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*Changes to legislation: There are currently no known outstanding effects for the Finance Act 2002, SCHEDULE 12. (See end of Document for details)*

## SCHEDULES

### SCHEDULE 12

Section 53

#### TAX RELIEF FOR EXPENDITURE ON RESEARCH AND DEVELOPMENT

##### PART 1

#### ENTITLEMENT TO RELIEF FOR R&D EXPENDITURE: LARGE COMPANIES

##### *Entitlement to relief under this Part*

- 1 (1) A company (in this Part referred to as “the company”) is entitled to tax relief under this Part for an accounting period if—
- (a) it is a large company throughout that period, and
  - (b) its qualifying R&D expenditure for that period is not less than—
    - (i) £25,000, if the accounting period is a period of 12 months, or
    - (ii) such amount as bears to £25,000 the same proportion as the accounting period bears to 12 months.
- (2) For the purposes of this paragraph the company’s qualifying R&D expenditure is “for an accounting period” if it is deductible in computing for tax purposes the profits for that period of a trade carried on by the company (including expenditure that is so deductible by virtue of section 401 of the Taxes Act 1988).

##### *Meaning of “large company” and “small or medium-sized enterprise”*

- 2 (1) For the purposes of this Schedule—
- (a) “large company” means a company that does not qualify as a small or medium-sized enterprise; and
  - (b) “small or medium-sized enterprise” means a small or medium-sized enterprise as defined in Commission Recommendation 96/280/EC of 3rd April 1996.
- (2) The Treasury may by order amend sub-paragraph (1)(b) so as to substitute another definition of “small or medium-sized enterprise” for the definition that is for the time being effective for the purposes of this Schedule.

##### *Qualifying R&D expenditure*

- 3 For the purposes of this Schedule the company’s “qualifying R&D expenditure” is—
- (a) its qualifying expenditure on direct research and development (see paragraph 4),
  - (b) its qualifying expenditure on sub-contracted research and development (see paragraph 5), and

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- (c) its qualifying expenditure on contributions to independent research and development (see paragraph 6).

*Qualifying expenditure on direct research and development*

- 4 (1) The company's qualifying expenditure on direct research and development is expenditure incurred by it where the following conditions are satisfied.
- (2) The first condition is that the expenditure is incurred on research and development directly undertaken by the company.
- (3) The second condition is that the expenditure is incurred—
- (a) on staffing costs, or
  - (b) on consumable stores.
- (4) The third condition is that the expenditure is attributable to relevant research and development in relation to the company.
- (5) The fourth condition is that the expenditure is not of a capital nature.
- (6) The fifth condition is that, if the expenditure is incurred in carrying on activities contracted out to the company, they are contracted out—
- (a) by a large company, or
  - (b) by any person otherwise than in the course of a trade, profession or vocation the profits of which are chargeable to tax under Case I or II of Schedule D.

*Expenditure on research and development directly undertaken on company's behalf*

- 5 (1) The company's qualifying expenditure on sub-contracted research and development is expenditure incurred by it where the following conditions are satisfied.
- (2) The first condition is that the expenditure is incurred in making payments to—
- (a) a qualifying body,
  - (b) an individual, or
  - (c) a partnership, each member of which is an individual,
- in respect of research and development contracted out by the company to the body, individual or partnership concerned (“the sub-contracted R&D”).
- (3) The second condition is that the sub-contracted research and development is directly undertaken on behalf of the company by the body, individual or partnership concerned.
- (4) The third condition is that the expenditure is attributable to relevant research and development in relation to the company.
- (5) The fourth condition is that the expenditure is not of a capital nature.
- (6) The fifth condition is that, if the sub-contracted R&D is itself contracted out to the company, it is contracted out—
- (a) by a large company, or
  - (b) by any person otherwise than in the course of a trade, profession or vocation the profits of which are chargeable to tax under Case I or II of Schedule D.

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### *Qualifying expenditure on contributions to independent research and development*

- 6 (1) The company's qualifying expenditure on contributions to independent research and development is expenditure incurred by it where the following conditions are satisfied.
- (2) The first condition is that the expenditure is incurred in making payments to—
- (a) a qualifying body,
  - (b) an individual, or
  - (c) a partnership, each member of which is an individual,
- for the purpose of funding research and development carried on by the body, individual or partnership concerned (“the funded R&D”).
- (3) The second condition is that the funded R&D is relevant research and development in relation to the company.
- (4) The third condition is that the funded R&D is not contracted out to the qualifying body, individual or partnership concerned by another person.
- (5) The fourth condition is that—
- (a) if the payment is made to an individual, the company is not connected with the individual when the payment is made, and
  - (b) if the payment is made to a partnership (other than a qualifying body), the company is not connected with any member of the partnership when the payment is made.

## **PART 2**

### ENTITLEMENT TO RELIEF FOR R&D EXPENDITURE: WORK SUBCONTRACTED TO SMALL OR MEDIUM-SIZED ENTERPRISE

#### *Entitlement to relief under this Part*

- 7 (1) A company (“the SME”) is entitled to tax relief under this Part for an accounting period if—
- (a) it qualifies as a small or medium-sized enterprise in that period, and
  - (b) its aggregate R&D expenditure for that period is not less than—
    - (i) £25,000, if the accounting period is a period of 12 months, or
    - (ii) such amount as bears to £25,000 the same proportion as the accounting period bears to 12 months.
- (2) In this paragraph “aggregate R&D expenditure” of the SME means the aggregate of—
- (a) its qualifying sub-contracted R&D expenditure (see paragraph 8), and
  - (b) its qualifying R&D expenditure within the meaning of Schedule 20 to the Finance Act 2000 (c. 17) (tax relief for R&D expenditure of small and medium-sized enterprises).
- (3) For this purpose the SME's aggregate R&D expenditure is “for an accounting period” if it is deductible in computing for tax purposes the profits for that period of a trade carried on by the SME (including expenditure that is so deductible by virtue of section 401 of the Taxes Act 1988).

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- (4) Any relief to which a company is entitled under this Part for an accounting period is in addition to any relief to which it may be entitled under Schedule 20 to the Finance Act 2000.

*Qualifying sub-contracted R&D expenditure*

- 8 For the purposes of this Schedule, the SME's "qualifying sub-contracted R&D expenditure" is the expenditure incurred by the SME on research and development that is contracted out to it where—
- (a) that research and development is contracted out to the SME—
    - (i) by a large company, or
    - (ii) by any person otherwise than in the course of carrying on a trade, profession or vocation the profits of which are chargeable to tax under Case I or II of Schedule D; and
  - (b) the conditions of either paragraph 9 or paragraph 10 are satisfied.

*Expenditure on research and development directly undertaken by the SME*

- 9 (1) The first condition of this paragraph is that the expenditure is incurred on research and development directly undertaken by the SME.
- (2) The second condition is that the expenditure is incurred—
- (a) on staffing costs, or
  - (b) on consumable stores.
- (3) The third condition is that the expenditure is attributable to relevant research and development in relation to the SME.
- (4) The fourth condition is that the expenditure is not of a capital nature.

*Expenditure on research and development directly undertaken on SME's behalf*

- 10 (1) The first condition of this paragraph is that the expenditure is incurred in making payments to—
- (a) a qualifying body,
  - (b) an individual, or
  - (c) a partnership, each member of which is an individual,
- in respect of research and development contracted out by the SME to the body, individual or partnership concerned.
- (2) The second condition is that the research and development is directly undertaken on behalf of the SME by the body, individual or partnership concerned.
- (3) The third condition is that the expenditure is attributable to relevant research and development in relation to the SME.
- (4) The fourth condition is that the expenditure is not of a capital nature.

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### PART 3

#### THE RELIEF

##### *Deduction in computing profits of trade*

- 11 (1) This paragraph applies where a company is entitled to relief under Part 1 or 2 of this Schedule for an accounting period.
- (2) In so far as the company's qualifying expenditure for that period is deductible in computing for tax purposes the profits for that period of a trade carried on by the company, it is entitled (on making a claim) to an additional deduction in computing the profits of the trade for that period of an amount equal to 25% of the qualifying expenditure.
- (3) In sub-paragraph (2) "qualifying expenditure" means—
- (a) in the case of relief under Part 1, qualifying R&D expenditure (see paragraph 3), and
  - (b) in the case of the relief under Part 2, qualifying sub-contracted R&D expenditure (see paragraph 8).

### PART 4

#### SPECIAL PROVISION FOR GIVING RELIEF TO INSURANCE COMPANIES

##### *Treated as large companies*

- 12 Where, in an accounting period, an insurance company (within the meaning of Chapter 1 of Part 12 of the Taxes Act 1988)—
- (a) carries on life assurance business, and
  - (b) qualifies as a small or medium-sized enterprise,
- Parts 1 to 3 of this Schedule apply to that company as if it did not qualify as such an enterprise in that period.

##### *Entitlement to relief in respect of "I minus E" basis*

- 13 (1) This paragraph applies where for any accounting period the profits arising to a company from its life assurance business are not charged to corporation tax under Case I of Schedule D.
- (2) The provisions of Part 3 which allow a deduction in calculating the profits of a trade apply in relation to the company to treat amounts as disbursed as expenses of management.
- (3) Where by virtue of section 436, 439B or 441 of the Taxes Act 1988—
- (a) any profits arising to the company from any category of life assurance business are treated as income chargeable under Case VI of Schedule D, and
  - (b) the profits of that part of that business are computed in accordance with the provisions of that Act applicable to Case I of that Schedule,
- Part 3 of this Schedule has effect as if the references to the trade carried on by the company were references to that part of that business (and sub-paragraph (2) does not apply in relation to that part).

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- (4) Subject to sub-paragraph (3), the provisions of Part 3 do not apply to allow any deduction in any computation of the profits of the company's life assurance business made in accordance with the provisions of the Taxes Act 1988 applicable to Case I of Schedule D.

## PART 5

### SUPPLEMENTARY PROVISIONS

#### *Research and development expenditure of group companies*

- 14 (1) Sub-paragraph (2) applies where—
- (a) a company ("A") incurs expenditure on making a payment to another company ("B") in respect of activities contracted out by A to B,
  - (b) the expenditure incurred on the payment is research and development expenditure of A, and
  - (c) A and B are members of the same group at the time the payment is made.
- (2) For the purposes of this Schedule —
- (a) any of the activities contracted out by A to B and directly undertaken by B shall be treated (to the extent that it would not otherwise be the case) as research and development directly undertaken by B, and
  - (b) where B makes a payment to a third party ("C") in respect of any of those activities that are contracted out by B to C and directly undertaken by C, those activities shall be treated (to the extent that it would not otherwise be the case) as research and development contracted out by B to C.
- (3) For the purposes of this paragraph A and B are members of the same group if they are members of the same group of companies for the purposes of Chapter 4 of Part 10 of the Taxes Act 1988 (group relief).

#### *Refunds of contributions to independent research and development etc*

- 15 (1) This paragraph applies where a company receives a payment refunding the whole or any part of—
- (a) any qualifying expenditure on sub-contracted research and development (see paragraph 5),
  - (b) any qualifying expenditure on contributions to independent research and development (see paragraph 6), or
  - (c) any expenditure which is qualifying sub-contracted R&D expenditure by virtue of paragraph 10,
- in respect of which it obtains relief under this Schedule.
- (2) The appropriate amount shall be treated as income of the company chargeable to tax under Case I of Schedule D for the accounting period in which the payment is made.
- (3) Where, by virtue of paragraph 13(3) (profits of life assurance business chargeable to tax under Case VI of Schedule D), the relief obtained in respect of the contribution or expenditure concerned is a deduction in computing for tax purposes the profits of a part of the life assurance business of the company—
- (a) sub-paragraph (2) does not apply, and

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(b) the appropriate amount shall be treated as income referable to that part which is chargeable to tax under Case VI of Schedule D for the accounting period in which the payment is made.

(4) For this purpose “the appropriate amount” means 25% of the payment.

#### *Artificially inflated claims for deduction*

- 16 (1) To the extent that a transaction is attributable to arrangements entered into wholly or mainly for a disqualifying purpose, it shall be disregarded in determining for an accounting period the amount of any relief to which a company is entitled under this Schedule.
- (2) Arrangements are entered into wholly or mainly for a “disqualifying purpose” if their main object, or one of their main objects, is to enable a company to obtain relief under this Schedule to which it would not otherwise be entitled or of a greater amount than that to which it would otherwise be entitled.
- (3) In this paragraph “arrangements” includes any scheme, agreement or understanding, whether or not legally enforceable.

## PART 6

### GENERAL PROVISIONS

#### *Meaning of “relevant research and developmen”t, “staffing cost”s and “consumable store”s*

- 17 The following provisions of Schedule 20 to the Finance Act 2000 (c. 17) (tax relief for R&D expenditure of small and medium-sized enterprises) apply for the purposes of this Schedule as they apply for the purposes of that Schedule—
- (a) paragraph 4 (relevant research and development);
  - (b) paragraph 5 (staffing costs); and
  - (c) paragraph 6 (expenditure on consumable stores).

#### *Meaning of “qualifying bod”y*

- 18 (1) For the purposes of this Schedule “qualifying body” means—
- (a) a charity (within the meaning of section 506(1) of the Taxes Act 1988);
  - (b) an institution of higher education;
  - (c) an Association of a description specified in section 508 of the Taxes Act 1988 (scientific research organisations);
  - (d) a health service body within the meaning of section 519A(2) of that Act; or
  - (e) any other body prescribed, or of a description prescribed, by the Treasury, by order, for the purposes of this Schedule.
- (2) In sub-paragraph (1)(b), “institution of higher education” means—
- (a) an institution within the higher education sector within the meaning of the Further and Higher Education Act 1992 (c. 13);
  - (b) an institution within the higher education sector within the meaning of Part 2 of the Further and Higher Education (Scotland) Act 1992 (c. 37) or a central

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institution within the meaning of the Education (Scotland) Act 1980 (c. 44);  
or

- (c) a higher education institution within the meaning of Article 30(3) of the Education and Libraries (Northern Ireland) Order 1993 (1993/ 2810 (N.I. 12)).

- (3) An order under this paragraph shall have effect in relation to such accounting periods or expenditure as may be specified in the order (which may include accounting periods beginning, or expenditure incurred, before the time the order is made).

*Other definitions etc*

- 19 (1) In this Schedule—

“life assurance business” has the meaning given in section 431(2) of the Taxes Act 1988;

“research and development” has the meaning given by section 837A of the Taxes Act 1988.

- (2) Section 839 of the Taxes Act 1988 (connected persons) applies for the purposes of this Schedule.

*Transitional provision*

- 20 (1) This Schedule does not apply to expenditure incurred before 1st April 2002.

For this purpose no account shall be taken of section 401 of the Taxes Act 1988 (pre-trading expenditure treated as incurred when trading begins).

- (2) Paragraphs 1(1) and 7(1) (requirement of minimum amount of qualifying expenditure in an accounting period) apply to an accounting period beginning before and ending after that date as if so much of the period as falls on or after that date were a separate accounting period.



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