

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 13: Additional relief for expenditure on research and development

Overview

Chapter 9: Supplementary

Overview

2888. This Chapter brings together the definitions of terms that apply to each of the earlier Chapters. Most of these definitions are given in Schedule 20 to FA 2000 but they are applied to Schedules 12 and 13 to FA 2002 by the respective paragraphs 17 and 5 of those Schedules. In such cases the commentary refers only to the Schedule 20 provision on which the definition is based.

Section 1119: “Small or medium-sized enterprise”

2889. This section defines “small or medium-sized enterprise”. It is based on paragraph 2 of Schedule 20 to FA 2000, paragraph 2 of Schedule 12 and paragraph 5 of Schedule 13 to FA 2002.

Section 1120: Qualifications to section 1119

2890. This section makes two qualifications to the European Union definition of small or medium-sized enterprise. It is based on paragraph 2 of Schedule 20 to FA 2000, paragraph 2 of Schedule 12 to FA 2002 and 5 of Schedule 13 to FA 2002.

2891. The European Union definition is in the Annex to Commission Recommendation 2003/361/EC of 6 May 2003, as incorporated by reference in section 1119(1). Article 3 of the Annex requires a company to include figures from a partner or linked enterprise in determining whether it breaches the qualifying thresholds (aggregation). This is called “aggregation”.

2892. Article 4(2) of the Annex gives the company a period of grace if the inclusion of those figures means it ceases to be a small or medium-sized enterprise. The company will cease to be a small or medium-sized enterprise within the European Union definition only if the limits are exceeded in two consecutive accounting periods.

2893. The purpose of Qualification 2 in this section is to remove that period of grace for the purposes of this Part, so that the company ceases to be a small or medium-sized enterprise in the second accounting period. The effect of Qualification 2 in this section is to disapply Article 4(2) of the Annex so that Article 2 of the Annex applies instead. Article 2 of the Annex provides: “In respect of any year, you must use the year end accounts for that year to classify the company, according to these criteria.”

Section 1121: “Larger SME”

2894. This section defines “larger SME”. It provides a convenient label for companies falling within Qualification 1 of section 1120. It is based on paragraphs 15A and 16A of Schedule 13 to FA 2002.

Section 1122: “Large company”

2895. This section defines “large company”. It is based on paragraph 2 of Schedule 12 to FA 2002.

Section 1123: “Staffing costs”

2896. This section defines “staffing costs”. It is based on paragraph 5 of Schedule 20 to FA 2000.

2897. Paragraph 5(1)(a) of Schedule 20 to FA 2000 refers to “emoluments paid by the company ... including all salaries, wages, perquisites and profits whatsoever other than benefits in kind”. This is based on the definition of emoluments that section 131 of ICTA applied for Schedule E before that Schedule was rewritten by ITEPA.

2898. None of the definitions of “earnings” in ITEPA is appropriate, because none matches the scope of the definition in paragraph 5(1)(a) of Schedule 20 to FA 2000.

2899. In rewriting Schedule 20 to FA 2000 the language has been modernised and the definition has been adapted so that it applies more clearly from the position of the company making the payment, rather than the employee receiving it. This is achieved by referring to money earnings and reimbursed expenses. When interpreting these definitions, it should be borne in mind that this Part does not create a new class of deduction. It merely enhances an existing staffing costs deduction, the scope of which is determined on ordinary principles. Before an expense can be considered for the purposes of this Part, it must first be deductible on ordinary principles. See for example section 1050(5).

2900. *Subsection (2)* rewrites the reference to salaries and wages by reference to money earnings. “Earnings” takes its ordinary meaning. The statutory definitions of “earnings” in ITEPA are not relevant to the scope of “earnings” in this subsection. See *Change 79* in Annex 1.

2901. *Subsection (3)* rewrites the reference to perquisites or profits whatsoever by reference to reimbursed expenses but making clear that it does not include benefits in kind. See *Change 79* in Annex 1.

2902. In subsections (2) and (3), the phrase “because of employment” is used instead of the ITEPA phrase “by reason of employment”. The effect is that interpretations developed in relation to ITEPA, which might not be appropriate to this section, cannot simply be read across into this section.

2903. ITEPA amended paragraph 5 of Schedule 20 to FA 2000 so that it referred to earnings which constitute employment income. In doing so it inadvertently expanded the definition to include benefits in kind. This change was reversed by paragraph 7 of Schedule 17 to FA 2004, which reinstated the original wording. Schedule 2 (transitionals and savings) preserves the wider definition inserted by ITEPA for the brief window in which it applies to accounting periods covered by this Act. It is relevant only to expenditure incurred before 1 April 2004.

Section 1124: Staffing costs: attributable expenditure

2904. This section identifies when staffing costs are attributable to relevant research and development. It is based on paragraph 5 of Schedule 20 to FA 2000.

2905. In *subsection (4)* and in sections 1126(4) and 1132(4) the phrase “appropriate proportion” is used, while in sections 1129(7), 1134(6) and 1138(4) the concept of a just and reasonable apportionment is used. The two phrases have different meanings and are used in different circumstances. “Appropriate proportion” is used where the quantities or qualities to be determined are objectively measurable. “Just and reasonable” is used where the quantities to be determined are not objectively measurable and the apportionment exercise requires a measure of subjectivity.
2906. When the legislation was introduced the test was that 80% of the director or employee’s working time had to be spent on relevant research and development. Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Act applies. It is relevant only to expenditure incurred before 9 April 2003 (Chapters 3 and 5) and 27 September 2003 (Chapters 2 and 7).

Section 1125: “Software or consumable items”

2907. This section defines “software or consumable items”. It is based on paragraph 6 of Schedule 20 to FA 2000.
2908. When the legislation was introduced relief under all the Chapters in this Part was given for expenditure on “consumable stores”. Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Act applies. It is relevant only to expenditure incurred before 1 April 2004.

Section 1126: Software or consumable items: attributable expenditure

2909. This section identifies when expenditure on software or consumable items is attributable to relevant research and development. It is based on paragraph 6 of Schedule 20 to FA 2000.

Section 1127: “Qualifying expenditure on externally provided workers”

2910. This section defines “qualifying expenditure on externally provided workers”. It is based on paragraph 8A of Schedule 20 to FA 2000.
2911. This section is the first of six sections that deal with the relief given in relation to expenditure on externally provided workers. Sections 1129 to 1131 explain how to calculate this amount. These sections focus on the subject matter of the expenditure. Section 1132 then identifies whether that expenditure is incurred on relevant research and development.
2912. The relief applies only to expenditure incurred on or after 9 April 2003 (Chapters 3 and 5) or 27 September 2003 (Chapters 2, 4 and 7). Schedule 2 (transitionals and savings) preserves this for pre-trading expenditure treated as incurred in the accounting periods to which this Act applies.

Section 1128: “Externally provided worker”

2913. This section defines “externally provided worker”. It is based on paragraph 8B of Schedule 20 to FA 2000.

Section 1129: Qualifying expenditure on externally provided workers: connected persons

2914. This section gives the amount of the qualifying expenditure if the company and the staff provider are connected. It is based on paragraph 8C of Schedule 20 to FA 2000.
2915. The definition of connected persons in section 839 of ICTA (applied by section 1316(1)) applies.

2916. *Subsection (3)* defines “relevant expenditure”. It provides for the exclusion for expenditure of a capital nature that is omitted in the rewrite of other provisions of the source legislation for this Part. Section 53 in Part 3 (trading income), which denies a deduction for capital expenditure, applies to determine if the expenditure would be deductible in calculating the trading profits. It would not apply to exclude capital expenditure from the staff provider’s actual relevant expenditure.
2917. The definition of “agency workers’ remuneration” in *subsection (6)* omits the reference to section 134 of ICTA in paragraph 8C(4)(b) of Schedule 20 to FA 2000. The ICTA provision was repealed by ITEPA and the cross-reference is no longer required.

Section 1130: Election for connected persons treatment

2918. This section allows a company and a staff provider who are not connected to elect for connected persons treatment. It is based on paragraph 8D of Schedule 20 to FA 2000.
2919. The word “other” in *subsection (2)* does not appear in paragraph 8D(2) of Schedule 20 to FA 2000 (the source for this subsection). It does appear in a similar context in paragraph 11(2) of Schedule 20 (the source for section 1131(2)). The inclusion of the word in subsection (2) of this section promotes consistency without changing the meaning of the law.

Section 1131: Qualifying expenditure on externally provided workers: other cases

2920. This section identifies the amount of the qualifying expenditure if the company and staff provider are not connected and have not made an election under section 1130. It is based on paragraph 8E of Schedule 20 to FA 2000.

Section 1132: External workers: attributable expenditure

2921. This section identifies when qualifying expenditure on externally provided workers is attributable to relevant R&D. It is based on paragraph 8A of Schedule 20 to FA 2000.
2922. The section follows the pattern of section 1124 which performs a similar function for staffing costs.

Section 1133: “Sub-contractor” and “sub-contractor payment”

2923. This section defines “sub-contractor” and “sub-contractor payment”. It is based on paragraph 9 of Schedule 20 to FA 2000 and paragraph 6 of Schedule 13 to FA 2002.
2924. This section is the first of a group of sections that apply to sub-contractor payments. The sections are very similar to those that apply to qualifying expenditure on externally provided workers.

Section 1134: Qualifying element of sub-contractor payment: connected persons

2925. This section identifies the qualifying element of a sub-contractor payment if the company and the sub-contractor are connected persons. It is based on paragraph 10 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 8 of Schedule 13 to FA 2002.
2926. The definition of connected persons in section 839 of ICTA (applied by section 1316(1)) applies.
2927. *Subsection (3)* defines “relevant expenditure”. It provides for the exclusion for expenditure of a capital nature that is omitted in the rewrite of other provisions of the source legislation for this Part. See the commentary on section 1129(3) for an explanation of this.

Section 1135: Election for connected persons treatment

2928. This section allows a company and a sub-contractor which are not connected to elect to be treated as if they were connected. It is based on paragraph 11 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 10 of Schedule 13 to FA 2002.
2929. Subsection (4) provides for a time limit in which the election must be made. This time limit does not apply in certain circumstances in the case of companies affected by the repeal of paragraph 6(3) of Schedule 13 to FA 2002 (100% relief where the subcontractor is a charity etc). Schedule 2 (transitionals and savings) provides that where the notice is given before 31 July 2009, the time limit does not apply.

Section 1136: Qualifying element of sub-contractor payment: other cases

2930. This section identifies the qualifying element of a sub-contractor payment if the company and the sub-contractor are not connected persons. It is based on paragraph 12 of Schedule 20 to FA 2000, paragraph 10B of Schedule 12 to FA 2002 and paragraph 11 of Schedule 13 to FA 2002.

Section 1137: Accounting periods: company not within charge to corporation tax

2931. This section treats a company as having an accounting period if it incurs qualifying Chapter 2 or 7 expenditure at a time when it is not within the charge to corporation tax. It is based on paragraph 25 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.
2932. An accounting period is the basis for the determination of tax liability. If a company does not have an accounting period, or is not deemed to have one, then that company will not be able to perform the calculations which are necessary for it to take advantage of the provisions in sections 1045 and 1092. Those sections allow a company to elect to create a loss in respect of pre-trading expenditure. A company that is not yet trading may not have an accounting period. Sections 1045 and 1092 operate by reference to accounting periods. This section treats the company as having the accounting periods it would have had if it had been trading when it incurred the expenditure.

Section 1138: “Subsidised expenditure”

2933. This section defines “subsidised expenditure”. It is based on paragraph 8 of Schedule 20 to FA 2000.

Section 1139: “Intellectual property”

2934. This section defines “intellectual property”. It is based on paragraph 7 of Schedule 20 to FA 2000.

Section 1140: “Relevant payments to the subjects of a clinical trial”

2935. This section defines “relevant payments to the subjects of a clinical trial”. It is based on paragraph 6A of Schedule 20 to FA 2000.
2936. Schedule 2 (transitionals and savings) excludes the application of this Part in relation to this category of expenditure if the expenditure was incurred before 1 August 2008 (for the purposes of Chapters 2, 3 and 7) or 1 April 2006 (for the purposes of Chapters 4 and 5). This preserves the commencement set out in section 28 of FA 2006.

Section 1141: “Payment period”

2937. This section defines “payment period”. It is based on paragraph 17 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

*These notes refer to the Corporation Tax Act 2009
(c.4) which received Royal Assent on 26 March 2009*

Section 1142: “Qualifying body”

2938. This section defines “qualifying body”. It is based on paragraph 18 of Schedule 12 to FA 2002.