

## TAXREP 37/07

### TAX LAW REWRITE: BILL 5: CORPORATION TAX

#### ADDITIONAL RELIEF FOR EXPENDITURE ON RESEARCH AND DEVELOPMENT

*Memorandum submitted in May 2007 by the Tax Faculty of the  
Institute of Chartered Accountants in England and Wales in  
response to Paper CC/SC(07)06 issued in February 2007  
by HMRC Tax Law Rewrite Team*

Contents	Paragraph
Introduction	1-2
General comments	3-7
Answers to questions	8-9
Specific comments on draft legislation	10-24
Detailed comments on drafting	25-34

Annex 1 - Who we are

Annex 2 - The Tax Faculty's Ten Tenets for a Better Tax System

ICAEW Tax Faculty, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ <a href="http://www.icaew.com/taxfac">www.icaew.com/taxfac</a>	T +44 (0)20 7920 8646 F +44 (0)20 7920 8780 E <a href="mailto:tdtf@icaew.com">tdtf@icaew.com</a>
--	--

## **TAX LAW REWRITE: BILL 5: CORPORATION TAX**

### **ADDITIONAL RELIEF FOR EXPENDITURE ON RESEARCH AND DEVELOPMENT**

#### **INTRODUCTION**

1. We welcome the opportunity to comment on Paper CC/SC(07)06 (Bill 5: Additional relief for expenditure on research and development) published in February 2007 by HMRC's Tax Law Rewrite team at <http://www.hmrc.gov.uk/rewrite/paper-cc-sc-07-06-research-and-development.pdf>.
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in Annex 1. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex 2.

#### **GENERAL COMMENTS**

3. The bringing together of all the additional reliefs for research and development in a single Part is a helpful simplification of the source legislation currently located in Schedule 20 FA 2000 and in Schedules 12 and 13 FA 2002.
4. We note that draft Schedule 1 (Consequential amendments) is work-in-progress at this stage, and that how to deal with insurance specific material on a Bill-wide basis remains under consideration.
5. We note from Budget 2007 press release BN05 dated 21 March 2007 that it is proposed to introduce legislation in Finance Bill 2007 to extend the SME relief scheme to companies with fewer than 500 employees having an annual turnover not exceeding 100 million euros and/or who have an annual balance sheet total not exceeding 86 million euros, including a restriction to prevent claims for relief in respect of the same expenditure under both the existing SME R & D scheme and the vaccine research relief scheme.
6. We also note the intention to amend the vaccine research relief to correct an unintended error, which might potentially allow relief of an additional 150% deduction rather than the 50% intended, with any necessary amendment arising in consequence to the Paper CC/SC(07)06 draft clauses.
7. We further note the proposal to make changes to the amount of the R & D tax credits in Finance Act 2008 (BN 05 paragraph 2).

#### **ANSWERS TO QUESTIONS**

8. **Q1** We agree the proposal to make clear in the drafting of clause 1(1) that Schedule 20 to FA2000 and Schedules 12 and 13 to FA 2002 apply only to companies liable to corporation tax.

9. **Q2** We agree the proposal to define “staffing costs” by reference to money earnings and reimbursed expenses.

## **SPECIFIC COMMENTS ON DRAFT LEGISLATION**

### **cl 4 Meaning of “small or medium-sized enterprise”**

10. **(1)** It would be helpful if the Explanatory Notes could explain more plainly what is meant by an SME, as clause 4(1) refers only to Commission Recommendation 2003/361/EC of 6 May 2003 details of which may not be readily available to the reader.
11. Whilst currently a small or medium company means a company with fewer than 250 employees and an annual turnover not exceeding 50 million euros and/or a balance sheet total not exceeding 43 million euros, it is of course intended to increase these amounts in Finance Act 2007 (Clause 49 Finance Bill 2007 - Budget 2007 press release BN05 refers) subject to European Commission approval that the EC state aid approval rules will still be met.

### **cl 5 Section 4: qualification**

12. This is not a clause which is readily comprehensible (but nor is the source legislation in paragraph 2(1) Schedule 20 FA 2000). It might be helpful to number consecutively the Conditions in clause 5(3)-(6) and to relocate clause 5(5) after 5(2). This would make clear that, taking into account the rest of the partner enterprise or linked enterprise to which a company is related, the company exceeded the employee limit or the financial limits because the rest of the partner enterprise or linked enterprise on its own exceeded those limits, even though on its own the company would satisfy the employee limit and at least one of the financial limits. It is necessary to refer to the explanatory notes to appreciate the effect otherwise of Article 4(2) applying. Even then, it is not clear how the effect set out in Explanatory Note 15 flows from clause 5 to cause the company to fail to qualify as an SME in the second accounting period and not in the first as well.
13. The reference to a partner enterprise or linked enterprise in the singular and alternative is also difficult to follow. Assuming this to be the case, it would be helpful for the explanatory notes to make clear that company C can only be a member of a single partner enterprise or of a single linked enterprise under the Commission Recommendation.

### **cl 13 Restriction on consortium relief**

14. **(2)** Whilst clause 13 accurately rewrites paragraph 22 Schedule 20 FA 2000, should it be made clear in clause 13(2) that the ‘amount’ at issue is limited to the amount of the relief under section 9 and/or 10 to which the surrendering company is entitled in the accounting period concerned? This effect is implied by the commentary in Explanatory Notes paragraph 33. The surrendering company may have incurred a trading loss in excess of the amount of such relief, and it is clearly not appropriate that the surrender of the excess should be precluded. Section 402(1) ICTA does refer to losses and ‘other amounts’, so that s 402 ICTA relief can be identified with section 9 and/or 10 relief only as other amounts for the purposes of clause 13; but, for clarity, it would be preferable to refer to an amount ‘not exceeding relief under section 9 or 10’ in draft clause 13(2).

- cl 16 Qualifying expenditure on in-house direct research and development**
15. (5) Should there be a signpost to the exception to Condition D as provided in Chapter 3 (Relief for SMEs: Research and development sub-contracted to SME))?
16. (6) Should there be a signpost to the exception to Condition E as provided in Chapter 4 (Relief for SMEs: subsidised expenditure on research and development)?
- cl 19 R & D threshold**
17. As a policy matter, is there any good reason for treating pre-trading expenditure differently in clauses 14 and 19 (with clauses 24 and 29) when counting towards the R & D threshold for an accounting period? We appreciate that any alignment of clauses 14 and 19 etc in this respect is beyond the remit of the Tax Law Rewrite; but following the source legislation does oblige the rewrite to maintain what appears to be an unnecessary complication. As a more modern view, it would appear appropriate to count pre-trading expenditure towards the threshold and to align clause 14 with clauses 19, 24 and 29. If this is beyond the remit of the TLR project, no doubt you will pass this point to your policy colleagues for comment as we would welcome clarification of the justification for this complication in the context of the wider search for simplification.
- cl 23 Additional deduction in calculating profits of trade**
18. (4) Does clause 23(4) need to make clear that the expenditure at issue is expenditure which would have been corporation tax deductible disregarding any subsidy relating to it?.
- cl 53 Amount of R & D tax credit**
19. (3) We note the inclusion now of the words 'and savings', which are not in the source legislation; but should the source legislation qualification 'as the Treasury think fit' also be included in the rewrite to make it clear that clause 53(3) is a Treasury power only?
- cl 55 Payment of R & D tax credit: supplementary**
20. (7)(a) Should the meaning of 'PAYE regulations' be interpreted, or will this be done elsewhere on a Bill-wide basis?
- cl 62 Anti-avoidance**
21. (4) Is there a reason why 'agreement' in the source legislation is rewritten as 'arrangement' in the definition of "arrangements" for the purposes of clause 62?
- cl 79 Meaning of "subsidised expenditure"**
22. (1) Does it need to be made clear that expenditure is treated as subsidised regardless of when State aid or other grant or subsidy is actually obtained, and regardless of when expenditure is actually met directly or indirectly by a person other than the company? This can be deduced from clause 79(1)(a)-(c), but it might be helpful to explain this further in the Explanatory Notes.
23. Are the words 'or has been' necessary in clause 79(1)(a)? It is not clear that they are needed; but, if they are, should they also be included in clause 79(1)(b) and (c)?
24. Should clause 79(1)(a) also make clear that the company's expenditure is treated as subsidised only to the extent that a notified State aid is or has been obtained in respect of it or any related expenditure?

## DETAILED COMMENTS ON DRAFTING

### **cl 1 Overview of Part**

25. In Explanatory Notes paragraph 8, the reference to Part '9B' should be to '9BA'.

### **cl 12 Treatment of deemed trading loss under section 10**

26. In Explanatory Notes paragraph 30, for 'losses' substitute 'profits'.

### **Chapter 4 Overview**

27. In Explanatory Notes paragraph 82, in the third sentence, the reference to paragraph 3 should be to paragraph 2 in the transitionals Schedule.

### **cl 29 R & D threshold**

28. (3) Whilst sub-clause 29(3) correctly rewrites paragraph 1(2) Schedule 12 FA 2002 by reference to "for" the accounting period, should it be aligned with the similar sub-clauses 14(5) and 19(4) which refer to deductibility "in" the accounting period?

### **cl 37 SMEs: amount of deduction**

29. In Explanatory Notes paragraph 127, the reference to subsection (2) should be to subsection (3).

30. In Explanatory Notes paragraph 128, the reference to subsection (3) should be to subsection (4).

### **cl 51 Meaning of "Chapter 2 surrenderable loss"**

31. In Explanatory Notes paragraph 169, in the second sentence, insert '50% of' before 'the amount of that relief'.

### **cl 63 Meaning of "staffing costs"**

32. (6) In the definition of "pension fund" should 'arrangement' be 'arrangements' as in paragraph 5(1A) of Schedule 20 FA 2000?.

### **cl 69 Meaning of "externally provided worker"**

33. (6) It would be clearer to retain 'of' before 'any other person'.

### **cl 82 Meaning of "qualifying body"**

34. (2)(c) Should 'education' be retained before 'institution'?

TJH/PCB

3.5.07

**WHO WE ARE**

1. The Institute of Chartered Accountants in England & Wales is a professional body representing some 128,000 members. The Institute operates under a Royal Charter with an obligation to act in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
2. The Tax Faculty is the centre for excellence and an authoritative voice for the Institute on taxation matters. It is responsible for tax representations on behalf of the Institute as a whole and it also provides services to more than 11,000 Faculty members who pay an additional subscription.
3. Further information is available on the ICAEW Tax Faculty website at [www.icaew.com/taxfac](http://www.icaew.com/taxfac) or telephone 020 7920 8646.

## THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.