HM Revenue & Customs

Corporation tax: research and development tax credits: consumables

Who is likely to be affected?

Companies carrying out research and development (R&D) activities.

General description of the measure

The measure restricts the expenditure in respect of consumable items that qualifies for R&D tax credits where the company sells the products of its R&D activity as part of its normal business. The revised definition of qualifying consumable items makes it clear that the cost of materials incorporated in such products that are then sold will not be eligible for the relief. The measure increases the focus of the tax credit regime on the real costs of carrying out R&D activity.

Policy objective

R&D tax credits are a key element in the government's commitment to an internationally competitive tax system and in its objective for strong and sustainable private sector-led growth. This measure ensures that they remain well targeted in incentivising R&D investment and that there is a level playing field between companies benefiting from R&D tax credits.

Background to the measure

The measure was announced at Autumn Statement 2014.

It affects only those entities within the charge to corporation tax (CT) as R&D tax credits are not available to unincorporated businesses liable to income tax.

The UK R&D regimes provide relief for expenditure on R&D, including the cost of materials and other items, such as water, fuel and power used up or transformed in the R&D activity. The definition of consumable items is common across each of the regimes; that is the tax credit schemes for large companies and Small and Medium Enterprises (SMEs), and the R&D Expenditure Credit scheme.

Detailed proposal

Operative date

This measure will have effect in relation to expenditure incurred on or after 1 April 2015.

Current law

The R&D relief regime is an incentive for R&D activity and investment in innovation. The legislation is in Part 13 Corporation Tax Act (CTA) 2009 and Chapter 6A of Part 3, CTA 2009. These provisions allow an enhanced tax deduction for relevant costs ("qualifying expenditure"), or in certain circumstances a payable tax credit instead of the deduction. Included in these costs is expenditure on software and consumable items. Consumable items is defined by section 1125 as including consumable or transformable materials.

Consumable or transformable materials are not further defined, however the guidelines produced by the Department for Business, Innovation and Skills state that the production of goods and services is not R&D activity. It is however recognised that in practice R&D activity can happen in conjunction with production, and in a way that makes the attribution of costs to one activity or the other debatable.

Proposed revisions

Legislation will be introduced in Finance Bill 2015 to amend the R&D provisions in CTA 2009 in order to restrict the extent to which costs of materials and other consumable items are eligible for relief. In the circumstances where the R&D activity results in goods or services sold in the normal course of a company's business, the cost of consumable items reflected in those goods or services will not attract tax credits. Qualifying expenditure on consumable items will be limited to the cost of only those items fully used up or expended by the R&D activity itself and do not go on to be sold as part of a commercial product.

Summary of impacts

Exchequer impact (£m)	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	-	+20	-	-	-	-
	These figures are set out in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside the Autumn Statement 2014.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals, households and families	The measure will apply only to corporate entities within the charge to CT and so is not expected to have an impact on individuals, households or family formation, stability or breakdown.					
Equalities impacts	The measure will apply only to corporate entities within the charge to CT and so is not expected to have any equality impacts.					
Impact on business including civil society organisations	This measure is expected to have a negligible impact on businesses. The measure will affect companies carrying out qualifying R&D activities. These are particularly prevalent in refineries, manufacturing, aeronautical, shipping and pharmaceutical sectors. There will be some negligible one-off costs for businesses, associated with familiarisation with the changes to the legislation and negligible ongoing costs will be from assessing the criteria for qualifying expenditure on consumable items. This measure is expected to have no impact on civil society organisations.					
Operational impact (£m) (HMRC or other)	There will be no significant impact on HM Revenue & Customs.					
Other impacts	Small and micro business assessment: small and micro businesses are not disproportionately represented in the small group of entities in which R&D takes place in conjunction with normal production processes. This measure is expected to have a negligible impact. Other impacts have been considered and none have been identified.					

Monitoring and evaluation

The measure will be monitored through information collected from tax returns and the R&D specialist units.

Further advice

If you have any questions about this change, please contact Martin Trott on 03000 585619 (email: martin.trott@hmrc.gsi.gov.uk).