HM TREASURY

Consultation on an 'Above the Line' credit for Research and Development

March 2012

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Contents

Foreword

The Government is committed to creating the most competitive tax system in the G20. Research and Development (R&D) tax incentives play an important role in this ambition and in supporting our strategy for growth. Each year they provide around £1 billion of support, to over 9200 companies for over £10 billion of R&D expenditure. This is a significant level of Government support.

The Government consulted on changes to the R&D tax regime in November 2010 and after announcing a package of improvements at Budget 2011, it consulted again on potential further improvements in July 2011. The responses to the consultations showed that many large businesses thought that the R&D tax relief should be changed to an 'above the line' (ATL) credit, and that this could improve the attractiveness of the UK as a location for R&D investment.

After considering the responses to the consultation, the Government announced in the autumn of 2011that it would introduce an ATL credit. This consultation seeks your views on how such a credit should work, ahead of its introduction in April 2013.

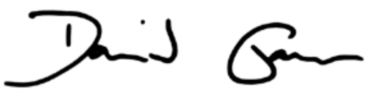
The Government's aim is for an ATL credit that works well for all businesses and provides the best mechanism for supporting UK R&D investment. Overall, we would like a system for supporting R&D which is simple for both business and HMRC to administer.

Reflecting this, we would also welcome your views on the existing large company scheme and whether it should be retained. If the existing scheme is more suitable for your business, the Government would welcome your views on why and how the final design of the ATL credit would affect your conclusion. The Government will consider views submitted and will not take a final decision on this issue until after the consultation.

Following responses to the previous consultation, we are not proposing to change the existing SME scheme to an ATL credit. In addition, the level of SME R&D tax relief will not be reduced as a result of a change to ATL. We would still welcome your views on retaining the existing SME scheme and the impact on SMEs of introducing an ATL credit for large business.

The UK Government is committed to putting research, development and innovation at the heart of its growth agenda and ensuring that the UK provides an internationally competitive environment for all companies to innovate. The introduction of the ATL credit from April 2013 will encourage large company research and development and ensure that the UK continues to be one of the most attractive places in the world to undertake research and development.

I am pleased to publish this consultation paper and hope that both large and small businesses, representative bodies and others interested in promoting the growth of innovative companies in the UK will play a full part in the consultation process.



David Gauke
Exchequer Secretary

March 2012

1 Introduction

Policy Intention

1.1 The policy intention is to introduce a new type of credit for supporting R&D, which will be more effective in supporting innovation by large companies. The Government's aim is to do this in a way that is consistent with fiscal sustainability, simplicity and ease of administration within the tax system.

Aim of the consultation

1.2 The Chancellor announced in the Autumn Statement 2011 that the Government intends to introduce an 'above the line' (ATL) Research and Development (R&D) credit in 2013 to encourage research and development by larger companies.

1.3 This consultation document sets out proposals on how the ATL credit could be implemented. It reflects responses received to last year's consultations and further work to develop the proposals. The Government is interested in feedback from a wide range of sources including individuals, companies, representative and professional bodies. Further details on the previous consultation can be found at:
http://www.hm-treasury.gov.uk/d/consult_r_d_tax_credits.pdf

1.4 The Government especially invites comments from research and development practitioners and/or those involved in the management of this part of the business. The ATL credit is intended to play a more central role in the decision making process for making R&D investment. The views of those involved in this process will be important in helping shape the final proposal.

1.5 The Government also particularly welcomes the assessment of accountants, as to whether the proposals in this consultation can be genuinely accounted for 'above the line'.

Previous consultation process

1.6 In the first R&D tax relief consultation that commenced in November 2010, the Government asked if there were any changes that could be made to the R&D tax relief schemes to make them more effective in incentivising R&D investment. A number of large companies argued that changing the R&D tax relief from a deduction against taxable profits to a system which provided a credit which could be offset against R&D expenditure, commonly referred to as 'above the line' (ATL), would increase R&D investment in the UK.

1.7 A further consultation, launched in June 2011, asked for views on moving to an ATL credit as well as on a number of other issues regarding the delivery of R&D tax relief. Respondents, together with a Working Group of HMRC's R&D Consultative Committee, provided evidence in support of moving to ATL which was taken into account in arriving at these proposals.

1.8 Three main arguments made in support of ATL were:

- visibility – an ATL credit would be more visible to those outside the tax department of a large business. It would also be easier to understand and calculate;

- certainty – an ATL credit would provide certainty over the timing and quantum of benefit and so a better incentive for investment; and
- the benefit to claimants with no net tax liability – 'loss makers' are not currently able to benefit from the R&D tax credit until the company has taxable profits.

Scope of the further consultation

1.9 This consultation seeks views on the detailed design of the ATL credit scheme. Budget announced that the minimum rate for the credit would be 9.1 per cent before tax. This is not subject to consultation. Final rates will be decided after the consultation.

1.10 This consultation does not cover issues where the Government has consulted previously and decided not to make any changes at this time, such as:

- definitions of R&D and 'production'. Following responses to previous consultations the Government intends to retain the current definition of R&D;
- subcontracting. The Government will continue to explore changes in this area, separately from this consultation; and
- claims process. The Government wants to build on a system that is working well, rather than replacing or radically changing it. HMRC has already acted to improve and simplify the system, for instance creating R&D specialist units and introducing a pilot scheme for testing the potential benefits of advance assurances.

Structure of the document

1.11 The remainder of this document is set out as follows. Chapter 2 explains the criteria that the Government proposes to use in evaluating proposals for the ATL credit. Chapter 3 concentrates on the main features of the ATL credit and presents two illustrative options for the payable part of the credit. Chapter 4 sets out detailed design questions, including on the existing R&D tax credit and the SME scheme. Chapter 5 covers analysis of the impact of the ATL credit.

1.12 Annex A seeks views specifically from accountants. This section outlines the Government's understanding of the relevant accounting standards that the ATL credit will need to meet. It also presents the proposed steps for calculating the ATL credit and asks for views on whether the two models being considered could be accounted for above the line.

Stage of consultation

1.13 The proposals set out in this document are at stage 2 (determining the best option and developing a framework for implementation including detailed policy design) of the Government's framework for tax consultation.

How to respond

1.14 Please send comments by 29 June 2012 to: Tim Power, R&D Tax Credits Reform, Excise and Enterprise Tax Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ

Email: ATL.credit@hmtreasury.gsi.gov.uk

Telephone (Treasury switchboard) 020 7270 5000

2 Criteria for the ATL credit scheme

2.1 The Government's aim for the ATL credit is to increase investment in R&D in the UK, improve the competiveness of the UK as a location for R&D, and to ensure the new credit meets its wider objectives for the tax system. The criteria the Government intends to use in assessing options for the ATL credit are listed below:

- **effectiveness at enhancing UK R&D** – any changes should effectively support innovative activity by businesses in the UK and attract further investments in R&D from overseas: the ATL credit should compare positively with schemes in other countries;
- **affordability** – any additional costs of introducing an ATL credit need to be considered in light of the Government's objectives for long term sustainability in the public finances;
- **simple and straightforward to administer** – the Government is committed to simplifying the UK tax system. Consistent with this, the ATL credit should be straightforward to apply and should not significantly increase administrative burdens for businesses or HMRC;
- **sustainable and not open to abuse** – the ATL credit should be designed for the long term to provide certainty for business. It should anticipate current and future commercial needs without requiring significant future changes. The credit should not create substantial additional avoidance opportunities; and
- **meets UK and international accounting requirements and complies with EU State aid rules** – the credit should be able to be treated as 'above the line' under UK and International Accounting Standards (IAS) and should be compatible with the EU State aid requirements.

2.2 The following sections of this document seek views on whether the options presented meet the above criteria. However, the Government is also seeking views on whether the above criteria represent the best set of objectives for assessing the final ATL scheme.

QUESTION 1

Do you agree with the above criteria for assessing proposals for the ATL credit? Please provide any comments as appropriate.

3 Main features

Basic model for the ATL credit

3.1 **The new ATL credit will be calculated directly from eligible R&D revenue expenditure,** instead of being an adjustment to the company's taxable profit as used under the existing R&D tax credit. Budget 2012 announced that the minimum rate for the ATL credit would be 9.1 per cent before tax. This means a company would receive a credit equal to 9.1 per cent of its total eligible expenditure on R&D. This rate is based on a conversion from the existing R&D tax credit at the corporation tax rate announced for 2013-14. A profitable company claiming under the ATL scheme would receive the same support as it would under the current R&D tax credit. The final rate for the credit will be decided following consultation.

3.2 **The ATL credit will be payable in cash to companies with no corporation tax liability, possibly at a discounted rate.** Under the existing R&D tax credit, companies must wait until they enter profit before the credit is paid. A payable credit provides greater certainty of receipt of Government support and should reinforce the case for accounting 'above the line'. The following section presents choices for how the payable credit could work. A final decision on whether a discount will be apply to the payable credit will be taken following consultation.

3.3 **The Government is proposing that the ATL credit should be taxable.** A minimum rate before tax of 9.1 per cent as outlined above is equivalent to an after tax rate of approximately 7.0 per cent using corporate tax rates planned for April 2013. Making the credit taxable further supports the case for accounting 'above the line'. It also allows for a higher headline rate. Previous consultations have highlighted the importance of headline rates in signalling to international investors and decision makers.

3.4 **The ATL credit will be administered and settled through the tax system.** The tax system offers a ready-made system of delivering the support and settling any payments. Accounting for the credit above the line, reflects a weakening of the link between the value of the credit and a company's final tax liability. However, the Government's view is that this should not constrain decisions about how the credit is administered.

3.5 A simplified illustration of how the ATL credit would work for a profit making business is set out in the table below, alongside a comparison with the existing R&D tax credit. The rates shown are for illustration only. The example uses the following assumptions:

- the business spends £2m on an R&D project, of which £1m is eligible for R&D tax relief. It then receives a total of £2.4m in income from the project; and
- the ATL credit provides financial support worth 10 per cent before tax (illustrative) of the company's qualifying R&D spend; and this payment is taxable, at a CT rate of 25 per cent (illustrative).

3.6 In the example, this business receives a credit, delivered through its tax bill of £75,000 for the project. The overall support provided remains the same as under the existing R&D tax credit. However the reported profit is increased with the ATL credit. This is because the value of government support for R&D is deducted directly from expenditure. This compares to the current system where government support is reflected in the tax calculation (in the lower part of the table). These changes assume the credit can be accounted for "above the line" – a fuller discussion of this for accounting professionals is provided in Chapter 5.

Table 3.A: Calculation of the ATL credit

		Existing R&D tax relief (£'000)		ATL credit (£'000)
Turnover		2,400		2,400
R&D expenditure	(1,000)		(1,000)	
ATL credit 10%	-	(1,000)	100	(900)
Other expenditure		(1,000)		(1,000)
Profit/ (loss)		400		500
Superdeduction 30%		(300)		-
Taxable profit/loss		100		500
Tax @25%		25		125
ATL credit		-		(100)
Tax payable		25		25
Tax saved		75		75

QUESTION 2

For the basic model of the credit, as it applies to profit making companies, what is your assessment of its effectiveness in meeting the criteria set out in Chapter 2?

QUESTION 3

Do you agree with the basic design proposals for the ATL credit? In particular, do you agree that the credit should be taxable?

Treatment of companies with no CT liability

3.7 **The ATL credit will be paid out in cash once a claim has been made by the company, even where no Corporation Tax liability exists.** This will mean businesses can be more certain of the value and timing of Government support. This compares to the current R&D tax credit where claimants with no net corporation tax liability do not benefit from the scheme until they enter profit. Under the current scheme, the unused relief is carried forward to be used against the taxable profits of the following years (it can be also carried backwards against past tax liabilities and 'sideways' against the tax liabilities of related companies).

3.8 **A reduced payable credit for loss making business could allow the Government to maintain a more competitive rate for the main part of the credit.** This is because some businesses claiming under the existing scheme may not have UK tax liabilities for long periods of time. Offering a payable credit means these businesses will be able to claim a payment up front. This increases the overall cost to Government of the scheme for a given headline rate. The current SME R&D tax relief already operates a reduced payable credit (to stay within European State aid rules).

3.9 **It is the Government's assessment that under an ATL credit with a reduced payable credit, most loss making companies would be substantially better off than they would be if they claimed under the existing R&D tax credit.** However a reduced payable credit would increase the relative complexity of the scheme. The next sections outline two models for the large company

ATL credit – one with a reduced payable credit and one without. The final rates for the payable part of the credit will be confirmed following this consultation.

Fully payable credit net of tax

3.10 The first option is for a full payable credit. The Government would offer the full credit in the first year, whether or not the business had a tax liability. This model provides a substantial benefit to those businesses that are loss making for long periods and do not benefit from the current R&D relief.

3.11 The Government proposes that under this model the credit would be payable net of tax. This is to prevent companies which continue to make losses for corporation tax purposes receiving a greater benefit than other companies. This could occur because the tax due on the credit would be offset by losses elsewhere in the business so that no tax was paid on the ATL credit payment.

3.12 While the credit would be paid net of tax, the Government would allow the corporation tax due on the credit to be offset against future tax liabilities. This is to ensure that a company which enters profit at some point after claiming the credit is no worse off than they would have been had they instead made a profit in the year of the claim. It also ensures there is no incentive to delay claims until a profit is made as companies would receive the same effective benefit.

3.13 An illustration of a system with a fully payable credit is provided below. The calculation uses the following assumptions (again rates are for illustration only):

- as before, the business spends £2m on an R&D project, of which £1m is eligible for Government support. In the year of the claim, the business only makes £1.4m of income from the investment, so overall it makes a loss;
- the credit provides financial support worth 10 per cent (illustrative) of the businesses qualifying R&D spend of £1m; and this payment is taxable, at a CT rate of 25 per cent; and
- it has been assumed in the example below that the full 10 per cent credit is accounted for above the line. However, the Government recognises that it is in fact more complicated and that the £25k tax withheld may not be recorded above the line. See Annex Table A.1.

Table 3.B: Calculation of the fully payable credit

	Existing R&D tax relief (£'000)		ATL credit (£'000)	
Turnover		1,400		1,400
R&D expenditure	(1,000)		(1,000)	
ATL credit 10%	-	(1,000)	100	(900)
Other expenditure		(1,000)		(1,000)
Profit/ (loss)		(600)		(500)
Superdeduction 30%		(300)		-
Taxable profit/loss		(900)		(500)
Tax @25%		-		-
Loss carried forward		(900)		(500)
Payable credit (net of tax)		-		75
Corporation tax withheld and c/f for future offset		-		25

3.14 Under this model the business receives a payable credit of £75,000 for the year the claim corresponds to. The business receives the same overall benefit as the previous example where it was assumed to be in profit. This compares to the existing R&D tax credit where this business receives an enhanced loss of £900,000 which can be used to reduced taxable profit in future years. The benefit of the carried forward loss under the existing scheme would be broadly the same as the ATL credit but the business would have to wait, in some cases significantly, longer before it could be realised.

Reduced payable credit

3.15 The second option is for a reduced payable credit. Where the business has no tax liability in the year of the claim, the ATL credit would be paid at a discount of (for example) 80 per cent. To ensure that loss-making companies who return to profit over a short period can still access the full (non-discounted) credit, the Government proposes that under this model the remainder of the credit could still be claimed for up to three years provided the business entered profit. This is to ensure these types of business are not worse off than under the current system where they are able to carry forward the unused credit. The Government welcomes feedback on whether the proposed period over which the ATL credit can be carried forward is appropriate.

3.16 A simplified illustration of how a discounted payable credit could work is provided below. The calculation is based on the following assumptions:

- as before, the business spends £2m on an R&D project, of which £1m is eligible for Government support. However in the year of the claim, the business only has £1.4m of income, so overall it makes a loss.
- the credit provides financial support worth 10 per cent (illustrative) of the businesses qualifying R&D spend of £1m; this payment is taxable, at a CT rate of 25 per cent; and
- as in the first model above, it has been assumed in the example below that the gross discounted credit (i.e. withheld £20k tax included) is accounted for above the line. However, the government recognises it is in fact more complicated and that the £20k tax withheld may be recorded differently. See Annex Table A.2.

3.17 Under this model the business receives a payable credit of £60,000 in the year it makes the claim. The remaining part of the credit is carried forward as a taxable credit of £20,000. When the business eventually enters profit this could be claimed and would be equivalent to approximately £15,000 after tax so that the total support is equivalent to that provided to a profit making business, £75,000. Again, this compares to the existing R&D tax credit where this business receives an enhanced loss to be used to reduce taxable profit in future years.

3.18 Overall, this model is less costly because some businesses may not have UK tax liabilities for long periods of time. As explained above, this could facilitate a higher headline rate for the ATL credit.

Table 3.C: Calculation of the reduced payable credit

	Existing R&D tax relief (£'000)		ATL credit (£'000)	
Turnover		1,400		1,400
R&D expenditure	(1,000)		(1,000)	
ATL credit (80%)	-	(1,000)	80	(920)
Other expenditure		(1,000)		(1,000)
Profit/ (loss)		(600)		(520)
Superdeduction 30%		(300)		-
Taxable profit/loss		(900)		(520)
Tax @25%		-		-
Loss carried forward		(900)		(520)
Payable credit (net of tax)		-		60
Corporation tax withheld and c/f for future offset		-		20
Remaining credit claimable for 3 years (taxable)				20

Deferral of the payable credit

3.19 The Government has also considered a system similar to that used in France, which offers a reduced credit to loss makers in the first year and pays out the remainder of the credit automatically over four years. This has little effect on the overall cost of the credit compared to a model where the credit is paid out in the first year. The Government does not propose to take this model forward on the basis of administrative complexity and the lack of a clear benefit to business over the second of the two models presented above. However it welcomes comments on this issue and international schemes more generally.

QUESTION 4

For the different models for the payable part of the credit, what is your assessment of their effectiveness in meeting the criteria set out in Chapter 2?

QUESTION 5

Taken together, do the above models for the payable credit change your assessment of the basic model of the ATL credit in response to Question 2? What are your overall comments on the basic proposals for the ATL credit?

QUESTION 6

Are there alternative models for the payable part of the credit that the Government should consider? Please describe and explain how this would better meet the criteria in Chapter 2.

4 Detailed design issues

4.1 The Government's aim is for an ATL credit which is suitable for the majority of businesses carrying out research and development in the UK. As well as other detailed design issues, this section sets out a number of proposals which are intended to help towards this aim. This includes questions on the existing R&D tax credit.

Transitional support for business

4.2 The Government is currently assessing how best to help business manage the transition from the existing R&D relief to the ATL credit. It is interested in businesses' views on possible challenges arising from the overall transition for example where companies might need to account for both the current R&D tax credit and the ATL schemes in the same accounting period.

4.3 Subject to final design, the Government proposes that business would be able to claim for the ATL credit for accounting periods beginning after 1 April 2013 rather than expenditure incurred after this date. This is intended to reduce complexity in the claims process.

4.4 The R&D specialist units will be available to assist businesses during this period. In particular they will be able to give advice on the formulation of claims and completion of the Company Tax Return to reflect claims under both regimes.

QUESTION 7

What challenges do you envisage businesses encountering on taking up the ATL credit? If necessary please provide details of any specific procedural changes and/or associated costs.

QUESTION 8

What specific steps could the Government take to help businesses who currently claim the existing R&D tax credit manage the transition to claiming ATL?

The existing R&D tax credit

4.5 The Government would like to use this consultation to seek industry views on whether the ATL credit should be mandatory. This means it would fully replace the existing large company R&D tax credit. In assessing the case for this, the Government is particularly keen to minimise potential administrative costs to business and HMRC. It is also keen to avoid the need for businesses to carry out calculations to compare the benefits under two schemes. A final decision on whether ATL should fully replace the existing R&D tax credit will be taken following consultation.

QUESTION 9

Do you think the ATL credit should fully replace the existing R&D tax credit? If not, please explain why and what changes to the ATL design might change your view.

QUESTION 10

Do you think maintaining two systems would be administratively burdensome for business? Would business be likely to claim under both systems? What would the effects of this be? Please provide examples of procedures and costs involved.

Provision of R&D under Government procurement

4.6 The Government is aware of industry concerns around the impact of the ATL credit on R&D contracted for by Government Departments. The Treasury is in discussions with Government Departments including the Ministry of Defence. It intends to look closely at this issue in the context of the objectives for the ATL credit set out in Chapter 2 and individual departments' approach to procurement. Over the summer further information and proposals will be released for comment. Prior to this the Government would like to seek further views on this area.

QUESTION 11

In what situations do businesses provide R&D services to Government where the contractual arrangement or price could be affected if the business claimed under an ATL credit as opposed to the existing R&D tax credit? What would be the effect of this?

QUESTION 12

Would you propose consequential changes to the ATL credit or Government procurement guidelines? If so what would these be?

Business operating in groups

4.7 The existing R&D tax credit scheme for large companies can create or increase a tax loss in the trade. In the usual way, this loss may be carried forward against future trade profits by the company that suffered the loss, or alternatively may be utilised against any other profits it realises in the year or carried back to the previous year. Such losses can also be surrendered as group relief to a fellow company in the same group.

4.8 For businesses in groups, an ATL model with a reduced payable credit could provide less benefit to a group. This could occur if the individual group member were required to take the credit at a discount where under the current system it would be able to realise the credit by claiming against the profits of another member of the group.

4.9 An option to apply an unused credit directly against the corporation tax liability of another group company, rather than receive a reduced cash sum may resolve this issue. If such a rule is included, it would also be possible to provide a rule ensuring that any reimbursement of the benefit surrendered by the claimant company has no tax consequences. This would mirror the rule applying where companies are compensated for the surrender of group relief. The Government would welcome views on whether such a facility would be useful.

QUESTION 13

To what extent might groups be disadvantaged if ATL credits were not available on a group basis enabling companies to surrender unused credit to fellow group members?

US based multinationals

4.10 The Government is interested in views from US based multinationals and similar jurisdictions, on the effect of maintaining both the existing R&D tax credit and introducing an ATL credit, (in particular on their ability to benefit from the ATL credit). The Government's current understanding is that these types of business do not benefit from the existing scheme. It would like to know whether an optional or mandatory scheme would affect the benefits from introducing an ATL credit.

QUESTION 14

For relevant multinational businesses, what are the effects on tax liabilities in other countries (or the home country) from moving to ATL in the UK? If ATL does <u>not fully replace</u> the existing scheme, does this assessment change?

Small and Medium Sized Businesses (SMEs)

4.11 **The Government's current intention is not to replace the current SME R&D tax credit with an ATL credit. In addition, the level of SME R&D tax relief will not be reduced as a result of a change to ATL**[1]. The Government proposes that SMEs would nonetheless be able to claim under the large company ATL credit if their circumstances required it. This section sets out some details of the SME scheme and seeks views on the Government's intention to retain the existing R&D tax credit for SMEs.

Existing SME scheme

4.12 The SME R&D tax credit scheme works in a similar way to the existing large company scheme, by providing a credit which reduces taxable profits. It includes a payable credit at a rate that is limited to 11 per cent (from April 2012). The rate of payable credit is limited by the EU State Aid rules and the Government applies the maximum rate currently allowed by these rules.

4.13 In Budget 2011 the Government announced several measures which provide additional support for SME R&D investment. From April 2011 the rate of the enhanced deduction increased from 175 per cent to 200 per cent and from April 2012 it will be further raised to 225 per cent. The Government has also removed the requirement for minimum expenditure of £10,000 and the rule limiting the payable credit according to the company's PAYE/NICs liability.

4.14 The existing SME scheme provides more than £320m of support annually for around £1.7 billion of R&D expenditure carried out by over 7200 SMEs. The 2011 and 2012 changes increase the support by an additional £75-100m a year. The number of claims has increased steadily since the scheme was introduced. The Government will be doing more over the summer to raise awareness and increase take up of the scheme.

[1] Originally announced in the 2011 Autumn Statement

SME's and the ATL credit

4.15 In earlier consultations companies were asked whether the SME scheme should move to an ATL credit system. The majority of respondents did not believe that an ATL scheme was appropriate for SMEs. Particular concerns were around: (i) above the line accounting treatment of the credit being less important for SMEs; (ii) the administrative costs of switching to and learning a new scheme and; (iii) general satisfaction with existing arrangements for SMEs. However, some respondents noted that consistency between the two schemes could simplify the situation for SMEs moving into the large scheme or claiming under both schemes.

4.16 If the SME R&D tax credit scheme were to be replaced with an ATL credit it would function in a similar way to the options set out in Chapter 3. There would be differences in rates as there are with the existing large and small company schemes. There might also be some changes to ensure the SME scheme remained within EU State Aid rules.

4.17 Overall the Government has not seen strong evidence to support replacing the existing SME scheme with an ATL credit. However, it is interested in businesses' views on this and the implications of introducing further differences between the large and small company schemes.

QUESTION 15

Do you agree that the Government should not replace the existing SME R&D tax credit with an equivalent ATL credit?

QUESTION 16

What would the additional impact be on SMEs of introducing ATL for large business, in particular for SMEs making the transition to the large company scheme and SMEs making claims under the large company scheme for subcontracted work for large business? Would these impacts be any different to the situation under the current large company R&D credit?

Openness to abuse

4.18 As outlined Chapter 2, one of the Government's key criteria for the design of the ATL credit is that it should not be open to abuse. This section sets out two issues on which the Government would like views and asks for general comments on how the credit could be designed to prevent avoidance opportunities.

Foreign Branches

4.19 An ATL scheme with a payable credit could encourage overseas concerns to establish a UK entity wholly or partly to access the benefits of R&D credits. Where that means making a genuine investment in the UK, this is a desirable outcome. However, this would not be the case if there is no real investment in UK R&D or where little or no R&D activity is carried out in the UK. The Government would like to ensure that the benefits of the scheme are only available to claimants on the basis of activities that promote employment and innovation in the UK.

4.20 The Government would be interested to receive views on the various ways that this objective might best be achieved. For example:

- by capping payable credits to companies with no tax liability using a reference to some measure of the scale of the business activity in the UK (such as a NIC and PAYE cap that existed in the SME scheme until recently); and
- by reference to a general anti-abuse rule, incorporating a purpose test.

Payments under a reduced credit

4.20.1 If the final model for the ATL credit includes a payable credit that is at a lower rate than the full credit, the Government would be interested in your views on whether there should be a rule to prevent arrangements intended to avoid that reduction in the credit. Such a rule might apply where for instance profits are artificially diverted to the claimant company through intra-group transactions to ensure that it has sufficient tax capacity to claim the full benefit of the R&D credit.

QUESTION 17

What would be the best way(s) to ensure that the benefits of the scheme are only available to claimants on the basis of activities that promote employment and innovation in the UK?

QUESTION 18

Do you think that there should be a rule to prevent a claimant from entering into arrangements intended to avoid any reduction in the credit?

QUESTION 19

Do you see any other particular opportunities for avoidance from the introduction of an ATL credit scheme?

5 Impacts of the ATL credit

5.1 This Chapter seeks views on the overall impact of introducing an ATL credit. An initial Tax Information and Impact Note (TIIN) is also provided for comment. Detailed questions are listed below.

Table 5.A: Draft Tax information and impact assessment (TIIN)

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-2017
	0	-5	-205	-*	-*
Economic impact	R&D tax relief reduces the cost of R&D investment that companies make and is therefore likely to increase R&D expenditure, which will benefit the economy more widely through the positive spillover effects. ATL credit is intended to improve the effectiveness of R&D tax credits for large companies. *Spending measures do not affect borrowing in 2015-16 and 2016-17 as they fall within the Total Managed Expenditure assumption.				
Devolution impact	None, UK wide.				
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 therefore considered that these proposals have no impacts on protected equality groups.				
Impact on businesses and third sector	Around 2,250[1] large companies claim R&D tax relief each year. Many of these companies will benefit from the ATL credit scheme, which improves the visibility and certainty of the R&D relief and provides benefit to loss makers.				
Operational impact (£m) – [HMRC or other]	There would be an operational cost for HMRC from the necessary changes to the claim process and from possible changes to the corporate tax return. The cost will depend on the outcome of the consultation and final decisions on the design of the ATL credit system.				
Other impacts	These changes respond to consultation with companies and other stakeholders. There will be a positive impact for large companies carrying out research and development, mainly in pharmaceutical/life sciences and automotive sectors and larger accounting firms. The impact to SME's should be minimal. There should not be any impact on competition as they do not affect or limit suppliers' ability to compete.				

[1] The total number of companies claiming R&D tax credits quoted in the foreword does not exactly equal the sum of companies claiming under the small and large schemes. This is because some SMEs claim under both schemes.

Questions on the impact of the ATL credit

QUESTION 20: Impacts of the ATL credit

These questions are intended to help the Government estimate the behavioural response and impact on tax receipts of introducing the ATL credit. They are not intended to assess the overall case for its introduction. If you would like to provide information on the design of the credit please refer to the questions in the previous chapters.

Impact on business decisions

- If your company has not benefitted from the current R&D tax relief, has this been affecting your R&D plans for future years?
- If your company is currently a loss maker, would you think of deferring some of your R&D expenditure for this coming tax year in order to benefit from a payable credit through ATL from April 2013?
- If your company was to receive new/more tax relief on R&D expenditure, will this all be re-invested in extra R&D in the future?
- Does the fact that the current R&D relief is calculated as part of the tax computations mean it is difficult to realise the benefit of the relief on R&D expenditure?
- If your company is a long term loss maker, do you expect to ever realise the benefit of the current super deductions that have built up over time?
- Do you have any comments on the conclusions in the Tax Information and Impact Assessment provided above?

International tax and accounting issues

- What the impact of the ATL credit be on relief for foreign tax (either in the UK, or for UK tax in another jurisdiction)?
- Would the ATL credit affect the cost to be used in transfer pricing calculations, and if so, would this produce any undesirable impacts?
- What would the impact of ATL be on the utilisation of double tax relief?

6 Summary of questions

QUESTION 1

Do you agree with the above criteria for assessing proposals for the ATL credit?

QUESTION 2

For the basic model of the credit, as it applies to profit making companies, what is your assessment of its effectiveness in meeting the criteria set out in Chapter 2?

QUESTION 3

Do you agree with the basic design proposals for the ATL credit? In particular, do you agree that the credit should be taxable and administered and settled through the tax system?

QUESTION 4

For the different models for the payable part of the credit, what is your assessment of their effectiveness in meeting the criteria set out in Chapter 2?

QUESTION 5

Taken together, do the above models for the payable credit change your assessment of the basic model of the credit in response to Question 2? What are your overall comments on the basic proposals for the ATL credit?

QUESTION 6

Are there alternative models for the payable part of the credit that the Government should consider? Please describe and explain how this would better meet the criteria in Chapter 2.

QUESTION 7

What challenges do you envisage businesses encountering on taking up the ATL credit? If necessary please provide details of any specific procedural changes and/or associated costs.

QUESTION 8

What specific steps could the Government take to help businesses who currently claim the existing R&D tax credit transition to claiming ATL?

QUESTION 9

Do you think the ATL credit should fully replace the existing R&D tax credit? If not, please explain why and what changes to the ATL design might change your view.

QUESTION 10

If both systems were to be retained, would some businesses be likely to claim under both schemes? If so what would be the administrative costs and issues associated with this?

QUESTION 11

In what situations do businesses provide R&D services to Government where the contractual arrangement or price could be affected if the business claimed under an ATL credit as opposed to the existing R&D tax credit? What would be the effect of this?

QUESTION 12

Would you propose corresponding changes to the ATL credit or procurement guidelines? If so what would these be?

QUESTION 13

To what extent might groups be disadvantaged if ATL credits were not available on a group basis enabling companies to surrender unused credit to fellow group members?

QUESTION 14

For relevant multinational business, what are the effects on tax liabilities in other countries (or the home country) from moving to ATL in the UK? If ATL does not fully replace the existing scheme, does this assessment change?

QUESTION 15

Do you agree that the Government should not replace the existing SME R&D tax credit with an equivalent ATL credit?

QUESTION 16

What would the additional impact be on SMEs of introducing ATL for large business? In particular for SMEs making the transition to the large company scheme and SMEs making claims under the large company for subcontracted work for large business. Would these impacts be any different than under the current large company R&D credit?

QUESTION 17

What would be the best way(s) to ensure that the benefits of the scheme are only available to claimants on the basis of activities that promote employment and innovation in the UK?

QUESTION 18

Do you think that there should be a rule to prevent a claimant from entering into arrangements intended to ensure that it does not suffer any reduction in the credit?

QUESTION 19

Do you see any other particular opportunities for avoidance from the introduction of an ATL credit scheme?

QUESTION 20 and A1 – A4

See Chapter 5 for detailed questions on the impact of the ATL credit. See Annex A for detailed questions on the accounting treatment of the ATL credit.

7 Next steps

Timetable and implementation

7.1 The consultation period will last three months, until 29 June 2012.

7.2 The responses to the consultation will be considered in preparation of the draft legislation for Finance Bill 2013, which we intend to publish with the Autumn Statement.

7.3 The ATL credit will be implemented from April 2013.

How to respond

7.4 Please send comments by 29 June 2012 to: Tim Power, ATL credit consultation, Excise and Enterprise Tax Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ

Email: ATL.credit@hmtreasury.gsi.gov.uk

Telephone (Treasury switchboard) 020 7270 5000

Confidentiality

7.5 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOI), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

7.6 If you want the information that you provide to be treated as confidential, please be aware that, under the FOI, there is a statutory Code of Practice with which public authorities must comply and which deals amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury or HMRC.

7.7 HM Treasury and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

The Government's Code of Practice on Consultation

7.8 This consultation is being conducted in accordance with Government's Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex A.

A 'Above the line' credit

A.1 This Annex is intended for an accountancy audience. It seeks views on the accounting treatment of the two proposed ATL models in Chapter 3.

'Above the line' accounting treatment

A.2 The Government understands the 'above the line' accounting treatment to mean that:

- the credit is accounted for within the company's profit and loss account, i.e. above the tax line;
- the credit is sufficiently independent from the company's tax calculations; and
- the credit is payable, or will have commercially significant value, notwithstanding the company's tax liabilities, i.e. credit is paid out if the company has no tax liability.

A.3 The Government would like to gather views from accountants on whether the models presented in this consultation would be accounted for 'above the line'.

International accounting standards

A.4 In respect of International Accounting Standards, IAS 20 and IAS 12 have been identified as the relevant standards to be considered. In essence, for the credit to be considered above the line, IAS 20 would need to be applicable either directly or by analogy.

A.5 There are several characteristics that distinguish an amount above the line (IAS 20) from an income tax credit (IAS12):

- the credit is similar in nature to a grant, e.g. taxable;
- it is determined as a percentage of qualifying expenditure , rather than by reference to or in determining taxable profit; and
- although the credit may be used to reduce the amount of corporation tax payable by the company, if no tax is payable, the amount of the credit can be claimed in cash.

A.6 The Government is interested in your views on which accounting standards are the most appropriate, when assessing whether the credit falls above the line and which characteristics of the credit are the most relevant to your accounting assessment.

Accounting treatment of proposed models for ATL credit

A.7 In Chapter 3 we proposed two models for an ATL credit:

- an ATL credit with fully payable credit (but paid net of tax); and
- a discounted payable credit with reduced payable credit.

A.8 In both models the credit would be taxable and calculated as a percentage of the qualifying R&D expenditure. The simplified calculations of the payable credit in both models are brought out in Chapter 3.

Profit makers

A.9 For your assessment, the Government proposes that a company which has sufficient corporation tax liability, would treat the credit as follows:

- accounting treatment of 10 per cent (illustrative) ATL credit, in case of £1m R&D qualifying expenditure;
- a company claims a credit of £100k, showing £900k in the accounts as net R&D expenditure;
- the reduction in the R&D entry in the accounts produces additional CT liability of say £25k (£100k @25 per cent);
- the full amount of the credit, £100k, is applied against its CT liability for the year;
- so the net benefit is £75k (£100k less the additional liability of £25k).

Fully payable credit net of tax

A.10 In the case of the fully payable credit (net of tax), if the business has no corporation tax liability for the year, then the credit is payable net of tax – HMRC withholds the tax on payable credit to be used against future CT liability.

A.11 If the company has no tax liability for the year, the consequences would be as follows:

- the company accounts for the net ATL credit in the profit and loss account, therefore decreasing its loss;
- it claims a payment of the credit;
- HMRC pay the company £75k, directly, and withholds tax of £25k, which would be available to set against any CT liability for future years (but would eventually write it off, if unused);
- the Government understands that the £25k of tax withheld may not be accounted for above the line on the basis that payment of the £25k is dependent on the future tax position of the company resulting in a £75k above the line credit. This is the case whether or not the company anticipates profits in the foreseeable future. The tax loss of the company will need to be adjusted by £25k to ensure that the tax losses have been reduced by the full £100k.
- that future liability will be increased by the £25k (assuming a stable CT rate) because tax losses carried forward will have been reduced by the £75k credit and the £25k tax adjustment above.
- the net benefit is still £75k.

A.12 The impact of the credit to companies with short or long term losses would be as follows:

- a company that never moves into profit that is sufficient to use its unpaid credit has a net benefit of £75k; and
- a company that has no liability for one year but has a liability in year two is able to offset £25k against their tax liability. This company is in a similar position to a company that used the credit fully in year one.

A.13 The Government welcomes accountants' views on what factors you would consider in determining the appropriate accounting treatment of the above arrangement.

Table A.1: Calculation of the fully payable credit (with only paid credit above the line)

	Existing R&D tax relief (£'000)		ATL credit (£'000)	
Turnover		1,400		1,400
R&D expenditure	(1,000)		(1,000)	
ATL credit 10% (see 3.17 below)	-	(1,000)	75	(925)
Other expenditure		(1,000)		(1,000)
Profit/ (loss)		(600)		(525)
Superdeduction 30%		(300)		-
Reduction in taxable loss (due to tax withheld)		-		25
Taxable profit/loss		(900)		(500)
Tax @25%		-		-
Loss carried forward		(900)		(500)
Payable credit (net of tax)		-		75
Corporation tax withheld and c/f for future offset		-		25

Reduced (discounted) payable credit

A.14 In case of the reduced payable credit, if the business has no corporation tax liability for the year, then 80 per cent (illustrative) of the credit is paid out net of tax as cash. The remaining 20 per cent can be offset against a tax liability within three years, after which the balance would be forfeited.

A.15 If the company has no tax liability for the year, the consequences would be as follows:

- the company accounts for the net ATL credit in the profit and loss account, therefore decreasing its loss;
- it claims the payment of the credit;
- HMRC makes an immediate payment of 80 per cent the credit net of tax, £60k. It withholds the taxable part of this reduced credit, £20k, to be claimed against future tax liabilities. As the £20k withheld is dependent upon the future tax liability it is likely to be accounted for below the line (i.e. in the tax line). As in the model above, an adjustment will be required to the tax losses of £20k to ensure they have been reduced by the full £80k.
- in addition HMRC retains the *remainder of the credit i.e. the discounted element*, also £20k before tax, which is then also available to settle any corporation tax liabilities of the company in the following three years. This is also likely to be accounted for below the line (i.e. in the tax line) as it is dependent upon the future tax position and an adjustment will be required to the future tax computation and liability.
- if the unused carried forward credit remains unused at the end of the three years, it is forfeited. A corporation tax deduction of the amount forfeited is available for the accounting period in which it becomes forfeit.
- the net benefits in this case will lie between £60k (long term loss makers) and the £75k benefit where the credit is fully utilised (short term loss makers).

Table A.2 Calculation of the reduced payable credit

	Existing R&D tax relief (£'000)		ATL credit (£'000)	
Turnover		1,400		1,400
R&D expenditure	(1,000)		(1,000)	
ATL credit (80%)	-	(1,000)	60	(940)
Other expenditure		(1,000)		(1,000)
Profit/ (loss)		(600)		(540)
Superdeduction 30%		(300)		-
Reduction in taxable loss (due to tax withheld)		-		20
Taxable profit/loss		(900)		(520)
Tax @25%		-		-
Loss carried forward		(900)		(520)
Payable credit (net of tax)		-		60
Corporation tax withheld c/f for future offset		-		20
Remaining credit claimable for 3 years				20

A.16 The impact of the credit to companies with short or long term losses would be as follows:

- a company that never moves into profit that is sufficient to use its unpaid credit has a net benefit of £60k;
- a company that has no liability for one year but has a liability in following years is able to use the unpaid element of the credit fully in the following three years. This company is in a similar position to a company that used the credit fully in year one, subject to a cash flow cost on retained part of the credit; and
- companies which have some but insufficient tax liability after the end of the four year period will gain some benefit from a corporation tax deduction.

A.17 The Government acknowledges that for this model there are several ways to account for the credit 'above the line', depending on whether the company expects to have a tax liability in the year or within the three following years (e.g. full credit or 80 per cent accounted in the first year)? We welcome accountants' views on what factors you would consider in determining the appropriate accounting treatment.

QUESTION A1

Do you agree that the ATL credit should be accounted for under IAS 20 or similar? What are your views of the key characteristics of the credit so that it falls to be accounted under IAS 20 (or similar?)

QUESTION A2

Do you agree that the fully payable credit (net of tax) model would be accounted for above the line? If no please explain the accounting criteria that you have used to make that assessment.

QUESTION A3

Do you agree that the reduced payable credit model, as proposed, would be accounted for above the line? If no please explain the accounting criteria that you have used to make that assessment.

QUESTION A4

Do you have any other concerns regarding the accounting treatment of the ATL credit? If yes, please provide a detailed accounting analysis of those concerns.

B The Government's Code of Practice on Consultation

About the consultation process

B.1 This consultation is being conducted in accordance with the Code of Practice on Consultation.

B.2 The consultation criteria:

1. When to consult – Formal consultation should take place at a stage when there is scope to influence the policy outcome.
2. Duration of consultation exercises – Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Clarity of scope and impact – Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Accessibility of consultation exercise – Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. The burden of consultation – Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Responsiveness of consultation exercises – Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Capacity to consult – Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

B.3 If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Amy Burgess, Consultation Coordinator, Better Regulation and Policy Team, HM Revenue & Customs, Room 3E13, 100 Parliament Street, London, SWA 2BQ

E-mail hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

HM Treasury contacts

This document can be found in full on our website: http://www.hm-treasury.gov.uk

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