

Clause 1 and Schedules 1 and 2: R&D tax credits for SMEs

Summary

1. This clause and Schedules introduce a new restriction to the payable element of the research and development (R&D) tax credit for companies which are small or medium sized enterprises (SMEs). The restriction – referred as the cap – is based upon the Pay-As-You-Earn (PAYE) and National Insurance Contributions (NIC) that the company is required to pay for its own employees, as well as some PAYE and NIC of connected companies. The change has effect for accounting periods beginning on or after 1 April 2021.

Details of the clause

2. Clause 1 introduces Schedule 1 and Schedule 2. Schedule 1 applies the new cap to the payable R&D tax credit for SME companies. Schedule 2 makes similar changes to the legislation for R&D tax credits that would apply if the Northern Ireland Assembly were to vary the rate of Corporation Tax for Northern Ireland companies,

Details of Schedule 1: R&D tax credits for SMEs

3. Subsection 1 and Schedule 1 amend Chapter 2 of Part 13 of Corporation Tax Act (CTA) 2009 which contains the rules for the research and development tax credit for SMEs.
4. Paragraph 2 of the Schedule amends Section 1058 CTA 2009, which defines the amount of payable tax credit that a company may claim, introducing the new cap.
5. The level of the cap for an accounting period is set in new subsection (1A) of s1058. It is calculated by adding together a minimum amount of £20,000, 300 per cent. of the company's own PAYE and NIC and, potentially, three hundred per cent. of some PAYE and NIC of connected companies. (The total of the PAYE and NIC to which the multiplier is applied, is referred to as the company's relevant expenditure on workers for payment periods ending in the accounting period).
6. New subsection (1C) provides an exception to the cap where conditions set out in new section 1058D are met.
7. Relevant expenditure on workers for a payment period is defined in new section 1058A. It is the sum of
 - The company's own total PAYE and NIC liabilities (defined in new section 1058B) less any amounts used by another company in calculating that company's own cap (defined in new section 1058C)

- Where the company pays another, connected, company for providing it with externally provided workers (EPWs) to carry out R&D, the relevant portion of the PAYE and NIC staffing costs incurred by the connected company, and
 - Where the company contracts out R&D activities to another, connected, company, any PAYE and NIC staffing costs incurred by the connected company in performing those activities.
8. Subsection (2) of new section 1058A defines the relevant portion of any staffing costs incurred by the EPW provider on an EPW. This is the fraction of the claimant company's qualifying expenditure on the EPW that is used to claim relief under Chapter 2, multiplied by the PAYE and NIC that the connected company is required to pay in respect of the EPW.
9. New section 1058B defines the company's total PAYE and NIC liabilities as needed by new section 1058A. This is the amount of income tax which the company must pay to HM Revenue & Customs (HMRC) under PAYE regulations, plus the amount of Class 1 NIC that it must pay, during the accounting period. Amounts that may be deducted by the employer to fund certain payments to employees are though disregarded so that these do not reduce the cap.
10. New section 1058C is a rule to prevent amounts of PAYE or NIC from being included in the calculation of two different companies' caps. This could happen where, for example, Company A subcontracts R&D activities to connected Company B which also carries out R&D its own right for which it claims tax credit. Company B would be calculating its cap based on its total PAYE and NIC while Company A might also be including part of Company B's PAYE and NIC (i.e. that relating to the subcontracted work) when calculating its cap. This could also happen where B supplies A with EPWs. New section 1058C ensures that in these circumstances, it is Company A that includes the overlapping PAYE and NIC when it calculates its cap.
11. New Section 1058D provides an exemption to the cap. For this to apply, a company must meet two conditions.
- Condition A requires the company to be creating or preparing to create intellectual property, or managing intellectual property which it holds. These activities must be undertaken largely by employees of the company, and the company must have the right (alone or with others) to exploit the intellectual property.
 - Condition B requires that the total of the company's qualifying expenditure with connected persons on EPWs and on subcontracting R&D activities is no more than 15 per cent. of its qualifying expenditure.

Details of Schedule 2: R&D tax credits for SMEs: Northern Ireland companies

12. Subsection 2 and Schedule 2 amend the separate legislation for the R&D tax credits for SMEs that would apply if the Northern Ireland Assembly were to vary the rate of Corporation Tax for Northern Ireland companies. That separate legislation ensures that the value of the relief would be the same for Northern Ireland and non-Northern Ireland companies.
13. As a consequence, however, there is a separate provision at s357PD CTA 2010 defining the amount of tax credit which parallels s1058 CTA 2009. It is necessary to amend this to introduce the cap. Schedule 2 therefore amends s357PD CTA 2010 in a similar fashion to the amendments made by Schedule 1 to s1058 CTA 2009.

Background note

14. The R&D tax reliefs, including the SME R&D tax credit, incentivise firms to invest in R&D. They are a core part of the government's support for innovation, supporting the Industrial Strategy target of the UK spending 2.4 per cent. of GDP on R&D by 2027.
15. However, the SME tax credit has become a target for fraud and abuse, in particular through companies claiming payable tax credit for work carried on by others in circumstances where they have very little substance in the UK. This legislation responds to that, ensuring the relief goes to those who should receive it.
16. The proposed change was first announced at Budget 2018 and the Government consulted on detailed design in 2019. There was a further consultation in Spring/Summer 2020, to ensure that the impact on genuine companies was minimised.
17. If you have any questions about this change, or comments on the legislation, please contact please contact Yasmin Achha/ David Harris on 03000 592504/ 03000 586834 (email: yasmin.achha@hmrc.gov.uk / david.harris@hmrc.gov.uk).