

# RESEARCH & DEVELOPMENT TAX CREDITS

## A. INTRODUCTORY NOTE

1. The tables in this section present National Statistics on Research & Development tax credit claims derived from company tax returns covering the period 2000-01 to 2009-10. The note below describes:

- Research & Development tax credits;
- The compilation of these statistics; and
- The content of the tables.

## B. RESEARCH & DEVELOPMENT TAX CREDITS

### Scheme to 2007-08

2. Research & Development (R&D) tax credits were introduced in April 2000 for companies that are Small and Medium-sized Enterprises (SMEs)<sup>1</sup>. The scheme was extended in April 2002 to companies not included in the SME definition (often called the 'Large Company' scheme), and an additional scheme (vaccines research relief) giving extra relief for expenditure on drugs and vaccines for TB, malaria and AIDS/HIV was also introduced with effect from April 2003.

3. R&D is defined for tax purposes in Section 1138 Corporation Tax Act 2010. This states that the definition of R&D for tax purposes follows generally accepted accounting practice. The accountancy definition is then modified for tax purposes by Department for Business, Innovation and Skills (BIS) guidelines, which are given legal force by HM Treasury Regulations.

4. Broadly, within the meaning of Section 1138, R&D takes place when an overall project seeks to achieve an advance in science or technology. Where R&D is being done by a company, certain costs of undertaking that R&D may qualify for R&D tax credits. Principally these are expenditure on R&D staff, materials used in the R&D, externally provided R&D workers and in certain cases some of the costs of sub-contracted R&D.

5. In addition to the basic 100% deduction for revenue expenditure on R&D, under the SME scheme companies can deduct an extra 50% of their qualifying revenue R&D expenditure when calculating taxable profits, or 25% under the large company scheme. For vaccines research relief, both SME and large companies are entitled to claim an additional 50% enhancement of any research expenditure, on top of any extra deductions for qualifying R&D expenditure. These extra deductions reduce the company's corporation tax bill.

6. In certain circumstances the SME scheme also allows companies making losses (and which therefore do not have a corporation tax bill) to surrender losses in exchange for a cash payment from HM Revenue & Customs. These payments are known as payable credits and have a value of 16% of the surrenderable loss.

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<sup>1</sup> The EU State Aid definition of an SME: a company that has fewer than 250 employees, and either an annual turnover not exceeding €50 million or an annual balance sheet total not exceeding €43 million, and is independent of one or more large enterprises that would fail these tests.

## **Developments since 2007-08**

7. From 1 April 2008 companies can deduct an extra 30% (up from 25%) of their qualifying R&D expenditure under the large company scheme. From 1 August 2008, the SME relief was extended to include companies with up to 500 employees and either turnover under €100 million or balance sheet assets under €86 million. Under the extended SME scheme, companies can deduct an extra 75% (up from 50%) of their qualifying R&D expenditure, or receive a payable credit of 14% (a change from 16% previously) of the surrenderable loss. Also from 1 August 2008, companies can deduct an extra 40% (change from 50%) of their qualifying vaccines research expenditure.

8. The rate of the additional deduction for expenditure on R&D for SMEs was increased again from 75 per cent to 100 per cent from 1 April 2011, giving a total deduction of 200 per cent. However, Vaccine research relief (VRR) will no longer be available for SMEs from 1 April 2012. Subject to receiving State aid approval, the rate of the additional deduction will be increased by a further 25 per cent to 125 per cent from 1 April 2012, giving a total deduction of 225 per cent. The rate of R&D relief for large companies remains at 130 per cent.

9. Further information on the R&D tax credit schemes can be found on the HM Revenue & Customs website at: [www.hmrc.gov.uk/randd/](http://www.hmrc.gov.uk/randd/).

## **C. R&D TAX CREDIT STATISTICS**

10. The administrative data used to compile National Statistics on R&D tax credits is derived from information provided by companies on the Company Tax (CT) return. The data covers all CT returns received by HMRC and records are available for all SME and large company claims.

11. The CT return collects information on the enhanced level of R&D expenditure and the amount of any R&D payable tax credit. Companies also specify whether they are claiming under the SME or large company scheme, and declare the expenditure they are claiming under the SME subcontractor or vaccines research relief scheme, if applicable.

12. Although the data are broadly complete, there are often a number of late returns which add to the existing data and therefore result in revisions to previously published figures. Accordingly, the results for all years should be considered as provisional, although any revisions are more likely to impact on the later years.

13. The figures also include cases in which the SME or large company claim box was ticked in the CT return but the associated expenditure was only recorded later as part of the CT assessment process.

14. The figures exclude a small number of large company claims made alongside the returns totalling about £20 million a year.

## **D. THE CONTENT OF THE TABLES**

15. The data in the tables relate to claims made in CT returns for the SME and large company R&D tax credit schemes, and vaccines research relief. The figures published cover the period 2000-01 to 2009-10 and are based on CT returns received on or before 31 August 2011.

16. Because a company can claim under more than one scheme in any one accounting period, and can have more than one accounting period ending during any one financial year, the number of companies making claims in any one year is less than the number of claims in that year. The following table provides the number of companies claiming R&D tax credits by financial year.

## Number of companies claiming R&D credits by financial year

Financial year	No of companies
2000-01	1,790
2001-02	3,280
2002-03	5,110
2003-04	5,950
2004-05	6,310
2005-06	6,120
2006-07	6,580
2007-08	7,580
2008-09	8,490
2009-10	9,180

### The number of claims

17. Table RD1 provides an estimate of the number of CT returns containing a claim for R&D tax credits broken down by scheme and type of claim.

18. Claims under the SME scheme are split into enhanced deductions only, payable credits only and claims which include a combination of both deductions and a payable credit. Similarly, claims under the large company scheme are classified as being made either by a large company or by a SME subcontractor (where the work has been subcontracted to the SME by a large company).

19. The number of SMEs claiming payable credits declined sharply in 2008-09, with simultaneous increases in those making combination and deduction claims. This is due to the changes to the R&D tax credit schemes which came into effect during 2008-09 as detailed in paragraph 7 above.

20. The totals of individual schemes may not sum to the totals for All R&D schemes because companies can, in some circumstances, claim under more than one scheme. For example, a SME may be able to claim under the SME scheme and as a SME subcontractor under the large company scheme in the same CT return. Claims for vaccines research relief should also be included in the return along with claims under the SME or large company scheme. Such claims have been included in the All R&D schemes total only once to avoid double counting.

21. An accounting period basis is used in Table RD1 to allocate claims to a specific financial year. For each claim the accounting period is defined by a start and end date. Claims are allocated to the financial year in which the accounting period end date falls.

- *There were 9,410 claims for R&D tax credits in 2009-10. 7,410 were received under the SME scheme and 2,280 under the large company scheme, including some claiming under both. 10 claims were received under the vaccines research relief scheme. The total number of companies making at least one claim in 2009-10 was 9,180 (see table in paragraph 16 above).*
- *The number of claims made under the large company scheme has increased each year from 690 in 2002-03, the first year of the scheme, to 2,280 claims in 2009-10.*
- *For the SME scheme, the number of claims increased from 1,860 in 2000-01 to 5,310 in 2004-05 but fell to 4,960 in 2005-06 before recovering to 7,410 in 2009-10.*

- *The number of SMEs claiming payable credits declined sharply in 2008-09, with simultaneous increases in those making combination and deduction claims. This was an expected behavioural response to a change in the R&D tax credit schemes which came into effect during 2008-09, increasing the enhanced deduction for SMEs to 175%, making it more valuable relative to the payable credit.*

### **Cost of support claimed**

22. Once the type of claim has been determined, each claim is converted into the associated cost to the Exchequer of the support being claimed. Costs arise from two sources: firstly, from deductions of the enhanced R&D expenditure from taxable profits; and, secondly, from the payable credits. Where claims are for a combination of deductions and payable credit, the cost has been separated out into deductions and credits.

23. Where a company deducts enhanced R&D expenditure from its taxable profits, the cost to the Exchequer arises from reduced corporation tax revenues. For claims under the SME scheme, the cost is estimated by applying the small companies tax rate (20% in 2007-08, for example) to the additional 50% (in 2007-08 for example) of expenditure deducted. Similarly the large company scheme cost is calculated by applying the higher 30% tax rate (in 2007-08 for example) - or 20% for SME subcontractors (again 2007-08) - to the additional 25% (again, in 2007-08) of expenditure deducted.

24. The same assumptions are used for the vaccines research relief, with the small companies tax rate for SMEs and a 30% tax rate (up to 2007-08) for large companies applied to the enhanced deductions.

25. Where a SME company is claiming payable credits, the cost is the amount of payable tax credit paid to the company.

26. Adding together the costs of deductions and payable credits for all claims gives the total cost of claims for the R&D tax credit to the Exchequer.

### **Costs on an accounting period basis**

27. The cost data in Table RD2 are comparable with the number of claims data in Table RD1 as both tables use an accounting period basis. The accounting period end date is used to allocate claims and associated costs to a financial year.

- *On the accounting period basis, the cost of support under the SME scheme has increased from £70 million for 2000-01 to £320 million for 2009-10. The cost of support claimed under the large company scheme has more than tripled since its introduction in 2002-03, from £200 million to £700 million for 2009-10.*
- *The support claimed under the large company scheme spiked (at £760 million) for 2008-09 due to a small number of unusually large claims, before falling back (to £700 million) in 2009-10. The upward trend remains.*

### **Costs on a receipts basis**

28. Table RD3 shows costs on a receipts basis to estimate the profile of costs according to when they are incurred by the Exchequer. This approach is useful to judge the timing of the impact of claims for R&D tax credits on tax revenues. Where a claim is for a combination, the cost has been separated out into deductions and credits.

29. The costs in table RD3 are now derived using a standard conversion formula to apportion accounting period basis costs from current and preceding years to estimate

receipts, rather than making assumptions about receipts based on the dates on tax returns. This change in methodology has resulted in some minor changes to historical data.

30. For payable credits, we assume that the payment is made, on average, one month after the company files its CT return. This assumption is based on qualitative feedback from tax offices.

- *On the receipts basis, a total of £990 million of support was claimed as R&D tax reliefs in 2009-10 - £290 million under the SME scheme and £700 million under the large company scheme, plus a small amount (less than £10 million) under the vaccines research relief scheme.*

## **E. ENQUIRIES AND FURTHER INFORMATION**

31. Requests for clarification or further information should be addressed to Phil Armitage, HM Revenue & Customs, KAI Direct Business Taxes, Room 2/43, 100 Parliament Street, London, SW1A 2BQ. A telephone enquiry number is given in the enquiry points section.