

R&D Tax Credits – 2011 Updates

Capital Allowances
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R&D Tax Relief

Background

While some may take pleasure in the coalition Government performing multiple reversals of policy over the previous months, there will definitely be over 6,000 companies celebrating the Conservative's about-turn from their pre-election desire to get rid of R&D tax credits. Indeed with up to £1bn worth of R&D support provided since inception of the scheme so far and facing pressure from industry, the coalition have committed themselves on a path to 're-focusing' R&D tax credits.

Budget 2011

In a welcomed move, George Osborne announced proposals to increase R&D tax relief rates for small / medium enterprises from 175% to 200% from April 2011 and up to 225% from April 2012. Additionally, the current cap on the cash credit for loss-making SMEs (restricted to PAYE / NIC payments made) and the minimum expenditure limit (currently £10,000) will be removed.

The amendment to 200% relief from April 2011 has been included within Finance Bill '11, which is currently winding its way through the halls of Parliament seeking Royal Assent. The new rate is subject to 'State Aid' approval rules, whereby the EU may over-rule fiscal incentives to businesses which are deemed too generous.

Loss-making companies may claim a cash credit for that enhanced tax relief at 14% of the total relief at present, but this number will reduce to 12.5% upon agreement of Finance Bill '11. However, with the current mechanism of relief, this would still create an increased level of cash credit available because it is linked to the total amount of R&D tax relief generated.

So under the new rules, a company spending £200,000 on qualifying R&D may claim up to £400,000 of taxation relief and if this company does not have sufficient profits, they may surrender this relief to HMRC in return for a cash payment of £50,000.

The Consultation Continues...

The Treasury produced a consultation into the R&D tax relief regime in November 2010 and following a round of responses, the Government is seeking views on more specific areas of policy.

In general, the respondents claimed that the scheme was well liked and seen as making a positive contribution to the UK economy. The Government's tinkering with the scheme is designed to ensure that R&D tax credits are 'effective in supporting innovation...for large companies and SMEs.'

The Government does not wish to make wholesale amendments to the schemes, but in the coming year, the following changes will be proposed in legislation:

- (i) The Government believes the Externally Provided Worker (EPW) rules are 'over-restrictive' and will bring forward legislation this Autumn allowing a wider range of circumstances to qualify.
- (ii) H M Revenue and Customs are to develop improved guidance with respect to the definition of R&D for tax purposes. This guidance will be published shortly.



- (iii) The Government wishes to introduce a more formal advance approval system for R&D claimants, which will hopefully provide comfort to claimants and reduce costs. HMRC will introduce a voluntary pilot scheme with new start-ups and first-time claimants.

Food for Thought...

The Government has extended the initial consultation until 2 September 2011 to encompass several queries raised through the responses received, including:

- Respondents have raised the possibility of an 'above the line credit' replacing the existing system, this would bring the UK R&D system more in line with other European countries. Some respondents to the consultation believed such a change would incentivise the project leaders in larger companies to include R&D tax credits within budgeting processes.
- Qualifying Indirect Activities may be included in R&D tax claims at present, however there is significant uncertainty regarding the rules. The Government is seeking responses to determine whether relief for such activities should be removed.
- Subcontracted R&D in certain circumstances may qualify for R&D tax relief, although often because of the onerous and uncertain rules, qualifying activities and the appropriate claimant may not be easy to ascertain. The Government proposes to introduce either a joint election or certification process to deliver certainty between sub-contractor and contractor to ensure the relief is available.
- PAYE/NICs cap will be removed for companies claiming the R&D cash credit, however the Government wishes to consult on the inclusion of safeguards to prevent misuse of the scheme.
- Going concern definition currently restricts R&D tax relief to only companies meeting the criteria. The Government proposes to replace this rule with the concept of a 'company in difficulty' according to the EU guidelines. This definition currently exists for both the EIS and VCT schemes.

Summary

The R&D tax credit system has increased in popularity and generosity since commencement in 2000. Although many companies benefit directly from the two schemes, the Government wishes to ensure the fiscal incentives available remain pertinent to expanding R&D within UK companies.

The move to increase rates will definitely assist small and medium enterprises, while the consultation continues to investigate a nip and tuck approach to increase the efficiency and usefulness of the scheme to all participants.

Details of the ongoing consultations are available at [The Treasury's website](#)

