IP developments and issues

Large Corporate | OMB | Tax voice



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David O'Keeffe provides an overview of some significant changes

There have been quite a few changes in the last few years to the R&D tax relief regimes and also to the relatively new Patent Box regime.

R&D Relief

Rates

The headline rate of relief for SMEs was increased to 230% (i.e. a 130% additional deduction) for expenditure incurred on or after 1 April 2015. The rate of payable credit, for those SMEs with insufficient taxable profits to utilise the deduction relief, increased to 14.5% for expenditure incurred on or after 1 April 2014.

At a CT rate of 20%, the effective benefit of the additional deduction (i.e. the amount of tax saved) is equal to 26% of the qualifying R&D expenditure. The payable credit, however, is now particularly valuable; for the 2015/16 year the cash payment is equal to 33.35% of the qualifying R&D expenditure.

State Aid

The SME R&D regime is subject to EU State Aid rules and there are, accordingly, some specific restrictions in the legislation as a result. One of these is a cap on total R&D relief that can be given per project. With the change of large company relief to RDEC (see below), the way this cap is applied is being changed to ensure SMEs will still receive the maximum benefit.

There are also some important administrative changes coming in this year's Finance Act. These changes are part of efforts by the EC to improve state aid transparency and will require HMRC to collect and publish certain information in respect of R&D claims (actually, these changes will also affect other reliefs). Very broadly, for awards of "aid" (i.e. the effective benefit of an R&D claim) of €500,000 or more, HMRC will have to collect and publicise details of the claimant's name, sector, region, whether it is an SME, the awarding body and the purpose of the aid. In practice, this is mostly information that HMRC will already have as part of the claim process so this is unlikely to impose any extra burden on the claimant. The important point, however, is that HMRC will be required to publish this information on an EU "portal" site and it will be publicly available.

HMRC's current intention is to publish the information in as broad a manner as possible. Amounts of R&D relief will only be given by reference to broad bandings and the 'purpose of the aid' will be something generic like "to promote R&D".

Consumables

There have also been some new restrictions introduced in respect of eligible expenditure. In particular, there is now a restriction on the amount of expenditure on consumable items that can qualify for inclusion in a claim for R&D relief. The restriction will apply in situations where a "relevant person" transfers ownership of any items produced in the course of the R&D. The restrictions will only apply to expenditure on consumable items where the products are transferred for money or money's worth in the ordinary course of the trade.

These new restrictions apply to expenditure incurred by an SME or a large company on or after 1 April 2015.

Reimbursed Expenses

HMRC will shortly publish guidance on the treatment of reimbursed expenses in the CIRD manual. CIOT still does not fully agree with HMRC's position but the final guidance is a vast improvement on HMRC's starting point.

HMRC Templates

HMRC is currently working to develop templates to help collect relevant information in respect of R&D claims in a format that will make it easier for them to review those claims. This project also involves developing a public version of an "RDEC Stencil" that HMRC already uses internally to check that RDEC is utilised correctly. I have been assured that "at present" the use of these templates and stencils will not be compulsory, although it is easy to imagine how their use could become de facto compulsory.

Large Company Relief

Important changes were also made in respect of Large Company R&D relief. With effect from 1 April 2013 the 30% additional deduction relief was phased out and replaced with the new R&D Expenditure Credit (RDEC). During the three-year transitional period, companies could choose to remain with the additional deduction or move straight into RDEC. For expenditure incurred on or after 1 April 2016 RDEC is the only form of large company R&D relief available.

RDEC is an above-the-line taxable credit – the rate is 11% for expenditure incurred on or after 1 April 2015 – that can then be used to discharge the company's CT liability. There is a seven step process that must be gone through in order to determine how the RDEC is utilised, including considering whether it can be surrendered to other group companies. Significantly, the RDEC is payable where it cannot be utilised to discharge tax liabilities.

Vaccine Research Relief

Vaccine Research Relief (VRR) is to be abolished for expenditure incurred on or after 1 April 2017.

Patent Box

The UK’s Patent Box regime is undergoing significant change, only three years after it first came into effect on 1 April 2013. The changes are a direct consequence of the recent OECD BEPS Action 5 report.

That report proposed a more restrictive structure for acceptable Patent Box regimes, with schemes required to comply with the “nexus approach”. This is intended to ensure that relief is only given for patent profits where there is a direct link with the R&D expenditure incurred on developing the patented invention. Following a brief consultation, initial draft legislation was published on 9 December 2015 and that was further updated with the publication of Finance Bill 2016. It is likely that there will be some more changes before Royal Assent.

The basic approach of the draft changes is to insert two new chapters into the existing Patent Box legislation in CTA2010 Part 8A. These chapters incorporate the new nexus-compliant rules that require the computation of a ‘nexus fraction’ to be used in computing the relevant patent box profits.

Chapter 2A will become the default position for new entrants after 30 June 2016 and for all companies after 30 June 2021. Companies already elected into the patent box will stay with the existing rules in respect of patents applied for before 1 July 2016 (or 2 January 2016 in certain situations where patents were transferred from overseas connected parties).

Chapter 2B covers situations where – until 1 July 2021 – a company has both existing and new patents.