice prior to carrying out capital transactions, in order for you to gain the maximum possible tax relief for your investment. This article expands on this area by explaining the basic workings of tax relief for capital expenditure, allowing you to understand where relief may be available for any future purchases or developments.

Tax relief is not given for capital expenditure in the profit and loss account. This is because it provides an enduring benefit for the trade. Additionally, depreciation is not usually tax deductible, due to its subjective nature.

Therefore, tax relief is given for certain capital expenditure via 'capital allowances' (CA). CA are available on qualifying assets when they are purchased outright or acquired via a hire purchase arrangement. However, where an asset is acquired via an operating lease, ownership does not pass from the lessor, so CA will not be available. The availability of the CA depends on the type of asset acquired. There are also various types of CA available, which give relief at different rates to different classes of assets.

Plant & Machinery (P&M) vs. Building

Generally, expenditure on P&M will qualify for CA, whereas expenditure on the building, or anything that helps create the setting of the business, will not qualify for CA. Therefore, it is important to understand what is classed as P&M and what is classed as the building, as this has a fundamental impact on the availability of CA.

P&M is apparatus that is used to carry on a business, which has a permanent nature, and is considered a chattel. HMRC consider anything with an expected life of over 2 years to be permanent.

A building is not a chattel; It is the setting in which a business is carried on, so the building itself will not qualify for CA. In addition, CA are not available on any asset which helps to form part of the setting of the trade. The following are some examples of what would be considered a building, or the setting, and will not qualify for CA:

- Walls, floors, ceiling, shutters, etc.
- Shafts or similar structures
- Tunnels, bridges, pavements, etc.

However, as nothing in tax is ever straight forward, there are some parts of the building that will be treated as plant, and therefore will qualify for CA. These are often grouped together and referred to as "integral features". A couple of examples of these are:

- Lifts and escalators;
- Central heating and air conditioning
- Electrical lighting, power and water systems
- External solar screening.

Annual Investment Allowance (AIA)

AIA provides 100% tax relief in the year of purchase on items that qualify for CA (different rules apply to cars, this is discussed in a later section). The annual limit of AIA from 1 January 2016 is £200,000, although there are special rules for companies who are part of a group, or for individuals who are involved in more than one business.

AIA can only be used in the year that the asset is purchased and is not available on assets purchased from a connected person.

Writing Down Allowance (WDA)

If a business uses its full AIA, or it is not tax efficient to claim 100% relief in the year of purchase, then WDA is available. WDA is available at the rate of either 8% or 18% on the tax written down value of the asset. WDA is given at 18% for all P&M but is only given at 8% on integral features. As AIA can be allocated as the business chooses, it should always be allocated against integral features before P&M.

First Year Allowances (FYA)

FYA is a further type of CA that gives relief at 100%. This is usually available on energy saving and environmentally beneficial P&M. The assets must be purchased new and not second hand. There is a specific, legislated list of assets which will qualify for this relief. Assets qualifying for FYA do not form part of the qualifying expenditure making up the £200,000 AIA threshold.

As will be discussed in the following article, expenditure on P&M and buildings (but not land) used for the purposes for carrying out Research and Development will also qualify for FYA.

Cars

As previously mentioned, cars do not qualify for AIA. Therefore, relief is given annually via WDA. The rate of WDA available depends upon the CO_2 emissions of the car. The rates for cars purchased on or after 1 April 2018 are:

- 0 – 110 g/km – 18% WDA
- Above 110 g/km – 8% WDA

FYA is also available on cars with CO_2 emissions 50g/km or less.

Property Acquisition

When acquiring property, capital allowances should be a key consideration when deciding on an allocation of the purchase price. Failure to agree a split during the legal process will most likely result in capital allowances being lost forever.

Other points

When an asset is disposed of, and CA have been claimed, this will have a bearing on the CA calculation. Therefore, it is important to keep track of any proceeds received, or any asset that is scrapped, as additional relief or charges may occur.

There are other rules to be aware of, such as:

- How to determine the date of purchase of an asset;
- Special treatment of "short" and "long" life assets;
- Time apportioning allowances for periods +/- 12 months;
- Private use adjustments in unincorporated businesses;
- Treatment of assets on the purchase of a new trade/building;

Due to the complex nature of capital allowances, and the potential for beneficial tax savings if completed correctly, advice should always be sought prior to making any large purchases. Wylie & Bisset will be able to advise and help in this area so that you will receive the maximum tax reliefs available to you.

Research and Development (R&D)

Due to increased competition, many businesses in the commercial world are spending vast amounts of resources on the R&D of products and services. Noting the importance of R&D, and in order to encourage companies to continue to invest money in R & D, the Government provides generous tax reliefs for R&D expenditure, especially for SMEs. There are many companies that do not take full advantage of these reliefs as it may not occur to them that work they are carrying out would be considered as R&D.

Accounting for R&D Costs

The accounting standards have rightly accepted the importance of dealing with R&D costs. However, the UK and the International Accounting Standards Board have varying viewpoints on how R&D expenditure should be accounted for. In this part of the article we explore the complications faced by companies when accounting for R&D expenditure.

What Constitutes R&D?

The definition of R&D can be found in FRS 102 or IAS 38 and is the same for both accounting and tax purposes. Broadly speaking, R&D occurs where a company is carrying out a project with the aim of an advance in science or technology. There is an incredibly wide array of activities that would constitute R&D, including:

- Activities with the aim of obtaining new knowledge.
- Looking for ways to apply knowledge and research findings, and evaluating the identified applications.
- Searching for alternatives for materials, devices, products, processes, systems or services;
- Formulating, designing, evaluating, and selecting such alternatives.

R&D may produce new knowledge, a new product, or an update to an already existing product. However, general analysis, copying, or incorporating an already existing product into your business, will not constitute R&D.

The Predicament

If at some point in the future economic benefits are likely to flow to the entity as a result of incurring R & D expenditure, then it can be justified that these costs should be treated as an asset, rather than as revenue expenditure. This is because the expenditure meets the definition of an asset prescribed by the Statement of Principles, as well as the IASB framework for the Preparation and Presentation of Financial Statements.

UK Treatment

Under the UK accounting standards, the accounting for R&D is governed by Section 18 of FRS 102.

R & D is categorised as an internally generated asset and is split into a research phase and a development phase.

Irrespective of the amount of the expenses incurred, research costs are always expensed to the profit and loss account. However, the boundaries between R&D are not always clear cut. In case of any ambiguity, all doubtful expenses are classified as research expenses and written off in the year in which they are incurred.

FRS 102 has issued a list of the following items that should always be expensed and not be treated as an intangible asset:

- Internally generated brands, logos, publishing titles, customer lists and items of a similar nature
- Start-up activities/costs
- Training activities
- Advertising and promotional expenses
- Relocating or reorganising part, or all, of an entity
- Internally generated goodwill

Additionally, entities can choose to capitalise or expense development costs. Development costs can only be capitalised (and subsequently amortised) if the following conditions are met. The conditions that are set out in FRS 102 are as follows:

- It is technically feasible that the asset will be completed
- The entity intends to complete the asset to use or to sell it and is able to do so
- The asset demonstrably can generate future economic benefits
- The entity has sufficient resources to allow for completion of the asset
- The expenditure on the asset can be measured with reliability

If a capitalisation policy is adopted under FRS 102, it should be applied consistently to all development projects which qualify under the conditions.

Where the development costs are recognised as an asset, they should be amortised over the period which the benefit is expected to arise. Amortisation begins only once commercial production commences or when the developed product or service comes into use.

All such capitalised projects are reviewed at the end of each accounting year to ensure that they still qualify and meet all the recognition criteria. Where the conditions are no longer met, the capitalised cost is expensed immediately.

It should be noted that FRS 102 allows a choice of capitalising development costs which clearly gives rise to inconsistencies between companies, and can lead to manipulation of the costs. Out with the UK, if the criteria for capitalisation of development costs are met, they must be treated as an asset.

Accounting Disclosure

The notes to the accounts should disclose the following additional information related to R&D costs:

- Accounting policy, including the basis for amortisation
- Total R&D costs incurred in each period for which an income statement is prepared and the amount of costs that have been capitalised or deferred in each period.

Conclusion

Considerable judgement is required to identify the points of progress in a R&D project, at which a new or improved product or process is defined as technologically feasible, marketable or useful. Neither can the probability of future benefits be readily assessed. A management decision to proceed with the project does not assure future benefits. There are, however, no set conditions that can be established for the capitalisation of costs, which could help achieve comparability among enterprises in the same industry. Hence the disclosure in the notes to the accounts is very important.

Tax Relief for R&D Expenditure

In the Winter Edition of our SME newsletter, we very briefly touched on the availability of R&D reliefs as a tax planning opportunity. This part of the article gives a more in depth overview of when the additional reliefs are available, how they are calculated, and aims to encourage companies to consider whether any of their current expenditure would qualify for additional relief.

How Is The Relief Given?

Depending on the size of the company, the relief can be given under two separate regimes:

Small and Medium Sized Enterprises (SMEs)

In order to qualify as a small or medium size company, the following two requirements must be met:

- Fewer than 500 employees; and
- Either annual turnover not exceeding €100m or an annual balance sheet figure not exceeding €86m.

SMEs are entitled to claim an additional deduction of 130% of the amount of qualifying R&D expenditure. This means that SMEs can deduct a total of 230% to arrive at their adjusted taxable profits. To gain relief under the SME regime, the R&D cannot be related to activities that are contracted out to the company, and the project cannot be subsidised by Notified State Aid. However, relief may be available to SMEs under the large company regime for this type of expenditure (see below). If a company is loss making, it is possible to surrender part of the loss and claim a tax refund from HM Revenue & Customs. The loss which can be surrendered is the lower of:

- The unrelieved trading loss; and
- 230% of the qualifying R&D expenditure

Once the surrenderable loss has been calculated, a credit of 14.5% of this amount will be repaid to the company. The deadline for making an R&D claim is 2 years from the end of the accounting period that the expenditure is incurred.

Large Companies

Since April 2016, large companies are entitled to R&D relief using the 'Research and Development Expenditure Credit' (RDEC). The RDEC is calculated at 12% of the qualifying R&D expenditure.This amount will either reduce the company's corporation tax liability or will be repaid to the company as a cash payment if there is no liability. As mentioned above, the RDEC is also available to SMEs who do not qualify for expenditure under the SME regime.

Qualifying Expenditure

To gain additional R&D relief, the R&D must relate to a trade carried on by the company and must be revenue expenditure (i.e. not capital). Deciding whether specific expenditure qualifies for the additional R&D relief can be a fairly intricate process. Generally, relief is available on:

- Staff and subcontractor costs;
- Consumable items;
- Software;
- Externally provided workers;
- Payments to subjects of clinical trials.

If your expenditure fits into one of these categories, there are further, intricate rules which need to be observed, in order to decide if it qualifies.

Capital Expenditure

Capital expenditure on plant, machinery, and buildings (but not land) used for the purposes of carrying out R&D qualifies for capital allowance, and, in particular, 'First Year Allowances'. This provides relief for 100% of the expenditure, effectively treating it as a normal revenue expense.

How We Can Help

Wylie & Bisset will be able to advise on the types of project that will qualify for additional R&D relief, as well as correctly identify which expenditure can qualify for the additional relief. In order to claim the relief, it is important to provide HM Revenue & Customs with evidence of how your project meets their definition of R&D. Wylie & Bisset have staff who are experienced in preparing reports to support claims.

If you would like any further information on current or future projects, please contact shehzad.ashaq@wyliebisset.com.

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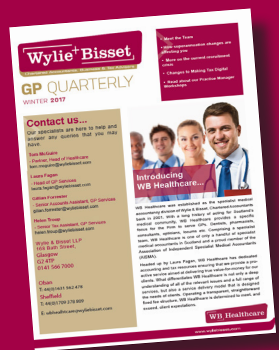

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