

the bottom line

Welcome to the Autumn edition of the bottom line, our accounting and taxation newsletter. In this edition we focus on R&D Tax relief, update on the long running Gaines-Cooper case and recent changes to the legal market.

RESEARCH & DEVELOPMENT TAX CREDITS

Many businesses need to continue to invest in technologically based research and development in order to sustain or improve profits and to expand their business. Several years ago the Government introduced (with EU backing) research and development (R&D) tax credits to encourage future investment. These are primarily a tax relief and many businesses are failing to claim these reliefs which can have a significant impact on the company's corporation tax liability.

What projects qualify as Research and Development under the scheme?

A basic definition is "work to resolve scientific or technological uncertainty aimed at achieving an advance in science or technology". Advances include new or improved products, processes and services.

Your company or organization can only claim for R&D Relief if an R&D project seeks to achieve

an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technology uncertainty – and not simply an advance in its own state of knowledge or capability.

There are guidelines that define all the following terms, and it's important to understand these concepts before attempting to reach a view on whether your company or organization has an R&D project for tax purposes.

The terms are as follows:

- Project
- Advance in science or technology
- Science
- Technology
- Directly contribute
- Scientific or technological uncertainty

You should consider what scientific or technological advance is being sought. This focuses attention on the project's aim for an advance, which is the key issue in judging whether R&D for tax purposes is being undertaken.

Science does not include work in the arts, humanities and social sciences – including economics.

It's not enough that a product is

commercially innovative. You cannot claim in respect of projects to develop innovative business products or services that don't incorporate any advance in science or technology.

Scientific or technological uncertainty exists when knowledge of whether something is scientifically possible or technologically feasible, or how to achieve it in practice, is not readily available or deducible by a competent professional working in the field.

But uncertainties that can be resolved through relatively brief discussions with peers are routine uncertainties rather than technological uncertainties. Technical problems that have been overcome in previous projects on similar systems are not likely to be technological uncertainties.

What are R&D tax credits?

The credit is made available either as a tax deduction based on R&D spending or it may be possible for certain loss making small or medium sized companies (SMEs) to surrender their losses in return for a cash payment from HMRC.

All companies spending at least



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£10,000 in their accounting year on qualifying R&D are entitled to claim a deduction when calculating their taxable profits of:

- 175% of qualifying expenditure for SMEs (companies with more than 250 but less than 500 employees, annual turnover not exceeding £100m and/or a balance sheet total not exceeding £6m) in respect of expenditure incurred on or after 1 August 2008 rising to 200% from April 2011 and 225% from April 2012 or;
- 130% of qualifying expenditure for larger companies from April 2008. reducing the company's UK corporation tax bill accordingly.

Alternatively, companies not in profit claiming under the SME scheme may be entitled to a cash payment worth 25% of qualifying expenditure from April 2011 and 24.75% of qualifying expenditure from April 2012.

In the 2011 budget, in addition to announcing changes in the rate of relief under the SME scheme, the Chancellor also announced the removal of the PAYE/NIC cap on the amount of payable credit that can be claimed, and the removal of the minimum (£10,000) expenditure rule before the credit can be claimed. These changes will be introduced in the Finance Bill 2012.

The Chancellor also announced that the Government will consult on options to allow relief through the large company scheme for sub-contracted activity which forms part of a wider R&D project.

From 9 December 2009 an SME no longer has to own any "intellectual property" attributable to its R&D expenditure as a condition of being able to claim.

What costs can be claimed?

Companies can claim R&D tax credits for their revenue expenditure on:

- employing staff directly and actively engaging in carrying out R&D;
- paying a staff provider for staff provided to the company who are directly and actively engaged in carrying out R&D;
- consumable or transformable materials used directly in carrying out R&D (broadly, physical materials which are consumed in the R&D);
- power, water, fuel and computer software used directly in carrying out R&D.

Capital expenditure is not eligible but this may be covered by 100% Capital Allowances (Research & Development Allowances) instead.

How can I claim?

Companies claim the credit when submitting their corporation tax return (CT600). Most claims are processed by HMRC R&D specialist units. The time limit for making R&D claims was reduced for accounting periods ending on or after 31 March 2006 from six to two years after the end of relevant accounting period.

Interaction with other grants Technology Strategy Board (TSB) Programme

The Technology Strategy Board (TSB) runs grant-based collaborative R&D programmes, via competitions, on behalf of BIS. Companies can claim R&D tax credits for their own qualifying R&D costs incurred on these projects. This is provided that the company has incurred a minimum of £10k qualifying R&D costs of the total of the company's R&D during the company's accounting year.

Companies can also claim for qualifying R&D costs funded by the grant, because there is no provision under the large company R&D tax credits scheme preventing subsidised expenditure from qualifying for R&D tax relief.

Claims from both SMEs and Large companies have to be made under the Large company scheme. This is because the type of grant delivered by the TSB is classified as a notified State aid. This means that the grant scheme has to be notified to and approved by the European Commission under the State aid rules. To prevent accumulation between different reliefs, the State aid rules prevent companies in receipt of any other State aid from claiming the SME R&D relief. The large company scheme is not a State aid and does not have this condition.

The State aid accumulation rules mean that in principal companies cannot normally receive two notified State aids for a project. You can check the EU state aid register to see whether a grant is a notified State aid.

EU Framework Programme

The Framework Programme for Research & Technological Development (FP), is the EU's main instrument for funding research in Europe. R&D tax relief can be claimed for work on projects funded by this Programme. Unlike the TSB-administered grants, the FP is NOT notified State aid. So SMEs in receipt of FP funding can claim relief under the SME R&D tax credits scheme, including the payable tax credit if appropriate, for their own expenditure on the project.

A claim cannot be made under the SME scheme if another form of notified state aid is being received for the project in which case a claim can in most circumstances be made under the Large company scheme.

It can be seen that there is a significant financial benefit in obtaining R&D tax credits and in some cases a simple restructuring of activities and allocation of costs could maximize any claim. If you require further advice on this please contact us.

END OF THE ROAD FOR GAINES-COOPER

The decision of the Supreme Court in *Gaines-Cooper* seems to have finally ended the long running saga of whether the taxpayer has the right to rely on HMRC published guidance.

The case revolved around Robert Gaines-Cooper who claimed to have left the UK as early as 1976 and became non-resident. Mr Gaines-Cooper relied upon HMRC booklet IR20 which set out HMRC's guidance on residence and in particular the time you could spend in the UK and what you could do.

IR20 had been published for many years and had been subject to a number of revisions. However the interesting point in the case was that HMRC argued it was not bound by its own stated practice. This caused great concern to both taxpayers and also the profession as IR20 had been used as the basis in many circumstances for determining what and what could not be done.

The Supreme Court found on 19 October 2011 in favour of HMRC and Mr Gaines-Cooper was held to have remained resident for UK tax purposes.

In itself the final decision in *Gaines-Cooper* will only be of historical importance and relevant to those who are having their residence position currently reviewed. The one positive outcome for taxpayers is that following a consultation period a new statutory definition of residency is due to be introduced next year. This will hopefully provide much needed certainty in an area where it was believed it already existed but suddenly

the "goal posts were moved".

More importantly it does re-emphasise the need for great care where reliance is being placed either on HMRC concession or guidance. In the latter case HMRC have shown where their guidance is more generous than the legislation they are now willing to argue the legislative rules should take precedence. Where planning is being undertaken, especially where this may be seen as aggressive by HMRC, reference should always be made to the legislation rather than HMRC guidance to ensure that the planning is based upon secure foundations.

CHANGES TO THE LEGAL MARKET LANDSCAPE

On 6 October 2011 the Government's Legal Services Act 2007 ('LSA') came into effect.

The Act makes available Alternative Business Structures (ABS's), enabling lawyers to form true partnerships with client facing non lawyers. This means that non-lawyers will be able to invest in and own law firms. It could even lead to law firms floating on the stock market – a situation which has already been achieved on the Australian stock exchange by the law firm Slater & Gordon ("SG") and legal business consolidator Integrated Legal Holdings ("ILH").

ABS's could develop into one-stop shops which deliver packages of legal services and other services that enhance competition and better meet the needs of

consumers. The term "Tesco Law" has been used to describe ABS's, not that Tesco has shown any signs of entering the legal market but just to demonstrate the fact that you could potentially in the future purchase your legal services together with your weekly shopping.

The reality is that potential new entrants to this market could arrive with teams on board brandishing experience in operating in a public environment and possessing greater branding power, human resourcing and product development skills than small law firms. Successful players are likely to provide legal services in a very different way to traditional high street firms. Instead of utilising the traditional model based on bespoke drafting and hourly billing it is expected that they will invest in cutting edge workflow and knowledge management systems which will introduce economies of scale to many areas of law.

So will we see similar changes to the UK legal market as we have seen in Australia? There is no reason to expect us not to.

The bottom line is that the emerging legal landscape poses serious challenges for traditional legal service providers, but also presents a wealth of opportunities for those firms who are willing to make the most of the changes. The impact of the reforms and the implementation of legal technology will allow forward-thinking firms to carve out an increasing share of the market as others succumb to increased market pressures.

NEWS IN BRIEF

New VAT Rules on Salary Sacrifice Arrangements

Following the recent ECJ judgement in the case of AstraZeneca, HMRC have reviewed their policy with regard to salary sacrifice arrangements. AstraZeneca issued staff with high street shopping vouchers in return for an element of their salary and the ECJ ruled that the amount of salary sacrificed amounted to a consideration for a supply for VAT purposes. This means that the business making the supply to the employee must account for VAT on the value of the salary sacrifice "payment" received from the employee with effect from 1 January 2012. Businesses can recover the input tax incurred in making the supply in accordance with the normal rules.

Typical arrangements which will be affected by the new policy are services provided under the Cycle to Work Scheme, subsidised meals, and vouchers. The supply of childcare vouchers is not directly affected as this supply is not subject to VAT in any case.

The new rules are effective from 1 January 2012 when VAT will be due on the amounts of salary foregone in return for taxable benefits. The new rules apply to all salary sacrifice arrangements entered into on or after 28 July 2011. Businesses operating salary sacrifice arrangements which were entered into prior to 28 July 2011 should be mindful of the new policy when renegotiating any existing arrangements or entering into new arrangements.

New Mortgage Verification Scheme

HMRC, in conjunction with the Council of Mortgage Lenders (CML) and the Building Societies Association have launched a scheme to combat mortgage application fraud which is estimated to cost £1 billion per annum. The scheme was announced in the March 2010 Budget and was piloted before being launched nationally on 1 September 2011.

In principle the scheme should reduce both mortgage and tax fraud. Any mortgage lender can use the scheme upon payment of a £14 fee to cover HMRC'S costs. However, mortgage lenders should only use the scheme where they suspect mortgage fraud following their own checks. Mortgage lenders will send HMRC details of declared income from mortgage applications for verification against income declared on income tax and employment returns. HMRC will confirm to the lenders whether or not the details correspond to assist them in making informed lending decisions.

HMRC has confirmed it will use the information supplied by lenders under the scheme to check the accuracy of information provided on tax returns. It remains to be seen the impact this scheme will have on both mortgage applicants and tax payers.

National Minimum Wage

The new National Minimum Wage rates applied from **1 October 2011** are as follows:

- for workers aged 21 and over, the rate increased from £5.93 per hour to **£6.08** per hour;
- for workers aged 18 to 20,

the rate increased from £4.92 to **£4.98** per hour;

- for workers aged below 18 the rate increased from £3.64 to **£3.68** per hour; and
- the rate for apprentices under 19 or 19 or over and in the first year of their apprenticeship increased from £2.50 to **£2.60** per hour

Online VAT Returns To Be Compulsory For All

A reminder that with effect from 1 April 2012 all VAT registered businesses will be required to submit their VAT returns online and make payments of VAT electronically. This has been a requirement for newly VAT registered businesses and those with a VAT exclusive turnover greater than £100,000 since 1 April 2010 but is being extended to all businesses.

HMRC have announced that they will show lenience during the first year for businesses that are newly required to submit their returns online but that penalties will be strictly applied after that period for businesses who continue to submit paper VAT returns. Penalties will be applied to paper VAT returns submitted for VAT return periods ending on or after 31 March 2013 for businesses first required to submit online from 1 April 2012.

Businesses that still submit paper VAT returns are urged to register for HMRC online filing and start submitting their returns online before the compulsory deadline in order to become accustomed to online filing and avoid potential penalties in future.

Contacts:

For further information about the issues raised in this newsletter or if you would like to find out about the range of services that we can offer, please contact Stephen Dabby, Morisha Christy, Tony Sian, Nick Nicolaou, Paul Bradley, Michael Avient or Pambos Patsalides.