

SME R&D relief - subsidised expenditure (Lecture B1302 – 12.07 minutes)

In computing their taxable profits, small and medium-sized companies are able to claim a special enhanced deduction in respect of their qualifying revenue R&D expenditure (S1044 CTA 2009). With effect from 1 April 2015, this allowable deduction (often referred to as a 'super-deduction') has been set at 230% of the relevant expenditure. For a company paying corporation tax at 19%, it represents an effective tax relief of 43.7%.

In order for a company to be classified as an SME, it must have:

- fewer than 500 employees (see Illustration below); and
- either:
 - a turnover not exceeding €100,000,000; or
 - a gross assets total in its balance sheet not exceeding €86,000,000.

Clearly, such companies may still be very substantial enterprises.

Illustration

For its year ended 31 December 2021, Brandon Industries Ltd employed the following staff:

- 440 full-time employees;
- 80 part-time staff (50 working 3 days a week and 30 working 4 days a week);
- 5 employees who joined the company on 1 June 2021;
- 3 employees who left the company on 31 March 2021;
- 10 apprentices who were employed for the whole year; and
- 2 employees who went on parental leave from 1 August 2021.

The employee headcount for Brandon Industries Ltd is calculated as follows:

Full- time		440.00
Part-time	$(50 \times 0.6) + (30 \times 0.8)$	54.00
New joiners	$5 \times 214/365$	2.93
Leavers	$3 \times 90/365$	0.74
Parental leave	$2 \times 212/365$	<u>1.16</u>
		<u>498.83</u>

This is below the 500-employee limit and so Brandon Industries Ltd meets the headcount requirement for being an SME.

Apprentices and students with vocational training contracts are not included in the headcount.

A company cannot claim R&D relief for expenditure which is subsidised (S1052(6) CTA 2009). The definition of 'subsidised' is set out in S1138 CTA 2009 and particular note should be taken of S1138(1)(c) CTA 2009 which states that there is deemed to be a subsidy where the expenditure 'is met directly or indirectly by a person other than the company'. The rationale for this stipulation is clear: if the company is not incurring the relevant costs, it should not be supported by the tax system.

Judgment in the case of *Quinn (London) Ltd v HMRC* (2021) has recently been published by the First-Tier Tribunal. The taxpayer company (Quinn) carried on a trade of providing construction and refurbishment works to a range of clients in return for an agreed price. HMRC accepted that Quinn was an SME and had expended sums on R&D which it was entitled to deduct in computing its taxable profits. However, HMRC contended that the company was not entitled to the enhanced R&D relief claimed on the basis that the relevant expenditure was 'subsidised' within the meaning of S1138(1)(c) CTA 2009.

What is subsidised expenditure? No-one doubts that, if a company receives a grant for a particular project, then this will represent a subsidy. But, in this case, Quinn, which HMRC accepted was carrying out appropriate R&D work, factored the cost of its R&D activities into the overall price which the company charged under the various contracts with its clients. Did that constitute subsidised expenditure? In an important decision, the First-Tier Tribunal judge (Judge Harriet Morgan) ruled that it did not. Judge Harriet Morgan's key conclusion in Para 47(5) deserves to be quoted in full:

'It would be wholly out of kilter with the overall SME scheme if an SME were to be denied enhanced R&D relief solely because, in doing what is envisaged by the legislation (namely, utilising the relevant R&D for the purposes of its trade), as is usual and to be expected of an entity carrying out a trade on a commercial basis, it seeks to recover some or all of the relevant costs of the R&D under its commercial contracts with its clients entered into in the course of its ordinary trading activities. Indeed, if HMRC's approach were to be adopted, the circumstances in which an SME could claim enhanced R&D relief would seem to be confined to those where it has no prospect of exploiting the R&D for commercial gain.'

It is difficult for the speaker to see why HMRC took this case because, as Judge Harriet Morgan implied, HMRC's arguments – taken to their logical conclusion – would have severely curtailed the scope for companies to obtain tax credits for genuine R&D activities.

All tax advisers involved with R&D claims will have breathed a sigh of relief that the judge's finding went the way that it did.

Contributed by Robert Jamieson