

**EXPLANATORY MEMORANDUM TO THE
FINANCE ACT 2000, SCHEDULE 20 (DEFINITION OF SMALL OR MEDIUM-
SIZED ENTERPRISE) ORDER 2004**

2004 No. 3267

1. This explanatory memorandum has been prepared by the Inland Revenue and is laid before the House of Commons by Command of Her Majesty.

2. Description

2.1 This Order provides for a new definition of small or medium-sized enterprises (SME) for the purposes of research and development tax credits, vaccines research relief and community investment tax relief. The definition of a SME for these purposes relies upon a Recommendation by the European Commission. This Recommendation was changed in 2003 and so it is appropriate to change the definition in UK tax legislation which relies upon it.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 This Order is the first made under the power at paragraph 2(2) of Schedule 20 to the Finance Act 2000. Schedule 20 deals with research and development tax credits for SMEs. However the definition of a SME at paragraph 2 of that Schedule is relevant for other tax purposes, namely research and development tax credits for large companies (Schedule 12 Finance Act 2002), vaccines research relief (Schedule 13 Finance Act 2002) and community investment tax relief (Schedule 16 Finance Act 2002).

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury, John Healey MP, has made the following statement regarding Human Rights:

“In my view the provisions of the Finance Act 2000, Schedule 20 (Definition Of Small Or Medium-Sized Enterprise) Order 2004 are compatible with the Convention rights.”

7. Policy background

7.1 This Order implements an intention already signalled by the Government in the Inland Revenue’s paper of 10 December 2003 “R&D tax credits: responses to ‘Defining Innovation’ and Government proposals”.

This Explanatory Memorandum refers to the Finance Act 2000, Schedule 20 (Definition Of Small Or Medium-Sized Enterprise) Order 2004

7.2 Research and development tax credits for SMEs and vaccines research relief are notified State aids. This means the schemes can only be operated with prior approval from the European Commission. The Commission requires, as a condition of its approval, that relief is given only to SMEs within its own definition. The Commission defines SMEs by a Recommendation. The Recommendation currently in force is used in UK tax legislation, i.e. Recommendation 96/280/EC of 3rd April 1996. However the Commission is withdrawing this Recommendation and replacing it with Recommendation 2003/361/EC of 6th May 2003 with effect from 1 January 2005.

7.3 The Commission's revised Recommendation increases the financial thresholds allowing larger businesses to qualify as SMEs. It also clarifies the circumstances in which the size of a SME must be judged together with any other entities it is associated with. These increases and clarifications will generally be beneficial to those claiming the UK tax reliefs which rely on the Commission's Recommendation.

7.4 In addition to changing the reference in paragraph 2(1) of Schedule 20 to the Finance Act 2000, this Order implements necessary anti-avoidance and transitional provisions.

7.5 If research and development tax credits for SMEs and vaccines research relief are to remain in operation it is essential that the definition of a SME under those schemes continues to mirror the Commission's definition of a SME. Therefore consultation on this Order is not appropriate.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it will have a negligible impact on business.

9. Contact

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