

Emerging Issues

R&D tax and expenditure credits under IFRS

CR Emerging Issues summarise changes in companies' reporting practice and collate changes identified previously in our CR Monitors. These reports address the most immediate issues facing companies reporting under IFRS, identify trends and highlight areas of evolving or divergent practices. The sample of companies covered reflects a mix of country, auditor and industrial classification. An Extract focusing on each company's disclosure accompanies the report.

This report addresses accounting for the new research and development (R&D) expenditure credit (RDEC) available from Her Majesty's Revenue and Customs (HMRC), the responsible tax authority in the United Kingdom, the previous UK scheme still in force for some companies and a similar scheme in Europe.

Introduction

This report addresses accounting for the new research and development expenditure credit (RDEC) available from the tax authority in the United Kingdom, the previous scheme still in force for some companies and a similar scheme in Europe. We note that two UK companies account for the new RDEC as a government grant rather than as a reduction in the income tax charge.

Summary

We cover two companies who account for R&D expenditure credit (RDEC) available from the relevant UK tax authority (HMRC) as government grants rather than as a reduction from income tax and a change of policy by a Belgian company in respect of a similar scheme. The change in reporting practice may affect reported profit before tax, with other effects possible on the statement of financial position where grants are capitalised. We examine the disclosures of two further companies who have not disclosed any change or election from the previous system. We covered another example of debate on the scope of IAS 12 "Income taxes" in the case of property and value added-based local taxes in France.

Reporting framework

The Research and Development Expenditure Credit (RDEC) is available in respect of qualifying expenditure from the UK tax authority (HMRC). During a three year transitional period from 1 April 2013, large companies can elect to receive the RDEC in place of R&D tax credits under the previous system. In general terms, RDEC is based on a percentage of qualifying R&D expenditure and are not contingent on a tax charge being incurred. RDEC will replace the previous system of R&D tax credits on 31 March 2016.

IAS 12 "Income taxes" applies to accounting for income taxes (para 1) and states that income taxes include all domestic and foreign taxes which are based on taxable profits (para 2).

Emerging Issues

R&D tax and expenditure credits under IFRS

IAS 20 "Accounting for government grants and disclosure of government assistance" defines government assistance as action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria; whilst government grants as assistance provided by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of a company (para 3). It distinguishes grants related to assets from those related to income. It contains criteria for recognition of government grants (para 7). IAS 20 requires that government grants are recognised in profit or loss on a systematic basis over the periods in which an entity recognises as expenses the related costs for which the grants are intended to compensate (para 12). Grants related to income are presented as part of profit or loss, either separately, under a general heading such as "other income", or deducted in reporting the related expense (para 29).

IAS 38 "Intangible assets" contains IFRS rules on research and development. Research is written off whilst **development expenditure may be capitalised when conditions are met. However, the definitions applicable with respect to UK tax credits are at the discretion of the UK government.**

We find no UK Financial Reporting Council guidance on its website. This contrasts with changes to tax in the French Finance Act of 2010, where we noted that the French authorities issued guidance for both French GAAP and IFRS.

Companies under review

We cover the interim accounts to October 2013 of Imagination Technologies, the 2015 annual report of *WS Atkins*, the 2013 and 2014 annual reports of Belgian company *UCB* and the 2014 annual reports of *AstraZeneca* and *Hikma Pharmaceuticals*.

Analysis An example of evocation of IAS 8 hierarchy to deal with a situation where there is no specific IFRS that addresses a transaction, condition or other event.

In its 2015 annual report, *WS Atkins (Atkins)* **adopts early the new UK RDEC regime with effect from 1 April 2013** (Extract 1: *WS Atkins Annual Report 2015* - page 141). **It explains that, the R&D credits have characteristics more similar to government grants rather than income taxes. As a result the company offsets the R&D credits against relevant expenditure rather than through the tax charge in the income statement.** This is in line with **IAS 20 "Accounting for government grants and disclosure of government assistance"** (para 29). The company discloses that the **credits result in a £5 million increase in reported profit in the current year, disclosed in the note on operating profit.** In **management commentary, it discloses that £5 million RDEC is included in underlying operating profit** in 2015. In contrast with *UCB* (see below) there is **no restatement of prior year profit before tax or profit.** Last year, *Atkins* stated that its tax profile was influenced by R&D **tax credits.** **The company explains that credits are recognised to the extent there is reasonable assurance that they will be received.** This follows IAS 20 (para 7).

Transitional period
from 1 April 2013
to 31 March 2016

MANAGEMENT COMMENTARY

[Read the management commentary: analyse its message](#)

Emerging Issues

R&D tax and expenditure credits under IFRS

Meanwhile, Belgian company *UCB* in its 2013 annual report disclosed adoption of the government grant model for R&D tax credits (Extract 2: *UCB Annual Report 2013* - page 43). The company has UK subsidiaries, but does not disaggregate its R&D expenses geographically in the 2013 annual report. The impact of adoption is the reclassification of the R&D tax credits from income tax expense to R&D expenses. After restatement, comparative R&D expense decreases by €29 million, representing 12% increase in continuing profit before tax, and income tax expense increases by the same amount in 2012. In its December 2014 annual report, *UCB* recognises €928 million R&D expenses on the face of the income statement and states (Extract 3: *UCB Annual Report 2014* - page 83) in its accounting policy on income taxes that R&D tax credits are recognised in the R&D expenses line of the income statement.

In its October 2013 interim accounts, *Imagination Technologies* changes its accounting policy for tax incentives for R&D (Extract 4: *Imagination Technologies Interim Report to October 2013* - page 19). The company states that the enhanced tax relief available for qualifying R&D expenditure has been replaced by a payable tax credit, which the company does not consider to be an item of income tax. Consequently, it recognises a credit of £2.07 million related to R&D tax incentives for the period within operating profit. The company does not disaggregate R&D expenses geographically in the 2013 annual report.

Cash receivable from the Govt.

We find no reference to R&D tax credits in the December 2014 annual report of *Hikma Pharmaceuticals*. The company shows movements in deferred tax arising from R&D costs in its deferred tax note.

We also find no reference to R&D tax credits in the December 2014 annual report of *AstraZeneca*. *AstraZeneca* recognises US\$5.58 million R&D expense on the face of the income statement, stating that in common with most pharmaceutical companies, it expenses R&D in the year it is incurred. The company makes no reference to R&D in its deferred tax note and does not allocate R&D expense geographically in its segmental information.

Conclusion

Our principal conclusions and observations are:

- Two companies examined who have early adopted the UK RDEC regime have preferred the government grant model in accounting for credits.
- One Belgian company changed policy and restated the 2012 annual period, though there is no evidence UK tax jurisdiction was involved.
- There are significant effects on several income statement lines, including R&D expenses, operating result, profit before tax and income taxes.
- There are differences in the detail of disclosure of accounting policies for RDECs in years subsequent to the year of adoption.
- This apparent emerging consensus in accounting policy has emerged without apparent intervention by accounting bodies.
- There is scope for greater disclosure on the geographical location of R&D expenditure and the tax jurisdictions involved in such credit schemes, though this is not currently an IFRS requirement.

Extract 1: WS Atkins Annual Report 2015 - page 141

Research and development (R&D)

All R&D expenditure is written off to the Income Statement as incurred. In the UK, the Group has early adopted the new UK R&D expenditure credit regime with effect from 1 April 2013. These credits have characteristics more akin to government grants than income taxes and therefore are offset against the relevant expenditure in the Income Statement rather than via the tax charge.

The credits are recognised to the extent that there is reasonable assurance that they will be received, albeit that the claim process takes place sometime after the original expenditure was incurred. In the Balance Sheet, the debtor is included within current other receivables.

Extract 2: UCB Annual Report 2013 - page 43

2.2 | CHANGES IN ACCOUNTING POLICY AND DISCLOSURES

The following new standards, amendments to existing standard or new accounting policies have been adopted by the Group for the first time for the financial year beginning on or after 1 January 2013:

- ▶ The Group has opted to adopt the government grant model as from 1 January 2013, leading to a reclassification of the R&D tax credits from the income tax expense line to the research and development expenses and a restatement of the 31 December 2012 (€ 29 million) consolidated income statement.

DR Income tax expense
CR R&D expenses

Reclassify RDEC to reflect IAS 20 (recognised for periods that matches it to the cost being in respect of specific costs) rather than IAS 12

Extract 3: UCB Annual Report 2014 - page 83

2.12 | INCOME TAXES

The tax expense for the period comprises current and deferred income taxes. Tax expense is recognized in the income statement except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In the case of items recognized in other comprehensive income or in equity, the tax is also recognized in other comprehensive income or directly in equity, respectively. In respect of R&D tax credits these amounts are recognized in the research and development expenses line.

Very clear - an instance of permissible netting off.

Extract 4: Imagination Technologies Interim Report to October 2013 - page 19

7. Taxation

Income tax expense is recognised based on management's best estimate of the weighted average annual income tax rate expected for the full financial year applied to the pre-tax income of the interim period.

There was a net tax charge in the period of £3,379,000 (2012: tax charge £2,438,000).

The tax charge for the interim period includes a charge of £2,982,000 in relation to a reduction in the value of deferred tax assets recognised in respect of share incentive arrangements. £1,741,000 of the reduction is attributable to a change in estimate of the available tax relief due to the fall in the company's share price since 30 April 2013, and £1,241,000 is attributable to a reduction in the applicable tax rate at which relief will be available, as a result of the introduction of the patent box rate of 10%. A blended tax rate has been used due to the phasing in of the patent box rate over the next 5 years.

The charges above are offset in part by a lower tax charge on profits of the interim period due to the introduction of the patent box rate. The effect is estimated at a reduction of £650,000 in the tax charge for the interim period.

In addition to the introduction of the patent box rate, changes have also been made to the tax incentives for R&D. In the prior period enhanced tax relief was available for qualifying R&D expenditure, resulting in a reduced tax charge. In the current period a payable taxable credit has been introduced. Having considered the nature of this credit, the directors concluded it is not an item of income tax. The gross pre-tax amount of the credit for the period is £2,070,000 and has been accounted for within operating profit. In which specific line?