

**EXPLANATORY MEMORANDUM TO  
THE RESEARCH AND DEVELOPMENT TAX RELIEF (DEFINITION OF “SMALL  
OR MEDIUM-SIZED ENTERPRISE”) ORDER 2005**

**2005 No.3376**

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

**2. Description**

2.1 This Order (‘the correcting Order’) corrects two errors in the Finance Act 2000, Schedule 20 (Definition of Small or Medium-Sized Enterprise) Order 2004, SI 2004 No. 3267 (‘the original Order’). The correcting Order is a ‘free issue’ order meaning any person who purchased the original Order may apply to the Office of Public Sector Information for a free copy of the correcting Order.

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

3.1 None.

**4. Legislative Background**

4.1 The correcting Order is made under the powers at paragraph 2(2) of Schedule 20 to the Finance Act 2000 and paragraph 2(2) of Schedule 12 to the Finance Act 2002. Both Schedules deal with tax relief for expenditure on research and development. Schedule 20 applies to small or medium-sized enterprises (SMEs) and Schedule 12 applies principally to companies that are not SMEs, but contains some provisions that are relevant to SMEs.

4.2 The definition of an SME at paragraph 2 of Schedule 20 is relevant for other tax purposes, namely tax relief for expenditure on vaccines research (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**

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

“In my view the provisions of the Research and Development Tax Relief (Definition of “Small or Medium-Sized Enterprise”) Order 2005 are compatible with the Convention rights.”

## **7. Policy background**

7.1 The original Order implemented a new definition of an SME for the purposes of research and development tax reliefs under Schedule 20 Finance Act 2000, vaccines research relief and community investment tax relief. The new definition was necessary as the European Commission had updated its Recommendation on the definition of an SME, and the UK wished to apply the updated definition to those tax reliefs.

7.2 Two errors were made in the original Order.

### *Article 2(1) of the original Order*

7.3 At Qualification 1(b) of article 2(1) of the original Order a mistake was made in the anti-avoidance provision. The effect of the mistake is that there is a possibility a company may fall outside the definition of an SME earlier than intended once it exceeds the relevant employee or financial tests. Article 2 of the correcting Order prevents this possibility.

### *Omission of reference to Schedule 12 Finance 2002 in the original Order*

7.4 Paragraph 2(1)(b) of Schedule 12 to the Finance Act 2002 defines an SME for the purposes of that Schedule as a company within Commission Recommendation 96/280/EC of 3rd April 1996. This is the former SME definition which it was intended that the correcting Order replace for all purposes of research and development tax reliefs.

7.5 The effect of the mistake is that the definitions of an SME in Schedule 20 to the Finance Act 2000 and Schedule 12 to the Finance Act 2002 are not aligned, meaning a company could simultaneously be both an SME under Schedule 20 and a non-SME under Schedule 12. Article 3 of the correcting Order corrects this incongruity.

## **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**

Richard Hopwood at HM Revenue & Customs Tel: 020 7147 2589 or e-mail: richard.hopwood@hmrc.gsi.gov.uk can answer any queries regarding the instrument.