Technology **Tax** Experts

MMP's Review of the Budget 2013

Introduction

The Chancellor's 2013 Budget built on the draft Finance Bill and Autumn Statement of December last year.

From a strictly business perspective, the result is an imaginative combination of macro and micro tax initiatives coupled with pro-active stimuli targeting specific hi-value sectors. There is the sense that the entire might of the Civil Service machinery at the Chancellor's disposal in the Treasury and HMRC was deployed with one mission statement: find ways to help get the economy growing again.

In contrast to the austerity culture affecting government spending, the culture in tax policy is focused on supporting technology innovation, helping businesses create growth, and reducing corporate taxes.

There are cuts in overall public spending, growth forecasts are lower than expected, and deficit reduction targets have been missed, but from a technology tax perspective the draft Budget includes several measures that will really help technology corporates, whether large or small. The government is also approaching these issues from an international context: it wants to create a corporate tax environment that will support British businesses and encourage overseas investment by demonstrating that Britain is open for business.

In addition, the new stimuli are aimed at sectors like aerospace, and at both SMEs and large corporates, to support the UK's strength and opportunities in these areas.

MMP Tax has played a full part in policy discussions on these new technology tax reliefs. We participate in the relevant Government policy working groups, and we have submitted formal responses to each of the public consultations.

Here are our main highlights from this year's Budget.

Direct initiatives for UK technology and hi-value industry

Main Rate of Corporation Tax

Firstly, the main rate of Corporation Tax is being reduced further to 20%. So far the Government has cut the main rate from 28 per cent to 24 per cent, and announced further reductions to come, to 23 per cent from April 2013 and 21 per cent from April 2014.

Now, in the 2013 Budget, the Government has announced an additional 1 percentage point reduction in the main rate of Corporation Tax to 20 per cent from April 2015. In turn, this means that from 1 April 2015, the small profits rate and the main rate of corporation tax will be unified at the same level of 20% – the first time this has happened for more than 40 years.

In addition, it means by the end of this Parliament the UK will have the joint lowest rate of corporation tax in the G20, and a rate that is significantly lower than the US, Japan, France and Germany.

Above the Line R&D Tax Relief

Government terminology and the legislation refers to R&D Expenditure Credits (RDEC). This shows the ultimate direction of travel for R&D Tax relief. It is our view that in due course it is inevitable the SME R&DTax Relief will follow the large company scheme and morph into RDEC “Above the Line”.

Government support of Research and Development (R&D) in the form of tax incentives shows the government’s commitment to helping businesses to invest in new ideas and technologies. The RDEC-ATL credit is designed to make R&D relief more visible to those making investment decisions and provide greater cash flow support to companies with no corporation tax liability, all of which in turn should promote the UK as the preferred location of multi-national corporations wondering where to site their R&D operations.

The ATL proposal for large company R&D Tax Relief was originally announced in the 2011 Autumn Statement. After extensive public consultation, in last year’s Budget it was proposed as a payable credit of 9.1% starting from April 2013.

This year’s Budget has now increased the headline rate of the ATL credit to 10 per cent for large company R&D expenditure incurred on or after 1 April 2013.

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 per cent to 225 per cent at Budget 2011, which continues to provide targeted support for early stage companies and start-ups investing in R&D in the UK.

The new credit will be:

- fully payable to large companies with no corporation tax liability;
- introduced alongside the existing super-deduction from 1 April 2013 and legislated to fully replace the super-deduction from 1 April 2016; and,
- paid at a higher headline rate to companies in the oil and gas ring-fence.

The RDEC-ATL scheme will initially be optional and companies will be required to elect to claim R&D relief under this scheme. Companies that do not elect to claim the RDEC will be able to continue claiming R&D relief under the current super-deduction large company scheme until 31 March 2016. The RDEC will become mandatory on 1 April 2016.

The new credit scheme will increase the attractiveness of the UK as a location for R&D investment by raising the visibility and certainty of tax relief for R&D expenditure. It will simultaneously provide greater support to those multi-national companies who use the UK as a high-skilled R&D cost centre, but generate minimal UK revenues and have no UK corporation tax liability.

Around 2,500 companies currently claim under the large-company R&D tax credit scheme each year. The new scheme only affects how R&D tax relief is delivered, not the conduct of actual R&D. The government estimates that there will be no change overall in ongoing administrative burdens between the old and new schemes, while the cost to the Treasury will be a maximum £205 million in year-ending April 2015, before settling down in steady state at no additional cost.

Creative Sector Tax Reliefs

Qualifying companies in the creative sector (incorporating the animation, video game and high-end TV production industries) will be able to choose between an additional deduction of 100% of qualifying expenditure, or a repayable tax credit of 25% of surrendered losses from April 2013.

As announced in Budget 2012, and following consultation last summer, the draft Finance Bill 2013 legislation allows for qualifying expenditure incurred after 1 April 2013 to be eligible for the reliefs subject to State aid approval by the European Commission. The Commission is expected to approve the animation and high-end television tax reliefs shortly, to start on 1 April 2013. The video games tax relief will be introduced following formal state aid approval.

The reliefs are modelled on Film Tax Relief. Since its introduction in January 2007, the FTR has supported £5.5 billion of investment into 825 British films which have received approximately £800 million in relief.

The new corporation tax reliefs will support investment in the production of animation, high-end television and video games in the UK. The payable tax credit under all three schemes will be worth up to 25 per cent of qualifying production expenditure.

HMRC estimate the annual administrative cost for them of running all three new creative industry tax credit regimes will be approximately £500,000. They will also set up a specialist unit to facilitate claims for animation and VGR (but not high-end tv production).

This is the most costly initiative by the government for the hi-tech creative industries, but it is also undertaking several other initiatives to capitalise on the UK's position as a global centre of excellence in digital media production. This sector is increasingly valuable in terms of exports and job creation. The other initiatives for this sector include:

- a new competition of up to £15 million managed by the Technology Strategy Board for consortia bids on digital content production from partnerships between industry, educational research facilities, and training providers;
- increased funding for the Skills Investment Fund (to £8 million each year over the next two years), with the government match-funding voluntary industry contributions to support skills development in the UK digital content sectors; and
- a public consultation led by the government on options to provide further support for the visual effects industry through the tax system.

High-end Television Production

The high-end television tax relief will allow eligible companies engaged in the production of qualifying high-end television productions to claim an additional deduction in computing their taxable profits and, where that additional deduction results in a loss, to surrender those losses for a payable tax credit. Both the additional deduction and the payable credit are calculated on the basis of UK core expenditure up to a maximum of 80 per cent of the total core expenditure by the qualifying company. The additional deduction is 100 per cent of qualifying core expenditure and the payable tax credit is 25 per cent of losses surrendered.

Productions must be certified by the Department of Culture, Media & Sport (DCMS) as culturally British in order to be eligible for relief. The definition of high-end production will be extended in the legislation to include high-end documentaries.

There are approximately 50 high-end television production companies in the UK that may benefit from the relief. This specific tax relief is likely to be of particular benefit to larger television production companies with the necessary resources to reach the minimum spend threshold.

HMRC estimate the steady state annual cost of the scheme after five years will be in the region of £70 million. It is estimated that on average companies will make one claim per year.

Animation

The animation tax relief will allow eligible companies engaged in the production of qualifying animated productions to claim an additional deduction in computing their taxable profits and, where that additional deduction results in a loss, to surrender those losses for a payable tax credit. Both the additional deduction and the payable credit are calculated on the basis of UK core expenditure up to a maximum of 80 per cent of the total core expenditure by the qualifying company. The additional deduction is 100 per cent of qualifying core expenditure and the payable tax credit is 25 per cent of losses surrendered.

Productions must be certified by the Department of Culture, Media & Sport (DCMS) as culturally British in order to be eligible for relief. The scheme will also allow programmes where animation makes up 51 per cent or more of the total production costs to qualify as animated programmes.

There are approximately 50-100 animation companies in the UK that may benefit from the relief.

HMRC estimate the steady state annual cost of the scheme after five years will be in the region of £15 million.

Video Games

The video games tax relief will allow eligible companies engaged in the production of qualifying video games to claim an additional deduction in computing their taxable profits and, where that additional deduction results in a loss, to surrender those losses for a payable tax credit. Both the additional deduction and the payable credit are calculated on the basis of UK core expenditure up to a maximum of 80 per cent of the total core expenditure by the qualifying company. The additional deduction is 100 per cent of qualifying core expenditure and the payable tax credit is 25 per cent of losses surrendered.

The video game tax relief will allow qualifying companies to claim a payable tax credit, supporting the production of culturally British video games. There are approximately 300 video games companies in the UK that may benefit from the relief.

HMRC estimate the steady state annual cost of the scheme after five years will be in the region of £25 million.

Seed Enterprise Investment Scheme capital gains holiday extension

The Seed Enterprise Investment Scheme, launched at Budget 2012, offers 50 per cent income tax relief on investments made into small, early-stage companies.

The Government has now announced that it will extend the original capital gains tax holiday to continue to encourage investors to take up the new scheme. Any investors making capital gains in 2013-14 will receive a 50 per cent capital gains tax relief when they reinvest those gains into seed companies in either 2013-14 or 2014-15. This relief is obviously in addition to the actual income and capital tax reliefs from the scheme.

This support for the SEIS sits alongside recent expansions to Venture Capital Trusts (VCTs) and the Enterprise Investment Scheme (EIS). So, the UK now offers generous investment tax reliefs for private investors to support small and growing businesses. These tax reliefs operate in conjunction with the technology tax reliefs that these same businesses can access in a corporate context.

Annual Investment Allowance

The Chancellor confirmed the immediate tenfold increase in the AIA to support capital investment in the economy for two years from 1 January 2013. The AIA limit has increased tenfold from £25,000 to £250,000. This gives 100 per cent capital allowance relief on qualifying expenditure.

This increase will cover annual plant and machinery investment levels made by 99% of all UK businesses.

Patent Box

Also confirmed in the Budget is the commencement from April 2013 of the Patent Box to give a reduced 10 per cent rate of corporation tax on profits from patents. The Patent Box is designed to drive growth and investment in the commercialisation of UK innovation, originally driven by R&D incentivised by R&D Tax Relief.

Stamp Duty removal on AIM share-trading

To help small, fast-growing companies access capital more cheaply, the government will abolish Stamp Tax on Shares for companies listed on growth markets (including the Alternative Investment Market (AIM) and the ISDX Growth Market) from April 2014. This will directly benefit hundreds of smaller quoted UK firms and help them grow into the large businesses of tomorrow.

Amendments to Controlled Foreign Companies (CFC) rules

There have also been some minor amendments to the Controlled Foreign Corporation (CFC) legislation introduced in Finance Act 2012 that were designed to prevent the artificial diversion of UK profits to controlled companies in overseas jurisdictions.

This is the complementary reaction to the UK-focused technology tax incentives. The government is managing the UK tax base in an international context by incentivising companies to locate their high-value activities in the UK, and then toughening up the rules to ensure the profits from those high-value activities stay in the UK.

Indirect initiatives for UK technology and hi-value industry

The Aerospace Technology Institute

The Government has a defined Industrial Strategy, announced in September 2012, to maintain and enhance the UK's global position in 11 key sectors: automotive, aerospace, life sciences, agri-tech, professional business services, information economy, construction, education, nuclear, oil and gas, and offshore wind.

The Government is working with industry to create sector strategies that identify long-term opportunities and address barriers to growth.

The Government will provide £1.6 billion of funding to support these strategies. This funding will be allocated over the course of 2013. The initial focus has been on the life sciences and aerospace sectors.

The Government confirmed in the Budget that, in partnership with industry, it will create an Aerospace Technology Institute (ATI). This will provide £2.1 billion of R&D support to the aerospace sector over seven years, with Government and industry contributing equal shares.

The UK currently has the second largest aerospace sector in the world (after the US), and the Government is determined to maintain the UK's position as a global leader in this growing market and the ATI is designed to keep the UK in the vanguard of efforts to develop the next generation of aircraft technologies.

Small Business Research Initiative Expansion

The Small Business Research Initiative (SBRI) addresses a twin barrier: where government departments find it difficult to access the latest innovations, and where SMEs find it difficult to meet the expectations and requirements of government procurement programmes.

Under the SBRI, small businesses compete for government contracts to develop new ideas which have the potential to turn into subsequent large scale public sector contracts.

The government has announced that it will substantially expand the SBRI among key departments so that the value of contracts through this route increases from £40 million in 2012-13 to more than £100 million in 2013-14 and more than £200 million in 2014-15.

Shale Gas and Carbon Capture industry development

The government is committing to support the development of a UK shale gas industry, along with its existing support for carbon capture storage (CCS). These emerging new sectors have the potential to provide new employment and support UK energy security, benefitting the economy, taxpayers and communities. The principal new initiatives are:

- a new shale gas field allowance and extension of the ring-fence expenditure supplement from six to ten years for shale gas projects to promote investment in this industry at an early stage of its development.
- two CCS projects representing the next step in the £1 billion CCS commercialisation programme.
- technical planning guidance on shale gas by July 2013 to provide clarity around the planning approach for shale gas developments.
- proposals to ensure that local communities will benefit from shale gas projects in their area.

Employee Shareholder Status

The Government confirmed its plans to create a new class of employee/shareholder - the new employee shareholder status. This will give staff a stake in their firms' future success and give firms greater choice about the contracts they can offer to individuals. Employee shareholders will have different employee rights and shares worth a minimum of £2,000 in their employer's business.

The Government will exempt gains on up to £50,000 of shares acquired by employee shareholders from capital gains tax. In addition, the first £2,000 of share value that anyone receives under the new status will be free from income tax and NICs.

The new status comes into force on 1 September 2013.

Conclusion

This is a generous Budget from a technology corporate perspective. There are direct technology tax reductions, direct technology tax 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 etc. 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. With base rates so low, companies will see the logic in investing for the future. The new technology tax framework is designed to incentivise by participation, rather than avoidance. In particular, companies will take advantage of the new rules because it will cost them less to invest in areas that create innovation and profits. This investment will be in R&D because it will generate the best and fastest innovations. Subsequently, investment in commercialising those innovations will stimulate the fastest levels of 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; by investing in the right equipment; and by understanding market needs and the innovation process.

UK plc will soon be full of companies that are optimised for performance *and* optimised for tax.