

# CORPORATION TAX ACT 2009

---

## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### **Part 13: Additional relief for expenditure on research and development**

##### **Overview**

2693. This Part gives additional relief for expenditure by a company on research and development including research and development into certain vaccines. It is based on Schedule 20 to FA 2000 and Schedules 12 and 13 to FA 2002.
2694. The relief is given in addition to any deduction allowed in calculating the company's trade profits. For example, section 87 in Part 3 (trading income) provides a deduction for expenditure on research and development.
2695. References to research and development are abbreviated to R&D when used in a longer phrase or a long section title. See, for example, "R&D threshold" in section 1050.
2696. In this Part, the rates at which the various reliefs are stated to be available apply only if the expenditure was incurred on or after 1 August 2008. Schedule 2 (transitionals and savings) preserves this commencement rule by providing that, in relation to expenditure incurred before that date, the reliefs are available at the rates previously applicable.

#### **Chapter 1: Introduction**

##### **Section 1039: Overview of Part**

2697. This section gives an overview of the Part. It is new.
2698. The source legislation refers to "tax relief" given to companies in calculating their trade profits. *Subsection (1)* makes clear that the relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1. This change affects the following sections in this Part: sections 1044, 1045, 1063, 1068, 1074, 1087 and 1092.
2699. The reference to Part 9A of Schedule 18 to FA 1998 in *subsection (10)* is to that Part as amended by this Act (see Schedule 1). As this Act brings all the additional reliefs for research and development together, it repeals Parts 9BA and 9C of Schedule 18 to FA 1998.
2700. **Chapters 2 to 4 and 7** of this Part provide for relief in the case of companies which are small or medium-sized enterprises as defined for the purposes of European Union rules on state aid. Section 1120 modifies the basic definition of "small or medium-sized enterprise" in section 1119 by increasing the limits above which a company ceases to be a small or medium-sized enterprise. Schedule 2 (transitionals and savings) contains provision excluding that modified definition in relation to expenditure incurred before 1 August 2008.

***Section 1040: Relief may be available under more than one Chapter of Part***

2701. This section confirms that “double relief” may be available in certain circumstances. It is based on paragraphs 7 and 10A of Schedule 12 to FA 2002 and paragraph 1 of Schedule 13 to FA 2002.

***Section 1041: “Research and development”***

2702. This section applies the definition of “research and development” in section 837A of ICTA to this Part. It is based on paragraph 25 of Schedule 20 to FA 2000, paragraph 19 of Schedule 12 and paragraph 27 of Schedule 13 to FA 2002.

2703. This phrase is used because it has a specific meaning in guidelines published by the Department for Business, Enterprise and Regulatory Reform (formerly, the Department of Trade and Industry). Details can be found on the website [www.businesslink.gov.uk](http://www.businesslink.gov.uk).

***Section 1042: “Relevant research and development”***

2704. This section defines “relevant research and development”. It is based on paragraph 4 of Schedule 20 to FA 2000, paragraph 17 of Schedule 12 and paragraph 5 of Schedule 13 to FA 2002.

2705. “Relevant research and development” is a key concept. All of the reliefs given in this Part include a condition that the expenditure is incurred on relevant research and development in relation to the company.

***Chapter 2: Relief for SMEs: cost of R&D incurred by SME***

**Overview**

2706. This Chapter sets out some rules that apply to a “small or medium sized enterprise” (“SME”). An SME is defined in section 1119.

***Section 1043: Overview of Chapter***

2707. This section summarises the contents of this Chapter. It is new.

2708. This Chapter rewrites the reliefs given by Schedule 20 to FA 2000 if a small or medium-sized enterprise incurs expenditure on in-house direct research and development or research and development that is sub-contracted out by it.

***Section 1044: Additional deduction in calculating profits of trade***

2709. This section allows the company to claim the relief, gives the conditions that have to be met and the amount of the relief. It is based on paragraphs 1 and 13 of Schedule 20 to FA 2000.

2710. Relief under this Chapter is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (5) and (7)*). The amount of the deduction is increased by 75% (see *subsection (8)*).

2711. The relief has to be claimed (see *subsection (6)*). The procedure for making the claim is in Part 9A of Schedule 18 to FA 1998.

2712. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

***Section 1045: Alternative treatment for pre-trading expenditure: deemed trading loss***

2713. This section allows a small or medium-sized enterprise to claim immediate relief for qualifying research and development expenditure incurred in a pre-trading period. It is based on paragraphs 1 and 14 of Schedule 20 to FA 2000.
2714. The usual treatment of expenditure incurred before a company starts trading is given by section 61 in Part 3 (trading income). Expenditure incurred up to seven years before the day the company starts to trade is treated as incurred on that day if it would have been deductible had the company been trading when the expenditure was incurred.
2715. This section allows the company to elect for pre-trading expenditure to create a deemed trade loss for the accounting period in which it was actually incurred. Subject to the restrictions in sections 1048 and 1049 the loss can be used in the same way as other trade losses. It can be set off against other profits under section 393A of ICTA or surrendered as group relief. Any part of the loss not used is carried forward. See the commentary on section 1048.
2716. If the company is entitled to relief because it has made an election under this section, *subsection (8)* provides that the expenditure is not allowed again under the ordinary rules in section 61 for dealing with pre-trading expenditure.
2717. The company has to meet the other qualifying conditions for the relief. In particular the pre-trading expenditure must exceed the threshold for relief (see *subsection (3)*) See the commentary on section 1050(5)(b) for more details on the treatment of pre-trading expenditure for the purposes of the threshold test.
2718. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

***Section 1046: Relief only available where company is going concern***

2719. This section sets out a precondition for relief under sections 1044 and 1045. It is based on paragraph 18A of Schedule 20 to FA 2000.

***Section 1047: Elections under section 1045***

2720. This section sets out the procedure for making an election under section 1045. It is based on paragraph 14 of Schedule 20 to FA 2000.

***Section 1048: Treatment of deemed trading loss under section 1045***

2721. This section imposes a restriction on the use of a deemed trade loss and explains how any unused loss is to be dealt with. It is based on paragraph 23 of Schedule 20 to FA 2000.
2722. It is not a condition of section 1045 that the pre-trading research and development leads to the establishment of a trade. But if it does any of the loss created by the section 1045 election that is unused when the trade starts is treated as a trade loss brought forward (see *subsections (3)* and *(4)*).

***Section 1049: Restriction on consortium relief***

2723. This section prevents a loss created by relief given under this Chapter being surrendered as consortium relief unless the claimant company is also a small or medium-sized enterprise. It is based on paragraph 22 of Schedule 20 to FA 2000.

**Section 1050: R&D threshold**

2724. This section gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 20 to FA 2000.
2725. *Subsection (2)* reduces this limit proportionately if the accounting period is less than 12 months. The source legislation does not explicitly state how the reduction is done. *Subsection (2)* eliminates uncertainty by prescribing the arithmetic formula to be used where an accounting period is less than 12 months. The formula adopted has been widely used in the rewrite Acts. It incorporates a denominator of 365 days, regardless of the length of the calendar year. In this case, it makes a small change adverse to the taxpayer. See *Change 78* in Annex 1. This Change also affects sections 1064, 1075, 1097 (see paragraphs [27672767](#), [28042804](#) and [28492849](#)).
2726. *Subsection (5)(b)* deals with pre-trading expenditure by deeming the company to be carrying on a trade for the purpose of deciding whether the expenditure would be deductible. In the absence of any special tax rule to the contrary pre-trading expenditure is allocated to periods of account in accordance with generally accepted accounting practice.
2727. *Subsection (5)(b)* is needed for the purposes of section 1045. That section allows a company to elect to create a trade loss out of its pre-trading expenditure on qualifying research and development. Section 1045(3) requires the company to meet the threshold test in the period covered by the election.
2728. [Section 1137](#) may also be relevant in this regard. It applies to a company that incurs qualifying Chapter 2 or 7 expenditure at a time when it does not have an accounting period. In practice this must be pre-trading expenditure. The section deems the company to have the accounting periods it would have had if it had been trading when it incurred the expenditure.
2729. *Subsections (7)* and *(8)* deal with expenditure that qualifies under Chapters 3 and 4 of this Part. The basic rule applies. The expenditure must be deductible in calculating the trade profits for the accounting period. In this case the ordinary operation of section 61 is not suspended.
2730. There is no requirement in this section that the expenditure is incurred in the same trade or pre-trading activity. So qualifying expenditure on one trade can be used to meet the threshold required to make a claim under section 1045 in respect of pre-trading expenditure on a separate activity.
2731. There have been a number of changes to the threshold since the relief was introduced by Schedule 20 to FA 2000. Most of these are not relevant to the accounting periods affected by this Act. But Schedule 2 (transitionals and savings), provides that expenditure incurred before 1 April 2002 is ignored for the purposes of subsection (3) (b) and (c), and that section 61 (which provides for up to 7 years' worth of pre-trading expenses to be treated as incurred on the start date of the trade) is ignored in applying this rule.
2732. In relation to qualifying Chapter 3 expenditure the transitional rule preserves the effect of paragraph 2(2) of Schedule 15 to FA 2002. That provision extended the threshold test to include expenditure that qualifies under Part 2 of Schedule 12 to FA 2002, rewritten in Chapter 3 of this Part.
2733. Paragraph 2(2) of Schedule 15 to FA 2002 provides that the extension does not apply to expenditure incurred before 1 April 2002 and that for this purpose no account is taken of section 401 of ICTA.
2734. In relation to qualifying Chapter 4 expenditure the transitional preserves the effect of paragraph 3(2) of Schedule 31 to FA 2003. That provision extended the threshold

test to include qualifying additional SME expenditure as defined in paragraph 10B of Schedule 12 to FA 2002, rewritten in this Part in Chapter 4.

2735. Paragraph 10B(a) of Schedule 12 to FA 2002 provides that:
- “qualifying additional expenditure” is any expenditure which had the SME been a large company throughout the accounting period in question, would have been qualifying R&D expenditure of that company
2736. This brings into play the commencement provision in paragraph 20(1) of Schedule 12 to FA 2002, which provides that Schedule 12 does not apply to expenditure incurred before 1 April 2002 and that “for this purpose no account shall be taken of section 401 of ICTA”.
2737. There are very limited circumstances in which the transitional applies. This Act has effect for accounting periods ending after 31 March 2009. The earliest date on which an accounting period covered by the Act could start is 2 April 2008. For the transitional rule to apply the expenditure would have to be incurred in the period between 2 April 2001 and 31 March 2002.

### ***Section 1051: Qualifying Chapter 2 expenditure***

2738. This section identifies the expenditure that qualifies for relief under this Chapter. It is new.

### ***Section 1052: Qualifying expenditure on in-house direct R&D***

2739. The section defines “qualifying expenditure on in-house direct research and development”. It is based on paragraph 3 of Schedule 20 to FA 2000.
2740. The broad aim of Schedule 20 to FA 2000 is to give relief to the company that incurs the expenditure on the research and development. Paragraph 3(3) of Schedule 20 to FA 2000 describes that as research and development directly undertaken “by the company” or “on its behalf”. A common set of conditions is used to decide whether expenditure on either type of research and development qualifies for relief.
2741. This Act uses the labels “in-house direct research and development” and “contracted out research and development” to describe the two types of research and development. It also rewrites the conditions that apply to each type of research and development separately. In part this is because the two types of activity are quite distinct and in part because the rules on sub-contractor payments apply only to contracted out research and development.
2742. The term “in-house direct research and development” is merely a label. It is not a condition of the relief that the research and development is incurred “in-house”. The condition that the research and development is directly undertaken by the company is rewritten in *subsection (3)*. This requires that the research and development is undertaken “by the company itself”.
2743. The expression “in-house direct research and development” is used because it has a specific meaning in the Department for Business, Enterprise and Regulatory Reform guidelines on the meaning of research and development for tax purposes. See paragraph 27022702. But the definition of what constitutes “direct research and development” in paragraph 3 of Schedule 12 and paragraph 3 of Schedule 13 to FA 2002 is identical in all material aspects to that in paragraph 3 of Schedule 20 to FA 2000. So referring to “in-house *direct* research and development” in this section does not introduce a new condition into the rewrite of paragraph 3 of Schedule 20.
2744. The section does not reproduce the condition in paragraph 3(2) of Schedule 20 to FA 2000 that the expenditure is not of a capital nature. This condition is unnecessary

because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

***Section 1053: Qualifying expenditure on contracted out R&D***

2745. This section defines what is meant by “qualifying expenditure on contracted out research and development”. It is based on paragraph 3 of Schedule 20 to FA 2000.
2746. The section does not reproduce the condition in paragraph 3(2) of Schedule 20 to FA 2000 that the expenditure is not of a capital nature. This condition is unnecessary because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

***Section 1054: Entitlement to and payment of tax credit***

2747. This section allows a small or medium-sized enterprise to claim an R&D tax credit. It is based on paragraphs 15 and 18 of Schedule 20 to FA 2000.
2748. **Sections 1054 to 1062** rewrite the paragraphs of Schedule 20 to FA 2000 that allow a small or medium-sized enterprise to surrender a loss, created as a result of the relief, in return for a cash payment described as an “R&D tax credit”.
2749. The section clarifies that a company may make part claims (*subsection (2)*).
2750. This Act does not rewrite paragraph 24 of Schedule 20 to FA 2000. This provision is no longer required, since the rule allowing the Commissioners for HMRC to deduct money for tax credits before paying their receipts into the Consolidated Fund is set out in sufficiently general terms in section 44 of CRCA (see subsections (1) and (3)(d) of that section). It is worth noting that paragraph 25 of Schedule 13 to FA 2002, which made similar provision to that made by paragraph 24 of Schedule 20 to FA 2000, was repealed by paragraph 96 of Schedule 4 to CRCA.

***Section 1055: Meaning of “Chapter 2 surrenderable loss”***

2751. This section defines “Chapter 2 surrenderable loss”. It is based on paragraph 15 of Schedule 20 to FA 2000.

***Section 1056: Amount of trading loss which is “unrelieved”***

2752. This section identifies the amount of a trading loss that is “unrelieved” It is based on paragraph 15 of Schedule 20 to FA 2000.

***Section 1057: Tax credit only available where company is going concern***

2753. This section sets out a precondition for relief under section 1054. It is based on paragraph 18A of Schedule 20 to FA 2000.

***Section 1058: Amount of tax credit***

2754. This section gives the amount of the R&D tax credit. It is based on paragraph 16 of Schedule 20 to FA 2000.

***Section 1059: Total amount of company’s PAYE and NIC liabilities***

2755. This section explains how to calculate the total amount of a company’s PAYE and NIC liabilities. It is based on paragraph 17 of Schedule 20 to FA 2000.
2756. In *subsection (4)*, amount B includes both primary and secondary Class 1 NIC liabilities. But amount B does not include Class 1 contributions where under paragraph 3B of Schedule 1 to the Social Security Contributions and Benefits Act 1992, the company and the employee have jointly elected to transfer liability to the employee.

2757. “National insurance contributions” is defined in section 1319. This definition is based on paragraph 25 of Schedule 20 to FA 2000 and paragraph 27 of Schedule 13 to FA 2002.

***Section 1060: Payment of tax credit***

2758. This section explains the circumstances in which the payment of an R&D tax credit can be withheld or set against arrears of corporation tax. It is based on paragraph 18 of Schedule 20 to FA 2000.
2759. In *subsection (7)(a)*, the words “PAYE regulations” are to be interpreted in accordance with section 684(8) of ITEPA.

***Section 1061: Tax credit payment not income of company***

2760. This section makes clear that a payment of an R&D tax credit is not income of the company for tax purposes. It is based on paragraph 20 of Schedule 20 to FA 2000.

***Section 1062: Restriction on losses carried forward where tax credit claimed***

2761. This section provides that any losses that are surrendered in return for an R&D tax credit are not available for carry forward. It is based on paragraph 19 of Schedule 20 to FA 2000.

***Chapter 3: Relief for SMEs: R&D sub-contracted to SME***

**Overview**

2762. This Chapter allows a company which is a small or medium-sized enterprise to claim relief for research and development sub-contracted to it. It is based on Part 2 of Schedule 12 to FA 2002.
2763. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).

***Section 1063: Additional deduction in calculating profits of trade***

2764. This section allows a small or medium-sized enterprise to claim relief for expenditure on research and development contracted out to it. It is based on paragraph 11 of Schedule 12 to FA 2002.
2765. As with relief under Chapter 2, relief under this Chapter is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (4) and (6)*). The amount of the deduction is increased by 30% (see *subsection (7)*).
2766. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

***Section 1064: R&D threshold***

2767. This section gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 7 of Schedule 12 to FA 2002.
2768. The rules are very similar to those in section 1050. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in section 1050, the source legislation does not explicitly state how the reduction is

done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

2769. A significant difference to section 1050 is the treatment of pre-trading expenditure.
2770. Under *subsection (5)*, unlike section 1050, the normal rules in section 61 for dealing with pre-trading expenditure are not suspended. Pre-trading expenditure is bunched into the accounting period in which the trade starts and counts towards the threshold for that period. This includes expenditure that qualifies under Chapter 2 of this Part. For the purposes of claiming relief under Chapter 2 itself section 61 is suspended (see section 1050(6)).

### ***Section 1065: Qualifying Chapter 3 expenditure***

2771. This section identifies the expenditure that qualifies for relief under this Chapter. It is based on paragraph 8 of Schedule 12 to FA 2002.
2772. Relief is given to companies that undertake the research and development themselves (section 1066), and to companies that commission the research and development from certain other persons (section 1067). This section prevents more than one company claiming the relief and the relief leaking out into the income tax sector.
2773. If a large company commissions the research and development that company will not be able to claim relief under Chapter 5 of this Part. This is because that Chapter requires the company to carry out the research and development itself. If the research and development is contracted out to a small or medium-sized enterprise the effect of *subsection (2)* is to allow that small or medium-sized enterprise company to claim relief under this Chapter.
2774. If the research and development is contracted out by another small or medium-sized enterprise that company will be able to claim relief itself under Chapter 2. *Subsection (2)* prevents relief being given to the sub-contractor company under this Chapter.
2775. The relief given by this Part is restricted to corporation tax payers. *Subsection (2)* prevents a sub-contractor company getting relief if the work has been contracted out by a person, other than a large company, who could get a deduction for the payment in calculating its trade profits. This prevents the sub-contractor passing on some of the benefit of the relief to an income tax payer by charging lower prices.

### ***Section 1066: Expenditure on sub-contracted R&D undertaken in-house***

2776. This section identifies the expenditure which qualifies for relief if the company undertakes the research and development itself. It is based on paragraph 9 of Schedule 12 to FA 2002.
2777. As in section 1052, this section uses the label “in-house” to describe research and development that the source legislation describes as being “directly undertaken” by the company.
2778. The section does not reproduce the condition in paragraph 9(4) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This condition is unnecessary because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

### ***Section 1067: Expenditure on sub-contracted R&D not undertaken in-house***

2779. This section identifies the expenditure which qualifies for relief if the company commissions another person to do the research and development. It is based on paragraph 10 to Schedule 12 to FA 2002.
2780. The section does not reproduce the condition in paragraph 10(4) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This condition is unnecessary

because section 53 in Part 3, the trading income Part, already prohibits a deduction for capital expenditure.

#### ***Chapter 4: Relief for SMEs: subsidised and capped expenditure on R&D***

##### **Overview**

2781. This Chapter allows small or medium-sized enterprises to claim relief for expenditure on research and development that is subsidised on the same basis as provided for large companies (see Chapter 5 of this Part). It is based on Part 2A of Schedule 12 to FA 2002.
2782. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).

##### ***Section 1068: Additional deduction in calculating profits of trade***

2783. This section allows a small or medium-sized enterprise to claim relief for expenditure on research and development that is subsidised. It is based on paragraph 11 of Schedule 12 to FA 2002.
2784. As with relief under Chapters 2 and 3, relief under Chapter 4 is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsections (4) and (7)*). The amount of the deduction is increased by 30% (see *subsection (8)*).
2785. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

##### ***Section 1069: R&D threshold***

2786. This section gives the minimum amount of qualifying expenditure the company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 10A of Schedule 12 to FA 2002.

##### ***Section 1070: Qualifying Chapter 4 expenditure***

2787. This section identifies the two categories of expenditure that qualify for relief under this Chapter. It is based on paragraph 10B of Schedule 12 to FA 2002.
2788. This Act takes a different approach to identifying the qualifying conditions from that taken in the source legislation. Paragraph 10B of Schedule 12 to FA 2002 defines what it calls “qualifying additional SME expenditure” by providing first that the expenditure would qualify for relief under Part 1 of Schedule 12 to FA 2002. It then superimposes the qualifying conditions in Schedule 20 to FA 2000. But it removes the condition that the expenditure must not be subsidised.
2789. In this Chapter the qualifying conditions are set out in full to avoid the reader having to make these modifications.

##### ***Section 1071: Subsidised qualifying expenditure on in-house direct R&D***

2790. This section defines what is meant by “subsidised qualifying expenditure on in-house direct research and development”. It is based on paragraph 10B of Schedule 12 to FA 2002.
2791. The section does not rewrite the condition in paragraph 10B(c) of Schedule 12 to FA 2002 that the expenditure “is not qualifying sub-contracted R&D expenditure for the purposes of this Schedule”. It is unnecessary.

2792. To qualify under Part 2A of Schedule 12 to FA 2002 the expenditure must qualify for relief under Schedule 20 to FA 2000 but for the fact it is subsidised. Expenditure would not qualify under Schedule 20 to FA 2000 if it were paid in respect of activities sub-contracted to the company. Condition E in *subsection (6)*, which reproduces condition D in section 1052, is all that is required.
2793. This section does not reproduce the condition that the expenditure must not be capital in nature. This condition is unnecessary because section 53 in Part 3, the trading income Part, already prohibits a deduction for capital expenditure.

***Section 1072: Subsidised qualifying expenditure on contracted out R&D***

2794. This section defines what is meant by “subsidised qualifying expenditure on contracted out research and development”. It is based on paragraph 10B of Schedule 12 to FA 2002.
2795. The section does not allow a small or medium-sized enterprise to claim relief for a subsidised contribution to independent research and development. A large company can claim relief for such expenditure (see section 1079). But a small or medium-sized enterprise cannot and therefore the condition in paragraph 10B(b) of Schedule 12 to FA 2002 would not be satisfied.
2796. This section does not reproduce the condition that the expenditure must not be capital in nature. This condition is unnecessary because section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

***Section 1073: Capped R&D expenditure***

2797. This section defines what is meant by “capped R&D expenditure”. It is based on paragraph 10C of Schedule 12 to FA 2002.

***Chapter 5: Relief for large companies***

**Overview**

2798. This Chapter gives relief for expenditure on direct research and development undertaken by a large company itself and for research and development that is contracted out to it. It is based on Part 1 of Schedule 12 to FA 2002.
2799. The Chapter applies only to expenditure incurred on or after 1 April 2002. See paragraph 20(1) of Schedule 12 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).
2800. A “large company” is any company which is not a small or medium-sized enterprise (see section 1122).

***Section 1074: Additional deduction in calculating profits of trade***

2801. This section allows a large company to claim an additional deduction for qualifying expenditure on research and development. It is based on paragraph 11 of Schedule 12 to FA 2002.
2802. As with the reliefs given to small or medium-sized enterprises, relief under Chapter 5 is given as an additional deduction for expenditure that is already deductible in calculating trade profits (see *subsection (6)*). The amount of the deduction is increased by 30% (see *subsection (7)*).
2803. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

***Section 1075: R&D threshold***

2804. This section gives the minimum amount of expenditure that a company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 12 to FA 2002.
2805. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in section 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.
2806. The normal operation of section 61 is not suspended. So pre-trading expenditure that is bunched into the accounting period in which the trade starts counts towards the threshold (see *subsection (4)*).

***Section 1076: Qualifying Chapter 5 expenditure***

2807. This section identifies the three categories of expenditure that qualify for relief under this Chapter. It is based on paragraph 3 of Schedule 12 to FA 2002.

***Section 1077: Qualifying expenditure on in-house direct R&D***

2808. This section defines “qualifying expenditure on in-house direct research and development”. It is based on paragraph 4 of Schedule 12 to FA 2002.
2809. “In-house direct research and development” is the term this Act uses to describe research and development that is undertaken directly by the company.
2810. The section does not reproduce the condition in paragraph 4(5) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.
2811. Condition C in *subsection (4)* identifies the expenditure that qualifies if the research and development is contracted out to the company. It prevents more than one company claiming the relief and the benefit of the relief leaking into the income tax sector.
2812. If a large company commissions the research and development the company will not be able to claim relief under this Chapter. This is because that Chapter requires the company to carry out the research and development itself. So *subsection (4)* allows a large company to which the research and development is sub-contracted to claim the relief.
2813. If the research and development is contracted out by a small or medium-sized enterprise that company will be able to claim relief itself under Chapter 2 of this Part. The effect of *subsection (4)* is to prevent relief also being given to the sub-contractor large company.
2814. The relief given by this Part is restricted to corporation tax payers. *Subsection (4)* prevents a sub-contractor company getting relief if the work has been contracted out by a person, other than a large company, who could get a deduction for the payment in calculating its trade profits. This prevents the sub-contractor passing on some of the benefit of the relief to an income tax payer by charging lower prices.

***Section 1078: Qualifying expenditure on contracted out R&D***

2815. This section defines “qualifying expenditure on contracted out research and development”. It is based on paragraph 5 of Schedule 12 to FA 2002.
2816. The section does not reproduce the condition in paragraph 5(5) of Schedule 12 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

***Section 1079: Qualifying expenditure on contributions to independent R&D***

2817. This section defines “qualifying expenditure on contributions to independent research and development”. It is based on paragraph 6 of Schedule 12 to FA 2002.
2818. The main purpose of this section is to support research and development carried out by universities and other non-taxpaying research institutions.

***Section 1080: Entitlement to relief: I minus E basis***

2819. This section describes the way a claim for R&D relief is given effect in the case of a company carrying on life assurance business. It is based on paragraph 13 of Schedule 12 to FA 2002.

***Chapter 6: Chapters 2 to 5: further provision***

***Section 1081: Insurance companies treated as large companies***

2820. This section provides that a company which carries on life assurance business in an accounting period and which qualifies as a small or medium-sized enterprise (see section 1119) is to be treated as a large company (see section 1122) for the purposes of Chapters 2 to 5. It is based on paragraph 12 of Schedule 12 to FA 2002.

***Section 1082: R&D expenditure of group companies***

2821. This section deals with the case where the research and development in a group of companies is undertaken by particular members of the group on behalf of other group companies. It is based on paragraph 14 of Schedule 12 to FA 2002.
2822. *Subsection (3)* extends the scope of the provisions to cover work contracted out to third parties.

***Section 1083: Refunds of expenditure treated as income chargeable to tax***

2823. This section applies the charge to tax under Chapter 2 of Part 3 if the company gets a refund of expenditure for which it has received certain of the reliefs given by this Part. It is based on paragraph 15 of Schedule 12 to FA 2002.

***Section 1084: Artificially inflated claims for relief or tax credit***

2824. This section denies relief for transactions that are intended to increase artificially the amount of relief or R&D tax credit. It is based on paragraph 21 of Schedule 20 to FA 2000 and paragraph 16 of Schedule 12 to FA 2002.

***Chapter 7: Relief for SMEs and large companies: vaccine research etc***

**Overview**

2825. This Chapter provides relief for research into certain vaccines and medicines. It is based on Schedule 13 to FA 2002.
2826. The Chapter applies only to expenditure incurred on or after 22 April 2003. See paragraph 28(1) of Schedule 13 to FA 2002. Schedule 2 (transitionals and savings) preserves this commencement rule (which, for the purposes of this Act, is relevant only to pre-trading expenditure).

***Section 1085: Overview of Chapter***

2827. This section describes the contents of the Chapter. It is new.

***Section 1086: Meaning of “qualifying R&D activity”***

2828. This section defines “qualifying R&D activity” for the purposes of the relief available for vaccine research. It is based on paragraph 4 of Schedule 13 to FA 2002.
2829. The relief is intended to encourage research into vaccines that protect against diseases that are particularly prevalent in the developing world. This is reflected in the scope of *subsections (1) and (2)*. A clade is a type of genetic grouping. Subsection (2) limits relief to research into the varieties of HIV that are most common in the developing world.

***Section 1087: Deduction in calculating profits of trade***

2830. This section allows the company to claim relief as a trade deduction for qualifying expenditure on vaccine research. It is based on paragraphs 14 and 21 of Schedule 13 to FA 2002.
2831. The section combines the qualifying conditions that apply to small or medium-sized enterprises in paragraph 14 and to large companies in paragraph 21 of Schedule 13 to FA 2002. The amount of the relief is then given separately for each type of company in the following sections. Also, section 1092 allows a small or medium-sized enterprise to elect to create a trade loss in respect of pre-trading expenditure.
2832. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

***Section 1088: Large companies: declaration about effect of relief***

2833. This section requires that a claim for relief under section 1087 be accompanied by a declaration. It is based on paragraph 21 of Schedule 13 to FA 2002.

***Section 1089: SMEs: amount of deduction***

2834. This section gives the amount of the deduction if a small or medium-sized enterprise claims relief as a trade deduction. It is based on paragraph 14 of Schedule 13 to FA 2002.
2835. The normal operation of section 61 in Part 3 is suspended when allocating qualifying expenditure to an accounting period (see section 1099(2)). Pre-trading expenditure is allocated to periods of account in accordance with generally accepted accounting practice and is not treated as incurred when the company starts to trade.
2836. The company may be carrying on one trade and incur pre-trading expenditure in respect of another activity. *Subsections (5) and (6)* make clear that relief can be claimed on the pre-trading activity and given as a deduction in calculating the profits of the existing trade. This follows from paragraph 14(1)(b) of Schedule 13 to FA 2002, which requires only that the company be carrying on *a* trade. There is no requirement that the relief is given in calculating the profits of *the* trade for which the relief is given.

***Section 1090: Modification of section 1089 for larger SMEs***

2837. This section modifies section 1089. It is based on paragraphs 13, 14 and 15A of Schedule 13.
2838. The purpose of this modification is to keep the deduction in section 1089 within the European Union limit on state aid. “Larger SME” is defined in section 1121. Schedule 2 (transitionals and savings) disapplies the “larger SME” category of company in relation to expenditure incurred before 1 August 2008. This preserves the commencement rule in section 50(7) of FA 2007.

***Section 1091: Large companies: amount of deduction***

2839. This section gives the amount of the deduction if a large company claims relief as a trade deduction. It is based on paragraph 21 of Schedule 13 to FA 2002.

***Section 1092: SMEs: deemed trading loss for pre-trading expenditure***

2840. This section allows a small or medium-sized enterprise to claim immediate relief for qualifying expenditure incurred in a pre-trading period. It is based on paragraph 15 of Schedule 13 to FA 2002.
2841. The section is very similar to section 1045. A small or medium-sized enterprise can elect to create a trading loss in respect of pre-trading expenditure that qualifies for relief under this Chapter.
2842. **Section 1099(1)(b)** has an important role to play in the operation of this section. It determines how pre-trading expenditure is allocated to accounting periods. This determines whether the threshold test in *subsection (3)* is met and the amount on which relief is given.
2843. This section makes clear that relief is given only to companies liable to corporation tax. See *Change 77* in Annex 1 and the commentary on section 1039 (overview of Part).

***Section 1093: Modification of section 1092 for larger SMEs***

2844. This section modifies section 1092. It is based on paragraphs 13, 14 and 15A of Schedule 13. The purpose of this modification is to keep the deduction in section 1092 within the European Union limit on state aid. “Larger SME” is defined in section 1121.

***Section 1094: Relief only available to SME where company is going concern***

2845. This section sets out a precondition for relief under sections 1087 and 1092. It is based on paragraph 18A of Schedule 13 to FA 2002.

***Section 1095: Elections under section 1092***

2846. This section gives the procedure for making an election under section 1092. It is based on paragraph 15 of Schedule 13 to FA 2002.

***Section 1096: Treatment of deemed trading loss under section 1092***

2847. This section imposes a restriction on the use of the trade loss and explains how any unused loss is to be dealt with. It is based on paragraph 15 of Schedule 13 to FA 2002.
2848. The section is identical in effect to section 1048.

***Section 1097: R&D threshold***

2849. This section gives the minimum amount of expenditure that a company must incur in an accounting period to claim relief under this Chapter. It is based on paragraph 1 of Schedule 13 to FA 2002.
2850. The minimum amount of expenditure is £10,000, reduced proportionately if the accounting period is less than 12 months long. As in section 1050, the source legislation does not explicitly state how the reduction is done. *Subsection (2)* removes any uncertainty by prescribing the arithmetic formula to be used. See *Change 78* in Annex 1.

***Section 1098: Meaning of “qualifying Chapter 7 expenditure”***

2851. This section identifies the three categories of expenditure which qualify for relief. It is based on paragraph 2 of Schedule 13 to FA 2002.

***Section 1099: SMEs: qualifying expenditure “for” an accounting period***

2852. This section explains how qualifying expenditure is allocated to the accounting periods of a small or medium-sized enterprise. It is based on paragraph 2 of Schedule 13 to FA 2002.

2853. *Subsection (2)* suspends the normal operation of section 61 in Part 3 for pre-trading expenditure. Pre-trading expenditure is not treated as incurred on the first day of trading. Instead *subsection (1)(b)* treats the expenditure as incurred for an accounting period if it would have been deductible in calculating the trade profits for that period if the company had been trading.
2854. Relief is available for pre-trading expenditure not just under section 1092 but also under the main rule in section 1089 if it can be deducted in calculating the profits of a trade.

***Section 1100: Large companies: qualifying expenditure “for” an accounting period***

2855. This section explains how qualifying expenditure is allocated to the accounting periods of a large company. It is based on paragraph 2 of Schedule 13 to FA 2002.
2856. *Subsection (1)* deals with in-house direct research and development and contracted out research and development. Expenditure is incurred for an accounting period if it is deductible in calculating the trade profits for that period. Unlike small or medium-sized enterprises the normal rules for pre-trading expenditure in section 61 in Part 3 apply (see *subsection (2)*). Any pre-trading expenditure will be treated as incurred the day the company starts trading.

***Section 1101: Qualifying expenditure on in-house direct R&D***

2857. This section defines “qualifying expenditure on in-house direct research and development”. It is based on paragraph 3 of Schedule 13 to FA 2002.
2858. “In-house direct research and development” is the term this Act uses to describe research and development that is undertaken directly by the company.
2859. *Subsections (2)* and *(3)* rewrite sub-paragraphs (2) and (3) of paragraph 3 of Schedule 13 to FA 2002 which refer to the expenditure being *on* qualifying R&D activity. This section refers to the expenditure being *attributable* to qualifying R&D activity in order to align the language with that in Chapters 2 to 5 of this Part.
2860. Paragraph 3(3) of Schedule 20 to FA 2000 and paragraphs 4(4) and 9(3) of Schedule 12 to FA 2002 all require that the qualifying expenditure is attributable to relevant research and development. The provisions that define particular classes of expenditure have rules for determining if the expenditure is attributable to relevant research and development.
2861. Paragraph 3(3) of Schedule 13 to FA 2002 requires that the “qualifying R&D activity on which the expenditure is incurred is relevant research and development in relation to the company”. This test is the same as requiring the expenditure to be attributable to relevant research and development and the section adopts the language of the earlier Chapters.
2862. The section does not reproduce the condition in paragraph 3(4) of Schedule 13 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

***Section 1102: Qualifying expenditure on contracted out R&D***

2863. This section defines “qualifying expenditure on contracted out research and development”. It is based on paragraphs 6 and 7 of Schedule 13 to FA 2002.
2864. The section covers payments to a sub-contractor. The conditions in the section have to be satisfied but it is also necessary to isolate the sub-contractor element of the payment. This is described in sections 1134 to 1136.
2865. *Subsections (3)* and *(4)* also refer to the expenditure being attributable to qualifying R&D activity. See the commentary on section 1101.

2866. The section does not reproduce the condition in paragraph 7(5) of Schedule 13 to FA 2002 that the expenditure is not of a capital nature. This is not necessary as section 53 in Part 3 (trading income) already prohibits a deduction for capital expenditure.

***Section 1103: Entitlement to and payment of tax credit***

2867. This section allows a small or medium-sized enterprise to claim an R&D tax credit. It is based on paragraphs 16 and 18 of Schedule 13 to FA 2002.
2868. The section clarifies that a company may make part claims (*subsection (2)*).

***Section 1104: Meaning of “Chapter 7 surrenderable loss”***

2869. This section defines “Chapter 7 surrenderable loss”. It is based on paragraph 16 of Schedule 13 to FA 2002.
2870. The section follows the same pattern as section 1055 (meaning of “Chapter 2 surrenderable loss”) but the restriction in *subsection (2)* if the claim is made by a trading company is slightly different.
2871. **Section 1055(2)(b)** gives relief both for the additional deduction and for the underlying expenditure. Subsection (2) denies relief for the underlying expenditure. This is because if the company has had relief under Chapter 2 it will already have had relief for the underlying expenditure in making an R&D tax credit claim under section 1055.

***Section 1105: Amount of trading loss which is “unrelieved”***

2872. This section lists the other ways in which a company may get relief for the loss. It is based on paragraph 16 of Schedule 13.

***Section 1106: Tax credit only available where company is going concern***

2873. This section sets out a precondition for relief under section 1103. It is based on paragraph 18A of Schedule 13 to FA 2002.

***Section 1107: Amount of tax credit***

2874. This section gives the amount of the R&D tax credit. It is based on paragraph 17 of Schedule 13 to FA 2002.

***Section 1108: Total amount of company’s PAYE and NIC liabilities***

2875. This section explains how to calculate the total amount of a company’s PAYE and NIC liabilities. It is based on paragraph 17 of Schedule 13 to FA 2002.

***Section 1109: Payment of tax credit***

2876. This section explains the circumstances in which the payment of an R&D tax credit can be withheld or set against arrears of corporation tax. It is based on paragraph 18 of Schedule 13 to FA 2002.

***Section 1110: Tax credit payment not income of company***

2877. This section makes clear that a payment of an R&D tax credit is not income of the company for tax purposes. It is based on paragraph 20 of Schedule 13 to FA 2002.

***Section 1111: Restriction on losses carried forward where tax credit claimed***

2878. This section provides that any losses that are surrendered in return for an R&D tax credit are not available for carry forward. It is based on paragraph 19 of Schedule 13 to FA 2002.

***Section 1112: Artificially inflated claims for relief or tax credit***

2879. This section denies relief for transactions that are intended to increase artificially the amount of relief or R&D tax credit. It is based on paragraph 24 of Schedule 13 to FA 2002.

***Chapter 8: Cap on aid for R&D***

**Overview**

2880. This Chapter sets out the rules for calculating the cap on R&D aid for the purposes of Chapters 2 and 7. It sets out the formula for the calculation of the cap, and brings together the definitions of terms that constitute that formula.

2881. **Schedule 2** (transitionals and savings) preserves the transitional provision in paragraph 7 of Schedule 10 to FA 2008. This provides that no account is to be taken, for the purpose of calculating “total R&D aid” in accordance with section 1089, of any relief or tax credit under Chapter 2 or 7 of Part 13 in respect of expenditure incurred before 1 August 2008.

***Section 1113: Cap on R&D aid under Chapter 2 or 7***

2882. This section imposes a cap on the total amount of R&D aid which may be claimed in respect of a project. It is based on section 29 of, and paragraph 6 of Schedule 10 to, FA 2008.

***Section 1114: Total R&D aid***

2883. This section sets out the rules for calculating the cap on R&D aid for a project. It is based on paragraph 1 of Schedule 10 to FA 2008.

***Section 1115: “The tax credits”***

2884. This section defines “the tax credits” for the purposes of the formula prescribed in section 1114. It is based on paragraph 2 of Schedule 10 to FA 2008.

***Section 1116: “The actual reduction in tax liability”***

2885. This section defines “the actual reduction in tax liability” for the purposes of the formula prescribed in section 1114. It is based on paragraph 3 of Schedule 10 to FA 2008.

***Section 1117: “The potential relief”***

2886. This section defines “the potential relief” for the purposes of the formula prescribed in section 1114. It is based on paragraph 4 of Schedule 10 to FA 2008.

***Section 1118: “The notional relief”***

2887. This section defines “the notional relief” for the purposes of the formula prescribed in section 1114. It is based on paragraph 5 of Schedule 10 to FA 2008.

***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

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

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.

***Section 1142: “Qualifying body”***

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