HM TREASURY

'Above the Line' credit for Research and Development:

response to consultation

December 2012

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Foreword

The Research and Development (R&D) tax credit schemes currently provide over £1.1 billion of annual relief to over 10,200 companies, supporting £10.9 billion of R&D expenditure. They are a key element in the Government's commitment to an internationally competitive tax system, and in its overall objectives for strong and sustainable private sector-led growth.

This document provides the Government's response to the issues raised by the consultation on the 'Above the Line' (ATL) credit for R&D and sets out the final design of the ATL credit to be introduced in April 2013.

The Government would like to thank all those who have contributed to this consultation and helped to shape the final proposals.

The ATL credit is designed to increase the visibility and certainty of R&D relief, and provide greater financial and cash flow support to companies with no corporation tax liability. The Government believes that the ATL credit will make R&D relief more effective at influencing large company investment decisions and help to increase the overall level of R&D activity in the UK.

The Government believes that in the long-run, a mandatory ATL credit will allow for a simple system of R&D relief that provides the strongest incentive for domestic and foreign firms investing in R&D in the UK. However, the Government recognises that some companies may need to time to adjust to claiming R&D relief 'above the line' and will therefore retain the existing super-deduction until April 2016 to allow businesses time to prepare for the transition.

The final proposals for the ATL credit will help to support the Government's wider strategy for innovation that includes a reduced rate of corporation tax on profits arising from patents and other types of intellectual property.

The proposals will ensure that the UK continues to be one of the most attractive places in the world for innovative investment and help to encourage the development of new processes, technologies and skills in the UK economy.

David Gauke

Exchequer Secretary to the Treasury

1 Introduction

Key points

- R&D tax credits currently provide over £1.1 billion of annual relief to over 10,200 companies, supporting £10.9 billion of R&D expenditure.
- The Government will introduce an 'Above the Line' credit for R&D investment by large companies in April 2013.
- The ATL credit will increase the visibility and certainty of UK R&D relief and provide greater financial and cash flow support to companies with no corporation tax liability.
- Following consultation, the Government has decided that the ATL credit will be:
    - a taxable credit paid at a headline rate of 9.1 per cent;
    - fully payable, net of tax, to companies with no corporation tax liability;
    - available for qualifying expenditure incurred on or after 1 April 2013;
    - introduced alongside the existing super-deduction in April 2013 and will replace the super-deduction in April 2016;
    - paid at a higher headline rate to companies in the oil and gas ring-fence, to preserve the effective rate of relief they receive from a 130 per cent super-deduction;
    - available to surrender to group companies; and
    - safeguarded from abuse through the introduction of a Pay As You Earn (PAYE)/National Insurance Contribution (NIC) cap on the payment of the credit to companies with no corporation tax liability.
- These proposals form a key element of the Government's strategy for innovation that includes a reduced rate of corporation tax on profits arising from patents and other types of intellectual property.
- The Government will be making no changes to the small and medium sized business (SME) R&D tax credit.

Aim

1.1 The aim of this document is to provide the Government's response to the issues raised by the HM Treasury consultation on an 'Above the Line' credit for Research and Development, published in March 2012.

Consultation process

1.2 In a consultation published in 2011[1], the Government asked for views on moving to an ATL credit, as well as a number of other issues regarding the delivery of R&D tax relief. Over three-quarters of respondents believed that changing the mechanism of relief, from a deduction against profits to a credit accounted for 'above the line', would be effective at increasing levels of R&D activity in the UK.

1.3 Following this consultation, the Government announced at the 2011 Autumn Statement that it would introduce an 'Above the Line' credit for large company R&D investment in April 2013. At Budget 2012, the Government announced that the credit would be taxable, available at a minimum pre-tax rate of 9.1 per cent, and payable to companies with no corporation tax liability.

1.4 A consultation on the ATL credit's detailed design and implementation was published on 31 March 2012.[2] The consultation closed on 29 June 2012 and received over 70 written responses. The consultation also comprised of a number of meetings and forum discussions with business, including an R&D working group, an accounting group, and a wider ATL workshop hosted by the Department for Business, Innovation and Skills. The Government would like to thank all those who have contributed to the consultation.

Scope of response

1.5 This document provides a summary of the responses to the ATL credit consultation. The document sets out the Government's response to the issues raised and its decisions on the final design of the ATL credit.

- Chapter 2 covers questions 1-12 and 14 of the consultation document.
- Chapter 3 covers questions 13 and 15-19 of the consultation document.
- Annex A covers questions A1-A4 of the consultation document.

Stage of consultation and next steps

1.6 The proposals set out in this document are at stage 3 of the Government's approach to tax policy making – drafting legislation to effect the proposed change. Draft legislation on the ATL credit, together with draft Explanatory Notes, has been published separately and is available here:

http://www.hm-treasury.gov.uk/9860.htm

1.7 The Government welcomes responses to the draft legislation by 6 February 2013. Responses should be sent to the following address:

Carol Johnson
CTIAA, CT and Business Income Tax
HM Revenue and Customs
100 Parliament Street
London SW1A 2BQ

carol.johnson4@hmrc.gsi.gov.uk

1.8 Following consultation, the Government will introduce legislation in Finance Bill 2013.

[1] http://www.hm-treasury.gov.uk/d/consult_r_d_tax_credits.pdf
[2] http://www.hm-treasury.gov.uk/d/condoc_above_line_credit_rd.pdf

2 Main features of the 'Above the Line' credit

Criteria for the ATL credit

2.1 The consultation document set out the Government's criteria for an ATL credit that is effective at enhancing UK R&D investment, affordable, simple and straightforward to administer, sustainable and not open to abuse, accountable 'above the line' under UK and International Accounting Standards (IAS), and compliant with European Union State aid rules. The consultation asked whether these criteria represented the best set of objectives for assessing options on the ATL credit's design.

> **Question 1**
>
> Do you agree with the above criteria for assessing proposals for the ATL credit? Please provide any comments as appropriate.

Response to the consultation

2.2 The majority of respondents agreed with the Government's criteria for assessing options on the ATL credit's design. Another suggested criterion was that no businesses under the large or SME R&D tax credit schemes should be worse off as a result of the final proposals.

Main features (questions 2-6)

2.3 The consultation document set out a basic model for an ATL credit that is calculated directly from qualifying R&D revenue expenditure, taxable, paid at a minimum rate of 9.1 per cent and payable in cash to companies with no corporation tax liability. The consultation document also proposed that the ATL credit be administered and settled through the tax system and be made available for accounting periods beginning on or after 1 April 2013 to reduce complexity in the claims process.

2.4 Two illustrative models were presented for the payment of the credit to companies with no corporation tax liability. It was suggested that the credit could either be paid in full (fully payable model), or paid at a discounted rate (reduced payable model) with the saving to the Exchequer potentially used to fund an increase in the credit's headline rate.

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?

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.

Response to the consultation

2.5 In line with the previous consultation, respondents generally welcomed the introduction of an ATL credit. Respondents believed that it will be a more visible form of relief than the existing super-deduction and, as a consequence, more effective at influencing R&D investment decisions. This visibility was particularly valued by companies operating in multinational organisations who are typically allocated group capital on the basis of their pre-tax earnings.

2.6 The introduction of a payable credit was seen to provide welcome financial and cash flow support to companies who operate in cyclical industries, companies who have long commercialisation periods, and companies who undertake cutting edge R&D projects for which returns can be uncertain. Respondents emphasised that these companies would now be able to incorporate R&D relief into investment decisions with greater certainty.

2.7 Respondents were overwhelmingly in favour of the fully payable credit model, believing it to be more consistent with the Government's criteria for a credit that is simple and straightforward model to administer, accountable 'above the line', and effective at enhancing UK R&D investment. While a number of respondents proposed a double-digit rate for the ATL credit, few believed that the payable credit should be discounted in order to facilitate this. Respondents agreed that a deferral model, similar to the one employed in France, would introduce unnecessary complexity into the scheme.

2.8 Most respondents were in favour of a taxable credit, emphasising the behavioural and signalling impacts of a higher headline rate. Advice from the accounting working group also confirmed that taxing the credit could provide marginal support for its 'above the line' accounting treatment. Some felt that taxing the credit, and paying it net of tax to companies with no corporation tax liability, would increase complexity in the scheme and disadvantage companies operating in groups. To address this, a number suggested that the credit should be non taxable or paid gross of tax to companies with no corporation tax liability.

2.9 The corporation tax system was generally seen to be the most effective mechanism for the administration and settlement of the ATL credit. Advice from the accounting working group confirmed that this would not impact on the credit's 'above the line' accounting treatment under UK and International Accounting Standards. Several respondents suggested that the ATL credit should be offset against PAYE or Value Added Tax liabilities to increase the cash flow benefit of R&D relief and create a stronger correlation between relief and underlying expenditure.

Government's response

2.10 Following the views expressed in the consultation, the Government has decided that the ATL credit will be:

- taxable;
- available at a headline rate of 9.1 per cent;
- fully payable, net of tax, to companies with no corporation tax liability; and
- administered and settled through the corporation tax system.

2.11 The introduction of a fully payable credit will greatly increase the value of R&D relief to companies with no corporation tax liability and make the UK a more attractive location for large company R&D investment. The Government will keep the headline rate of the ATL credit under review as part of its commitment to an internationally competitive tax system.

2.12 The Government has decided that the ATL credit will be taxable and paid net of tax to companies with no corporation tax liability, ensuring that profit makers and loss makers are treated equally in terms of the benefit they derive from the relief. Where a credit is paid to a company rather than set against its corporation tax liability, tax will be withheld at the main rate of corporation tax. This withheld tax will be available to be carried forward to set against any future corporation tax liabilities of the company. The Government will introduce provisions to ensure that taxing the credit does not disadvantage companies operating in groups (see 3.5).

Transitional support for business

2.13 The Government asked business whether there were likely to be significant administrative costs and challenges in claiming R&D relief 'above the line'.

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?

Response to the consultation

2.14 Respondents highlighted that a start date of accounting periods beginning on or after 1 April 2013 would delay the benefits of the ATL credit to a large number of companies. This was viewed as inconsistent with the 2011 Autumn Statement announcement and likely to reduce the immediate impetus behind the ATL credit's introduction. Respondents proposed a number of alternative start dates including accounting periods beginning on or after 1 January 2013 and expenditure incurred on or after 1 April 2013. No significant concerns were raised about the complexity of a mid-year implementation date, with companies citing their experiences in dealing with mid-year capital allowances and corporation tax rate changes.

2.15 Respondents pointed to potential administrative challenges in moving to an ATL credit. It was highlighted that, under an ATL credit, the amount of a company's R&D relief claim would need to be established much earlier for the purposes of compiling statutory accounts. It was also believed that that the disclosure of this amount in the profit and loss account would attract greater scrutiny from auditors and make prior year adjustments more frequent and burdensome. Reflecting the above, some respondents emphasised the need for earlier certainty from HMRC regarding the accuracy of claims, with a number advocating a real time, pre-approval system such as the voluntary advance assurance scheme proposed for SMEs.

Government's response

2.16 The Government has listened to business concerns on the start date and will **allow companies to claim the ATL credit for their expenditure incurred on or after 1 April 2013**. This will allow companies to realise the benefits of the ATL credit sooner and will ensure that companies are not disadvantaged by the timing of their accounting period.

2.17 The Government will be retaining the super-deduction until April 2016, giving businesses time to prepare for any administrative challenges associated with claiming R&D relief 'above the line.' The Government will not be offering a formal advance assurance scheme but will continue to support businesses in making R&D claims through HMRC's Large Business Service and specialist R&D units.

Optional or mandatory (questions 9-12 and 14)

2.18 The consultation document sought business views on whether the ATL credit should fully replace the existing super-deduction in April 2013 and whether there would be additional administrative costs to HMRC and business by maintaining two systems in parallel. Responses on this question were motivated by a number of other questions raised in the consultation document. In particular,

- whether US-parented multinationals would be able to benefit from the ATL credit if the super-deduction is retained; and
- whether the ATL credit would impact on the pricing of Government-funded R&D contracts, particularly in the defence sector.

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.

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?

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 not fully replace the existing scheme, does this assessment change?

Response to the consultation

US-parented multinational corporations (US MNCs)

2.19 Respondents were of the view that an ATL credit would be of benefit to all US MNCs, provided it is mandatory and paid in full to companies with no corporation tax liability. A small number also believed that it was necessary for the credit to be paid in cash, as opposed to being settled through the corporation tax system, and to be paid gross of tax to loss-makers.

2.20 Respondents highlighted that a number of US MNCs may be unable to benefit from the current system of UK R&D relief. The super-deduction reduces their UK tax but, in doing so, reduces the double-tax relief they receive from the US Government when they repatriate profits. For these US MNCs, the benefit of UK R&D relief is therefore offset by an increase in US tax liability. Respondents emphasised that this would continue to be the case if the ATL credit was introduced as part of an optional system.

2.21 Discussions with business suggested that this is unlikely to be an issue for US MNCs who either permanently reinvest their profits in the UK or have structures in place to insulate their UK profits from US tax. However, for a number of US MNCs, these solutions were deemed to be costly, uncommercial and complicated by industry-specific regulation.

Government procurement

2.22 While respondents questioned the impact of an ATL credit on a number of UK Government contracts and pricing models (e.g. Pharmaceutical Price Regulation Scheme (PPRS)), the main concerns were in relation to contracts in the defence sector. Respondents pointed out that, unlike the existing super-deduction, the Ministry of Defence (MoD) would look to claw back the ATL credit in the pricing of its non-competitive R&D contracts with industry. It was believed that foreign

Government departments, such as the US Department of Defence, would take a similar approach to the MoD in looking to appropriate the benefit of the ATL credit from their UK contractors.

2.23 There was a concern that, for businesses and supply chains generating large revenues from these contracts, the introduction of an ATL credit could significantly reduce earnings and have a negative impact on investment and employment decisions in the UK. It was also argued that businesses would face significant administrative burdens in providing the MoD with an up-front projection of an ATL credit claim in order for it to be appropriated in the contract negotiation. On this basis, a number of respondents put forward strong arguments in favour of either retaining the existing super-deduction or, as an alternative, amending the MoD's procurement guidelines to ensure that contract prices remain unaffected by the introduction of the ATL credit.

Ring-fence companies

2.24 Respondents highlighted that companies in the oil and gas ring-fence, whose profits are taxed at a rate of 62 per cent, would derive more benefit from a 130 per cent super-deduction than a 9.1 per cent ATL credit. Moving to a mandatory ATL credit would reduce the effective rate of R&D relief that these companies receive from 18.6 per cent to 3.5 per cent, significantly reducing the incentive for investment. Respondents believed that this could be addressed by either retaining the super-deduction or allowing companies in the oil and gas ring-fence to claim the ATL credit at a higher headline rate.

Other issues

2.25 There were mixed views on the administrative complexity of running two systems in parallel. Respondents emphasised that the main administrative burden in the R&D tax credit scheme is the identification of qualifying expenditure, the definition of which would remain identical across both schemes. However, others felt that companies would be compelled to make potentially onerous comparisons between the relative benefits of each scheme based on complex timing considerations and uncertain forecasts of future profits.

2.26 A number of groups viewed an optional system as a fallback if either the ATL credit was to be paid at a discounted rate or if steps were not taken to ensure that groups are not disadvantaged by the payment of the credit net of tax to loss-makers.

Government's response

2.27 Following the views expressed in the consultation, the Government has made the following decisions on the credit's design:

- the ATL credit will be introduced alongside the existing super-deduction in April 2013 and legislated to fully replace the super-deduction in April 2016;
- companies will be able to elect to claim R&D relief via the ATL credit at the end of their accounting period, for expenditure incurred on or after 1 April 2013. Once a company has elected to claim the ATL credit, it will not be able to claim via a super-deduction in subsequent accounting periods; and
- the ATL credit will be paid at a 49 per cent headline rate to companies in the oil and gas ring-fence to preserve the effective rate of relief they receive from a 130 per cent super-deduction.

2.28 The Government believes that the treatment of R&D tax relief in the pricing of MoD single-source contracts is a matter of procurement policy and should be reviewed on its merits as part of the MoD's response to the Currie Review[1]. The Single-Source Regulations Office (SSRO) – an independent body tasked with amending and overseeing single-source pricing regulations – is due to be set up in 2014-15. Following consultation with MoD and industry, the SSRO will make a recommendation on the 'fair and reasonable' treatment of R&D relief in the pricing of MoD single-source contracts. In making this recommendation, the SSRO will consider the implications for levels of R&D investment in the UK defence sector. Consequential amendments to the single-source pricing regulations would take effect from April 2016 at the earliest.

2.29 The Government understands that the ATL credit is unlikely to have a negative impact on companies operating under PPRS and has not been able to identify other contractual arrangements or pricing structures that will be impacted by the introduction of an ATL credit.

2.30 By retaining the super-deduction until April 2016, businesses will have time to prepare for the administrative challenges associated with claiming R&D relief 'above the line.' In the long-run, a mandatory ATL credit will achieve the Government's objective for a simple and straightforward system of R&D relief that is visible, certain, and effective at enhancing UK R&D investment. The final design of the credit will also increase the attractiveness of the UK as a location for overseas investment and maintain the strong incentive for R&D investment in the oil and gas sector.

[1] http://www.mod.uk/NR/rdonlyres/894BD700-CE90-43AD-AD52-A94E681AC86B/0/review_single_source_pricing_regs.pdf

3 Detailed design issues

3.1 This chapter covers the remaining detailed design issues set out in Chapter 4 of the consultation document.

Group companies (question 13)

3.2 Under the current system, a company can surrender losses attributable to the R&D super-deduction to a profitable member of the same group. The consultation asked whether groups could be disadvantaged, relative to the current system, if the ATL credit is paid at a reduced rate to companies with no corporation tax liability.

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?

Response to the consultation

3.3 Respondents emphasised that groups could be disadvantaged under a reduced payable credit if they were forced to take the credit at a discount rather than realising its full value against the taxable profits of a group member.

3.4 Respondents also highlighted that groups could be disadvantaged by the payment of the credit net of tax to companies with no corporation tax liability. To resolve this issue, a number proposed that companies should be able to monetise the tax withheld on the credit's payment against the corporation tax liability of a group member. Several responses also suggested that this issue could be resolved by making the ATL credit non taxable or paying it gross of tax to companies with no corporation tax liability.

Government's response

3.5 The Government wants to ensure that groups are not disadvantaged under an ATL credit regime and **will allow companies to either; (i) surrender the credit, in whole or in part, to set against the corporation tax liability of a group member; or (ii) surrender the tax withheld on a payable credit to set against the corporation tax liability of a group member.**

Small and Medium Sized Businesses (SMEs) (questions 15 and 16)

3.6 Based on responses to the June 2011 consultation, the Government did not see strong evidence for replacing the existing SME scheme with an ATL credit. However, it welcomed views on this judgement and on 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?

Response to the consultation

3.7 Respondents emphasised that the existing SME scheme, and its supporting infrastructure, is well understood and effective in incentivising UK R&D investment. There was general agreement that the 'above the line' accounting treatment of R&D relief is less relevant for SMEs, who do not typically have the same degree of separation between their R&D and tax departments. Several responses highlighted that, in certain sectors, a significant 'key performance indicator' for SMEs is their R&D spend which would appear to be reduced under an ATL credit.

3.8 Some respondents suggested that by introducing an ATL credit in the large company scheme, there may be additional complexity for companies crossing the definitional thresholds and for SMEs claiming under the large company scheme. However, others believed that the access to a payable credit would outweigh any additional complexity and that the existing two-year grace period would ease the transition for businesses changing status.

Government's response

3.9 Based on responses to both the 2011 and 2012 consultations, **the Government will not be introducing an ATL credit into the SME scheme**. The Government accepts that there may be additional complexity for SMEs claiming under the large company scheme but, by retaining the existing super-deduction until April 2016, the Government believes that these companies will be able to manage the transition effectively and thus benefit from a credit that is payable in the absence of a corporation tax liability.

Avoidance and abuse (questions 17-19)

3.10 The Government invited views on ways to safeguard the ATL credit scheme from abuse. The consultation document suggested that this could be achieved by capping the amount of payable credit at the amount of a company's PAYE/NICs liabilities.

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?

Response to the consultation

3.11 A number of respondents identified opportunities for abuse upon the introduction of a credit that is payable to companies with no corporation tax liability and therefore welcomed the Government's intention behind a PAYE/NICs cap.

3.12 There was a concern among respondents that a PAYE/NICs cap could introduce compliance burdens and prove restrictive for R&D claims in particular situations, such as where a company uses a high proportion of externally provided workers (EPWs). Some questioned the need for additional provisions, while others believed that a general anti-avoidance rule backed up by a purpose test may be a more appropriate backstop to assess the legitimacy and integrity of claims.

Government's response

3.13 The Government believes that a PAYE/NICs cap is necessary, and the most effective way to protect the Exchequer from abuse of the scheme. **The Government will therefore limit the amount of payable credit to the amount of a company's PAYE/NICs liabilities in relation to staff engaged in qualifying R&D activities in the accounting period.**

3.14 The Government wants to ensure that the cap does not restrict claims for genuine R&D activity. **Companies will therefore be able to carry forward the portion of the credit which has been limited by the PAYE/NICs cap and treat this as an ATL credit arising in a following accounting period**. The Government has looked closely at the issue of EPWs but does not intend to extend the cap due to the complexities involved.

Further issues

3.15 A number of other issues were raised about the ATL credit in the consultation:

- A number of respondents believed that the ATL credit could impact on transfer pricing, specifically where a cost-plus methodology is used to calculate the arm's length price of R&D provided between connected parties. These respondents suggested that, unlike the current super-deduction, a company may be required to pass the benefit of the ATL credit to its customer, either in part or in its entirety.
- Respondents sought clarity on the interaction of the ATL credit with Patent Box, double tax relief (DTR), and video games tax relief.

Government's response

3.16 The impact of the ATL credit on transfer pricing for the provision of R&D between connected parties will be dependent on an entity's specific circumstances. To satisfy Organisation for Economic Cooperation and Development transfer pricing guidelines, an entity would need to demonstrate that passing on the benefit of the ATL credit to its customer in a connected transaction was commercially rational.

3.17 The calculation of the UK measure of a company's income for DTR purposes will reflect the ATL credit that is included in the company's taxable profits. **The Government will make consequential changes to the Patent Box legislation to ensure that a company can claim the full benefit of R&D relief under the ATL regime when claiming Patent Box benefits.**

3.18 To ensure that only one form of Government support is provided in respect of the same underlying expenditure, companies will only be entitled to claim either R&D tax relief or video games tax relief on expenditure that qualifies under both schemes.

A 'Above the line' accounting treatment

A.1 The Government invited views on whether the proposed models for the ATL credit, as set out in the consultation document, would be accounted for 'above the line' under International Financial Reporting Standards (IFRS). HMT officials set up a working group of accountants to discuss these questions in detail.

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.

Response to the consultation

A.2 IAS12 'Income Taxes' and IAS20 'Accounting for Government Grants' were identified as the relevant standards to consider. To account for the credit 'above the line,' IAS20 would need to be the applicable standard, either directly or by analogy.

A.3 The majority of respondents believed that the ATL credit was an 'investment tax credit' and, as such, out of scope of both standards. Companies would be required to draw an analogy to either IAS12 or IAS20 based on the ATL credit's final design. For IAS20 to be the relevant standard, respondents emphasised that the credit must be directly related to a company's qualifying expenditure and have a monetary value that is independent of a company's corporation tax liability. Taxing the credit and attaching additional conditions to its receipt, such as the requirement for a given level of PAYE/NICs liability, was seen by some respondents to provide marginal support for the IAS20 analogy. Settlement of the ATL credit through the corporation tax system was not deemed to have any consequences for its accounting treatment.

A.4 There was a consensus that a fully payable ATL credit could be accounted for 'above the line' under IAS20. The majority of respondents believed that the gross amount of the credit should be recognised 'above the line', with a corresponding entry in the tax line to recognise the application of the withheld corporation tax.

A.5 It was highlighted that in the reduced payable ATL credit model, a portion of the credit can only be monetised by a company with a corporation tax liability. This could bring this element back within the scope of IAS12 and cause companies to account for it in the tax line. Respondents believed that this would introduce significant accounting and administrative complexity, contrary to the objectives laid out in the consultation document.

A.6 The accounting treatment of both the fully payable and reduced payable ATL credit models under UK General Accounting Practices (UK GAAP) was generally seen to align with IFRS. SSAP4 'Accounting for Government Grants' was deemed the relevant standard to consider although it was noted that new accounting standards would come into force on 1 January 2015.

Government's response

A.7 Based on the views provided in the consultation and from the accounting working group, the Government is confident that companies will be able to account for the fully payable ATL credit 'above the line' under both UK GAAP and IFRS. This will increase the visibility of the relief and make it more effective at influencing R&D investment decisions at both a company and group level.

B List of respondents

AAT

Aiglon

Airto

Ansys UK

Armstrong Watson

AstraZeneca

Association of British Pharmaceutical Industry (ABPI)

BAE Systems

Baker Tilly

BBC

BDO

Bentley Motors

BioIndsutry Association (BIA)

Bombardier

British American Tobacco

BT

BTG International

Caterpillar

CBI

Chemical Industries Association (CIA)

Chartered Institute of Taxation (CIOT)

Deloitte

EEF

Eisai

Ela8

Ernst and Young

Freescale Semiconductor

FTI Consulting

Fujitsu

General Electric (GE)

GKN

GlaxoSmithKline (GSK)

Grant Thornton

Hogg Robinson Group

ICAEW

ICAS

Innovation Group

Intel

Intellect

Jaguar Land Rover

Johnson Matthey Group

JP Morgan

Kingly Brookes

KPMG

Leicester R&D Unit

Leyton

Lilly

Lockheed Martin Insys

Lumesse

Magna

Manufacturing Technologies Association (MTA)

Metaswitch

MMP Tax

Nationwide

NMI

Pfizer

PWC

QinetiQ

Reed Elsevier

Richard Service - Mazars

Rolls-Royce

Sainsburys

SMMT

Solent R&D Pharma Unit

Sony

Tait Walker

Tata Steel

Thales

True Research

Try Lunn & Co

UCB Pharma

UK Oil Industry Tax Committee (UK OITC)

Ultra Electronics

Unilever

Williams Grand Prix Holdings

Zurich

HM Treasury contacts

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