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Support Announced for R&D-Intensive SMEs in UK's Spring Budget 2023, Other Changes to R&D Tax Relief Regime

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In recognition of the need to support the UK's most innovative businesses, an additional tax relief for research and development-intensive small- and medium-sized enterprises (SMEs) was recently announced in the Spring Budget 2023, partially counteracting reforms decreasing the SME R&D tax relief rates that were announced in the Autumn Statement 2022. Additionally, the previously announced reform with respect to the new territorial restrictions intended to refocus R&D relief toward activities undertaken in the UK will be postponed, and there are changes to certain filing requirements.

The changes that were previously announced, which included a decrease in the SME R&D enhanced deduction and credit rate, in respect of expenditure incurred on or after 1 April 2023, were discussed in our January 2023 client alert on significant changes to the R&D tax regime, published following the Autumn Statement 2022.

The changes announced in the Spring Budget 2023, which come as welcome news to early-stage companies focused on innovation, including those in the life sciences sector, are discussed below.

Targeted relief for R&D-intensive SMEs

After engagement with industry, the government acknowledged in the Spring Budget 2023 that the reductions to the rates of the reliefs available for SMEs under the R&D tax relief regime announced in the Autumn Statement 2022 have created challenges for some R&D-intensive SMEs.

In recognition of this, as well as the value of R&D-intensive SMEs to the UK's wider innovation ecosystem and the difficulties such SMEs face when raising capital, the government announced that loss-making SMEs whose qualifying R&D expenditure incurred after 1 April 2023 is at least 40% of total annual expenditure – and that therefore qualify as "R&D-intensive" – will be entitled to the R&D credit rate of 14.5% (rather than the reduced credit rate of 10% announced in the Autumn Statement 2022). However, the enhanced deduction available to such SMEs will be the previously announced rate of 86% (which is less generous than the rate for pre-April 2023 expenditure).

The effect of the changes is that R&D-intensive SMEs will be entitled to an R&D credit equal to 26.97% of amounts incurred on qualifying R&D, rather than 18.6%, which will apply to SMEs that do not qualify as R&D-intensive. Therefore, some funding support for loss-making R&D-intensive SMEs will be lost from April, but the reduction is much less than was feared. The previously announced increases to the rates of the "above-the-line" R&D expenditure credit (RDEC), primarily targeted at larger companies, will remain the same.

The broad "net" effect following all of the announced rate changes is summarized in the table below.

	Pre-April 2023	From April 2023
Loss-making R&D-intensive SME	Enhanced deduction: **130%** R&D credit: **14.5%** Benefit: **33.35%**	Enhanced deduction: **86%** R&D credit: **14.5%** Benefit: **26.97%**

Other loss-making SME	Enhanced deduction: **130%** R&D credit: **14.5%** Benefit: **33.35%**	Enhanced deduction: **86%** R&D credit: **10%** Benefit: **18.6%**
Profit-making SME	Enhanced deduction: **130%** Corporation tax rate: **19%** Benefit: up to **24.7%**	Enhanced deduction: **86%** Corporation tax rate: **25%** Benefit: up to **21.5%**
RDEC company	RDEC credit rate: **13%** Corporation tax rate: **19%** Benefit (after tax): **10.53%**	RDEC credit rate: **20%** Corporation tax rate: **25%** Benefit (after tax): **15%**

As these changes will be legislated after 1 April 2023, R&D-intensive SMEs can either claim any payable credit at the new 10% rate applying from 1 April 2023 and subsequently amend their corporation returns to claim the higher rate, or they can delay making their claim until the legislation is introduced (the government intends to introduce the legislation in Finance Bill 2023 – 24).

Postponement of overseas expenditure restrictions and changes to certain filing requirements

The new territorial conditions restricting R&D relief in respect of some overseas expenditure (discussed in our previous alert) will now come into effect from 1 April 2024, a year later than had been planned, to allow the government to consider the interaction between this restriction and the design of a single UK R&D regime (see below). This may be seen as good news for some businesses, but its late announcement has left little time for planning.

The requirement to file an additional information form, providing information such as the breakdown of costs across qualifying categories and a description of the R&D, has been brought forward and will now apply to claims submitted on or after 1 August 2023 (instead of claims submitted for accounting periods beginning on or after 1 April 2023).

Possible merging of the RDEC and SME schemes

The government will continue to consider the possible merging of the RDEC and SME schemes into a single scheme and will publish a summary of responses to the recent government consultation and draft legislation in July 2023. It has committed to a more collaborative approach with impacted industries than it did in the lead-up to the changes announced in the Autumn Statement 2022, which should ensure a more informed approach is taken to any future changes.

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