

Research and Development Tax Relief

Who is likely to be affected?

Companies claiming research and development (R&D) tax relief.

General description of the measure

Following consultation in November 2010 and June 2011, the Government intends to legislate improvements to R&D tax relief in Finance Bill 2012. In particular, for the small or medium enterprise (SME) scheme only:

- the rate of additional deduction for a SME company will be further increased from 100 per cent to 125 per cent from April 2012, giving relief of 225 per cent in all;
- to allow the increase in the additional deduction for SMEs while remaining within state aid limits, the rate of payable credit for SMEs will be reduced to 11 per cent, and vaccine research relief for SME companies will be withdrawn;
- the rule limiting the amount of payable R&D tax credit to the amount of a company's PAYE/NIC liability will be removed; and,
- the existing definition of when a company is a "going concern" will be clarified to confirm that companies in administration or liquidation are excluded from relief.

For the SME and large company schemes:

- the requirement for minimum expenditure of £10,000 a year will be removed; and,
- the scope of the definition of an "externally provided worker" will be widened.

Policy objective

To improve the overall competitiveness of the UK tax system for R&D companies by increasing the incentive for them to carry out R&D, increasing R&D and innovation in the UK. The aim is to make the UK a preferred location for companies to carry out R&D and boost productivity and growth.

Background to the measure

The changes announced follow consideration by the Government of responses to:

- a consultation document *Corporate Tax reform: delivering a more competitive system* was published on 29 November 2010 on the HM Treasury website and included consultation on the R&D tax relief; and,
- a response document, *Research and Development Tax Credits: response and further consultation* published on 10 June 2011 on the HM Treasury website.

Budget 2011 announced increases to the rate of SME R&D relief, together with abolition of the PAYE/NIC limit and £10,000 a year minimum expenditure.

Legislation implementing the increase in the rate of additional SME R&D relief to 100 per cent was included in Finance Act 2011.

State aid approval for the increases in the rate of SME relief and the abolition of the PAYE/NIC limit and the £10,000 a year minimum expenditure was received in September 2011. The increase in the rate of additional SME R&D relief to 100 per cent, with effect from 1 April 2011, was then brought into effect.

Detailed proposal

Operative date

For the SME scheme only:

- The further increase in the rate of additional deduction for SMEs and the corresponding reduction in the rate of payable tax credit to 11 per cent, together with removal of vaccine research relief for SMEs, will have effect for expenditure incurred on or after 1 April 2012.
- The abolition of the PAYE/NIC limit will have effect for accounting periods ending on or after 1 April 2012.
- The clarification of what constitutes a company being a 'going concern' will apply to claims for relief made on or after 1 April 2012.

For the SME and large company schemes:

- The removal of the £10,000 minimum expenditure will have effect for accounting periods ending on or after 1 April 2012.
- The revised definition of an "externally provided worker" will have effect for expenditure incurred on or after 1 April 2012.

Current law

The current rules are in Part 13 of the Corporation Tax Act 2009 (CTA). Separate rules deal with claims by companies which are SMEs (the SME scheme), claims by large companies, and claims for vaccines research relief (VRR).

Section 1044 provides that a company which is a small or medium sized enterprise will receive an additional deduction of 100 per cent of its qualifying R&D expenditure, and sets out the conditions for this, including that its expenditure meets the R&D threshold (section 1044(3)).

Section 1057 provides that payable tax credit is only available where a company is a going concern. Section 1058 defines the amount of payable tax credit to which a company is then entitled and limits this to the amount of its PAYE and NIC liability for the period in question.

Section 1074 imposes the same R&D threshold for large companies and section 1087 imposes it for vaccine research relief.

Sections 1127-1132 define an externally provided worker for all three schemes.

Proposed revisions

Legislation will be introduced in Finance Bill 2012 to increase the additional deduction for SME companies to 125 per cent of qualifying R&D expenditure. To allow for the increase, while remaining within state aid intensity thresholds:

- Vaccine Research Relief for SMEs will be abolished for expenditure incurred on or after 1 April 2011; and,
- the rate of payable SME R&D tax credit will be reduced to 11 per cent for expenditure incurred on or after 1 April 2012.

Legislation will also be introduced in Finance Bill 2012 to:

- abolish the rule limiting a SME company's payable R&D tax credit to the amount of PAYE and national insurance contributions (NICs) it pays;
- remove the £10,000 minimum expenditure condition for all companies;
- simplify the rules defining an externally provided worker to allow for cases where additional parties are involved in providing workers; and,
- clarify that where a company is in administration or liquidation it is not a "going concern" and is excluded from relief.

Summary of impacts

Exchequer impact (£m)	2011-12	2012-13	2013-14	2014-15	2015-16
	The figures were set out as part of a wider reform to R&D tax credits in Table 2.1 of Budget 2011 and have been certified by the Office of Budget Responsibility. More detail can be found in the policy costings document published alongside the Budget. This element of the reform is expected to decrease receipts by approximately £60 million a year.				
Economic impact	<p>R&D expenditure is likely to have positive spillover effects in terms of increased innovation and productivity in the wider economy. But as these will not be reflected in the return to R&D investment that individual companies make they will tend to under invest in R&D. This is supported by academic studies.</p> <p>R&D tax relief reduces the cost of R&D investment that companies make and is therefore likely to increase aggregate R&D expenditure, which will benefit the economy more widely through the positive spillover effects.</p>				
Impact on individuals and households	There is no impact on individuals or households. This change only affects companies involved in research and development and not individuals.				
Equalities impacts	This change only affects companies involved in research and development and not individuals. It is considered that these proposals have no significant impacts on protected equality groups.				
Impact on business including civil society organisations	<p>Around 7,000 SME and 1,750 large companies claim R&D tax relief each year. These companies will benefit from the improved incentive to carry out additional R&D and the simplification of the rules.</p> <p>These are straightforward changes with a negligible one-off administrative impact on companies claiming R&D tax relief.</p>				
Operational impact (£m) (HMRC or other)	Some increases are anticipated in the number of companies making claims, in the amount of R&D expenditure companies incur, and in the amount of relief claimed. However, no structural changes are necessary to operational delivery and there should be no significant impact on HMRC operational costs.				
Other impacts	<p><u>Small firms impact test:</u> These changes respond to consultation with small companies and other stakeholders. There will be a positive impact for small firms carrying out research and development, as they will benefit from increased tax relief.</p> <p><u>Competition assessment:</u> There should not be any impact on competition as they do not affect or limit suppliers' ability to compete.</p>				

Monitoring and evaluation

Uptake of the number of companies claiming the relief and amounts of relief claimed are regularly monitored, and published as National Statistics.

Further advice

If you have any questions about this change, please contact David Harris on 020 7147 2562 (email: david.harris@hmrc.gsi.gov.uk) or Neil Smillie on 020 7147 0864 (email: neil.smillie@hmrc.gsi.gov.uk).

1 Relief for expenditure on R&D

Schedule 1 contains provision about corporation tax relief for expenditure on research and development.

SCHEDULE 1

Section 1

RELIEF FOR EXPENDITURE ON R&D

Introductory

- 1 Part 13 of CTA 2009 (additional relief for expenditure on research and development) is amended as follows.

Amount of relief for expenditure on R&D by small or medium-sized enterprises (“SMEs”)

- 2 (1) Chapter 2 (relief for SMEs: cost of R&D incurred by SME) is amended as follows.
 - (2) In section 1044 (additional deduction in calculating profits of trade), in subsection (8), for “100%” substitute “125%”.
 - (3) In section 1045 (alternative treatment for pre-trading expenditure: deemed trading loss), in subsection (7), for “200%” substitute “225%”.
 - (4) In section 1055 (tax credit: meaning of “Chapter 2 surrenderable loss”), in subsection (2)(b), for “200%” substitute “225%”.
 - (5) In section 1058 (amount of tax credit), in subsection (1)(a), for “12.5%” substitute “11%”.

Removal of R&D threshold

- 3 (1) Chapter 2 (relief for SMEs: cost of R&D incurred by SME) is amended as follows.
 - (2) In section 1043 (overview of Chapter), in subsection (3), omit paragraph (e) (but not the “and” after it).
 - (3) In section 1044 (additional deduction in calculating profits of trade), omit subsection (3).
 - (4) In section 1045 (alternative treatment for pre-trading expenditure: deemed trading loss) –
 - (a) in subsection (1), omit “, B”, and
 - (b) omit subsection (3).
 - (5) Omit section 1050 (R&D threshold).
- 4 (1) Chapter 3 (relief for SMEs: R&D sub-contracted to SME) is amended as follows.
 - (2) In section 1063 (additional deduction in calculating profits of trade) –
 - (a) in subsection (1), omit “, B”, and
 - (b) omit subsection (3).
 - (3) Omit section 1064 (R&D threshold).

- 5 (1) Chapter 4 (relief for SMEs: subsidised and capped expenditure on R&D) is amended as follows.
 - (2) In section 1068 (additional deduction in calculating profits of trade) –
 - (a) in subsection (1), omit “, B”, and
 - (b) omit subsection (3).
 - (3) Omit section 1069 (R&D threshold).
- 6 (1) Chapter 5 (relief for large companies) is amended as follows.
 - (2) In section 1074 (additional deduction in calculating profits of trade) –
 - (a) in subsection (1), omit “, B”, and
 - (b) omit subsection (3).
 - (3) Omit section 1075 (R&D threshold).
- 7 (1) Chapter 7 (relief for SMEs and large companies: vaccine research etc) is amended as follows.
 - (2) In section 1085 (overview of Chapter), in subsection (5), omit paragraph (c).
 - (3) In section 1087 (deduction in calculating profits of trade) –
 - (a) in subsection (1), omit “, B”, and
 - (b) omit subsection (3).
 - (4) In section 1092 (SMEs: deemed trading loss for pre-trading expenditure), omit subsection (3).
 - (5) Omit section 1097 (R&D threshold).
- 8 In consequence of the amendments made by paragraphs 3 to 7, in Schedule 4 to CTA 2009 omit each of the entries for “R&D threshold”.

Company not a going concern when in administration or liquidation

- 9 Chapter 2 (relief for SMEs: cost of R&D incurred by SME) is amended as follows.
- 10 (1) Section 1046 (relief only available where company is going concern) is amended as follows.
 - (2) At the end of subsection (2) insert –

“This is subject to subsection (2A).”
 - (3) After subsection (2) insert –
 - “(2A) A company is not a going concern at any time if it is in administration or liquidation at that time.
 - (2B) For the purposes of this section a company is in administration if –
 - (a) it is in administration under Part 2 of the Insolvency Act 1986 or Part 3 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19)), or
 - (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.
 - (2C) For the purposes of this section a company is in liquidation if –

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- (a) it is in liquidation within the meaning of section 247 of that Act or Article 6 of that Order, or
 - (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.”
 - 11 (1) Section 1057 (tax credit only available where company is going concern) is amended as follows.
 - (2) At the end of subsection (4) insert –
“This is subject to subsection (4A).”
 - (3) After subsection (4) insert –
“(4A) A company is not a going concern at any time if it is in administration or liquidation at that time.

(4B) For the purposes of this section a company is in administration if –
 - (a) it is in administration under Part 2 of the Insolvency Act 1986 or Part 3 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19)), or
 - (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.
(4C) For the purposes of this section a company is in liquidation if –
 - (a) it is in liquidation within the meaning of section 247 of that Act or Article 6 of that Order, or
 - (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.”
 - 12 Chapter 7 (relief for SMEs and large companies: vaccine research etc) is amended as follows.
 - 13 (1) Section 1094 (relief only available to SME where company is going concern) is amended as follows.
 - (2) At the end of subsection (2) insert –
“This is subject to subsection (2A).”
 - (3) After subsection (2) insert –
“(2A) A company is not a going concern at any time if it is in administration or liquidation at that time.

(2B) For the purposes of this section a company is in administration if –
 - (a) it is in administration under Part 2 of the Insolvency Act 1986 or Part 3 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19)), or
 - (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.
(2C) For the purposes of this section a company is in liquidation if –
 - (a) it is in liquidation within the meaning of section 247 of that Act or Article 6 of that Order, or

- (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.”
- 14 (1) Section 1106 (tax credit only available where company is going concern) is amended as follows.
 - (2) At the end of subsection (4) insert –
“This is subject to subsection (4A).”
 - (3) After subsection (4) insert –
“(4A) A company is not a going concern at any time if it is in administration or liquidation at that time.

(4B) For the purposes of this section a company is in administration if –
 - (a) it is in administration under Part 2 of the Insolvency Act 1986 or Part 3 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19)), or
 - (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.
 - (4C) For the purposes of this section a company is in liquidation if –
 - (a) it is in liquidation within the meaning of section 247 of that Act or Article 6 of that Order, or
 - (b) a corresponding situation under the law of a country or territory outside the United Kingdom exists in relation to the company.”

Removal of limit on amount of tax credit based on PAYE and NIC liabilities

- 15 (1) Chapter 2 (relief for SMEs: cost of R&D incurred by SME) is amended as follows.
 - (2) In section 1058 (amount of tax credit), in subsection (1), omit paragraph (b) (and the “or” before it).
 - (3) Omit section 1059 (total amount of company’s PAYE and NIC liabilities).

Abolition of vaccine research relief for SMEs

- 16 (1) Section 1039 (overview of Part 13) is amended as follows.
 - (2) In subsection (6), for the words from “companies” to “companies)” substitute “large companies”.
 - (3) In subsection (7) –
 - (a) for “Chapters 2 and 7 also provide” substitute “Chapter 2 also provides”, and
 - (b) in paragraph (a), omit “or 7”.
- 17 In section 1042 (“relevant research and development”), in subsection (3), omit “SMEs and”.
- 18 In section 1046 (relief only available where company is going concern), in subsection (2)(b), omit “or Chapter 7”.

- 19 In section 1057 (tax credit only available where company is going concern), in subsection (4)(b), omit “or Chapter 7”.
- 20 Chapter 7 (relief for SMEs and large companies: vaccine research etc) is amended as set out in paragraphs 21 to 30.
- 21 (1) Section 1085 (overview of Chapter) is amended as follows.
- (2) In subsection (1), for the words from “companies” to “companies)” substitute “large companies”.
- (3) For subsection (3) substitute –
- “(3) The relief available is a deduction under section 1087 (the amount of which is determined under section 1091).”
- (4) Omit subsection (4).
- (5) For subsection (5) substitute –
- “(5) Sections 1098 to 1102 contain provision about when a company’s expenditure is “qualifying Chapter 7 expenditure” for the purposes of obtaining relief and when such expenditure is “for” an accounting period.”
- (6) Omit subsection (6).
- (7) In subsection (7), omit “or R&D tax credits”.
- 22 (1) Section 1087 (deduction in calculating profits of trade) is amended as follows.
- (2) In subsection (1), for “and C” substitute “, C and D”.
- (3) After subsection (4) insert –
- “(4A) Condition D is that the company is a large company throughout the period.”
- (4) For subsection (7) substitute –
- “(7) For the amount of the deduction see section 1091.”
- (5) In subsection (9) –
- (a) in paragraph (a), omit “large”,
- (b) omit paragraph (b), and
- (c) in paragraph (d), for “sections 1099 and 1100” substitute “section 1100”.
- 23 (1) In section 1088 (large companies: declaration about effect of relief), in subsection (1), omit “large”.
- (2) Accordingly, the heading of that section becomes “**Declaration about effect of relief**”.
- 24 Omit sections 1089 and 1090 (which relate only to SMEs).
- 25 (1) In section 1091 (large companies: amount of deduction), in subsection (1), omit paragraph (b) (and the “and” before it).
- (2) Accordingly, the heading of that section becomes “**Amount of deduction**”.

- 26 Omit sections 1092 to 1096 and 1099 (which relate only to SMEs).
- 27 (1) In section 1100 (large companies: qualifying expenditure “for” an accounting period), for subsection (1) substitute –
- “(1) A company’s qualifying Chapter 7 expenditure is “for” an accounting period if it is allowable as a deduction in calculating for corporation tax purposes the profits for the period of a trade carried on by the company.”
- (2) Accordingly, the heading of that section becomes “**Qualifying expenditure “for” an accounting period**”.
- 28 Omit sections 1103 to 1111 (tax credits).
- 29 (1) Section 1112 (artificially inflated claims for relief or tax credit) is amended as follows.
- (2) In subsection (1), for “the purposes mentioned in subsection (2)” substitute “the purpose of determining for an accounting period relief to which a company is entitled under this Chapter”.
- (3) Omit subsection (2).
- (4) In subsection (3) –
- (a) at the end of paragraph (a) insert “or”, and
- (b) omit paragraphs (c) and (d).
- (5) Accordingly, the heading of that section becomes “**Artificially inflated claims for relief**”.
- 30 The heading of Chapter 7 becomes “RELIEF FOR LARGE COMPANIES: VACCINE RESEARCH ETC”.
- 31 (1) Chapter 8 (cap on aid for R&D) is amended as follows.
- (2) In section 1113 (cap on R&D aid under Chapter 2 or 7), in subsection (4)(b), omit “SMEs and”.
- (3) In section 1115 (“the tax credits”), in subsection (1), omit “or 7”.
- 32 In consequence of the amendments made by paragraphs 16 to 31 –
- (a) in Schedule 4 to CTA 2009 (index of defined expressions), omit the entry for “Chapter 7 surrenderable loss”,
- (b) in Schedule 1 to CTA 2010, omit paragraphs 672 to 674, and
- (c) in section 43 of FA 2011, omit subsections (7) to (11).

Meaning of “externally provided worker”

- 33 (1) Chapter 9 (supplementary) is amended as follows.
- (2) In section 1128 (“externally provided worker”), in subsection (7), for “the staff provider” substitute “a person other than the company”.
- (3) In section 1129 (connected persons), in subsection (6)(a), for “the contract mentioned in section 1128(7)” substitute “a contract between the worker and the staff provider”.

Application

- 34 The amendments made by paragraphs 2 and 16 to 33 have effect in relation to expenditure incurred on or after 1 April 2012.
- 35 The amendments made by paragraphs 3 to 8 and 15 have effect in relation to accounting periods ending on or after 1 April 2012.
- 36 The amendments made by paragraphs 9 to 14 have effect in relation to claims or elections made on or after 1 April 2012.

EXPLANATORY NOTE

RELIEF FOR EXPENDITURE ON R&D

SUMMARY

1. This clause and Schedule amends Part 13 of the Corporation Tax Act 2009 (CTA 2009) to make a number of changes to research and development (R&D) relief for both small or medium (SME) and large companies.

DETAILS OF THE SCHEDULE

2. Paragraph 2 of the Schedule increases the rate of the additional deduction for R&D expenditure provided by section 1044 CTA 2009 from 100 per cent to 125 per cent for SME companies.
3. It also increases the relief for pre-trading expenditure claimed as a deemed trading loss by a corresponding amount and reduces the rate of payable tax credit for a SME to 11 per cent of the surrendered loss.
4. Paragraphs 3 to 8 remove, for both SMEs and large companies, the £10,000 per annum minimum R&D expenditure.
5. Paragraphs 9 to 14 clarify that a company in administration or liquidation is not a going concern for the purposes of SME R&D relief and Vaccine Research Relief.
6. Paragraph 15 removes the restriction, to the level of the company's PAYE and NIC liabilities, of the amount of tax credit a SME company may claim.
7. Paragraphs 16 to 32 abolish Vaccines Research Relief for SMEs.
8. Paragraph 33 amends the definition of "externally provided worker" in sections 1128 and 1129 of CTA 2009.

BACKGROUND NOTE

9. Additional tax relief for expenditure on R&D was introduced in 2000 for SME companies and in 2002 for all other companies. Further relief - Vaccines Research Relief or VRR - was introduced in 2003 for expenditure into vaccines and medicines for strains of TB, malaria and Aids/HIV prevalent in the developing world.

10. A consultation document "Corporate Tax reform: delivering a more competitive system" was published on 29 November 2010 on the HM Treasury website and included consultation on the R&D tax relief. A response document, "Research and Development Tax Credits: response and further consultation" was published on 10 June 2011, and a further response on 6 December, both on the HM Treasury website.
11. Budget 2011 announced increases to the rate of SME R&D relief, together with abolition of the PAYE/ NIC limit and £10,000 pa minimum expenditure.
12. The SME R&D Relief currently gives an additional deduction equal to 100 per cent of the qualifying expenditure. This, combined with the normal deduction for such expenditure, gives a total of 200 per cent.
13. Losses arising from expenditure on R&D can be surrendered by a loss making company in return for a payment at a rate of 12.5 per cent. giving relief of 25 per cent on the original expenditure.
14. The rate of the additional deduction is to be increased to 125 per cent for expenditure incurred on or after 1 April 2011. The rate at which losses can be surrendered will be reduced to 11 per cent, giving relief overall worth 24.75 per cent of the R&D expenditure. The reduction is necessary to keep the value of the relief within the 25 per cent. threshold set out in EU State aid rules.
15. If you have any questions about this change, or comments on the legislation, please contact Neil Smillie on 020 7147 0864 (email: neil.smillie@hmrc.gsi.gov.uk)