Tax breaks for tech innovators

Peter Denison-Pender FCCA explains how a quiet tax revolution is under way for technology innovators that is going to change corporate behaviour in the UK

A foundation of new technology tax incentives is now in place that will transform the tax culture for technology innovators in the UK.

The highest-profile new tax relief is the 'patent box', which started in April and allows a reduced 10% rate of corporation tax on profits generated by products incorporating patents. The patent box is designed to promote the commercialisation of UK innovation. It is complementary to the research and development (R&D) tax incentives which encourage companies to undertake their R&D in the UK.

Companies calculate their qualifying patent box profit from qualifying revenues derived from products incorporating qualifying patents. This process will require care and attention. However, the forecast net benefit for companies will be several percentage points of earnings, which will definitely catch the attention of CEOs.

Research and development

R&D tax relief was introduced in 2000, and has steadily increased in generosity to help businesses invest in new ideas and technologies.

In his March Budget, the chancellor continued this trend by confirming a new R&D credit for large companies and increasing the payable rate to 10% for R&D expenditure incurred after 1 April 2013. This new credit is known as the R&D expenditure credit and is an 'above the line' credit when it comes to the financial statements. It is designed to make R&D relief more visible to those making R&D budgeting and investment decisions. It should also provide better cashflow for companies with no corporation tax liability, and thus promote the UK as the preferred location for multinational corporations to site their R&D operations.

This improvement in the large company R&D tax relief scheme follows an increase in the rate of the SME R&D tax credit from 175% to 225% in Budget 2011.

THE NEW TAX FRAMEWORK AIMS TO INCENTIVISE BY PARTICIPATION, RATHER THAN AVOIDANCE

As a result, there is now a coherent policy to support all companies that are investing in R&D and commercialisation in the UK. Companies are incentivised to spend on R&D, and then incentivised again to make profits by commercialising the R&D.

Creative sectors

The creative industries have not been left out because they can benefit from new tax reliefs that also started in April. Qualifying companies (from the animation, video game and high-end TV production sectors) can now choose between an additional deduction of qualifying expenditure or a payable tax credit where they are loss-making.

These reliefs are modelled on film tax relief and are designed to support investment in the production of animation, high-end TV and video games that would not necessarily otherwise take place in the UK.

Both the additional deduction and the payable credit for the new reliefs are calculated with qualifying expenditure comprising a maximum of 80% of total UK production costs. The additional deduction is 100% of qualifying expenditure and the payable tax credit is 25% of qualifying expenditure (so, effectively, the payable credit is a maximum 20% of total production cost).

There are several other initiatives to capitalise on the UK's position as a global centre of excellence in digital media production, such as a new £15m competition managed by the Technology Strategy Board for digital content production.

Technology investors

Meanwhile, individual investors are being encouraged to support high-risk early-stage companies with generous reliefs on the demand side – for example, the extension of the original capital gains tax holiday for investors taking up the seed enterprise investment scheme. Any investors making capital gains in 2013/14 will receive a 50% capital gains tax relief

when they reinvest those gains into seed companies in either 2013/14 or 2014/15. This is in addition to the conventional 50% income tax and full capital gains relief from the scheme.

Innovation triggers

All of this sits alongside smaller initiatives, some direct, others indirect, designed to kick-start more corporate innovation in the UK, such as:

* R&D capital allowances, with 100% relief on eligible R&D capital expenditure, complemented by the tenfold increase (from £25,000 to £250,000) in the annual investment allowance to support capital investment in the economy for two years from 1 January 2013;
* expanding the small business research initiative, where small businesses compete for initial government contracts to develop new ideas which might subsequently turn into large-scale public sector contracts. The value of contracts awarded under the scheme is being increased from £40m in 2012/13 to over £100m in 2013/14 and over £200m in 2014/15;
* creating in partnership with industry an Aerospace Technology Institute (ATI) to provide £2.1bn of R&D support to the aerospace sector over seven years. The UK currently has the second largest aerospace sector in the world and the ATI is designed to keep the UK in the forefront of development of next-generation aerospace technologies;
* new tax allowances for shale gas and unconventional gas technologies, and consulting on new planning frameworks for these emerging sectors.

And, of course, by April 2015 the equalisation of UK corporation tax at 20% means that the UK will not only have the joint lowest rate of corporation tax in the G20, but a rate that is significantly lower than that in France, Germany, Japan and the US.

Finally, this is all linked to the new controlled foreign companies legislation introduced last year to protect the UK tax base by incentivising companies to site their high-value activities in the UK, and then tightening the rules to ensure the profits from those high-value activities stay in the UK.

Optimising performance

Overall, the UK now has a very generous technology tax foundation with direct technology tax reductions and incentives, and indirect technology enterprise initiatives.

In effect, the government's fiscal policy is sacrificing short-term corporation tax receipts for longer-term tax receipts from other parts of the corporate tax base, such as PAYE, VAT, employment taxes, and so on. The intention is clear – to encourage innovation and wealth creation, thereby generating higher tax receipts across the spectrum. The various working groups and consultation exercises for this new technology tax framework have had extensive input into the macro and micro details of each scheme, but the momentum behind the changes has undoubtedly been deliberate and co-ordinated government policy.

In time, these policies will change UK corporate behaviour. The new technology tax framework is designed to incentivise by participation rather than avoidance. With base rates so low, companies will see the logic in investing for the future. This investment will be in R&D because it will cost less and will generate innovation. Subsequent investment in commercialising this innovation will stimulate profit and wealth creation.

With greater investment in R&D and commercialisation comes a greater emphasis on getting the underlying business processes working effectively, by recruiting the right people, investing in the right equipment, and understanding market needs and the innovation process.

Companies in future must focus on optimising operating performance and tax performance.

Peter Denison-Pender FCCA is a director of MMP Tax, which provides technology tax consulting services, and sits on the government working groups for both the patent box and R&D tax relief
www.MMP-Tax.co.uk