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## HMRC internal manual

# Corporate Intangibles Research and Development Manual

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[Back to contents](#) > [CIRD80000](#) > [CIRD91000](#)

## CIRD92000 - R&D tax relief: SME definition: change of status to and from SME

### Preservation of status - transition period

Generally, where at the balance sheet date an enterprise goes over, or falls below, the staff headcount, or financial thresholds ([CIRD91800](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird91800>)), this will not result in a change

of status from SME to large company, or vice versa, until the position is repeated for the second consecutive year.

So, for example, if company A has 480 employees in year one but goes up to 510 employees in year 2 it will remain a SME for year 2. If however it still has at least 500 employees in year 3 it will be a large company for year 3.

The transition period also applies when a large company becomes a SME. This could be as a result of a demerger or simply a contraction of the company's size and operations. Taking a demerger situation as an example, in year one company B is large by virtue of its membership of a group of companies which results, on aggregation, in it exceeding the staff headcount. In year two company B leaves the group and at its balance sheet date it meets the staff headcount and financial thresholds, however it will still be a large company for that year. It will attain SME status in year three if it meets the SME threshold tests for a second year in succession.

However, the transition arrangements are different where:

- a change of status occurred as a result of a change of independence in a period during which the 1996 EC SME Recommendation applied, or
- in applying the 2003 EC SME Recommendation a company has to take account of a partner or linked enterprise which exceeds the employee threshold or a financial threshold, or
- there is a difference in the treatment of a company under the 1996 and the 2003 EC SME Recommendations.

These variations are explained below.

[Top of page](#)

## **Change of status as a result of change in independence - 1996 EC SME Recommendation**

Under the 1996 recommendation where a company changed its SME, or non-SME, status as a result of a change in its independence there was no transition period before the new status applied.

However, normally, a company could be accepted for the purposes of the R&D tax relief legislation as a SME under the 1996 recommendation for an accounting period during which it was an SME while it was engaged in R&D, as a matter of practice.

This practice only applied where the change of status was not manipulated artificially, and did not cover periods as an SME when the R&D was not being carried out. It also only applied to the claimant company.

[Top of page](#)

## **Partner or linked enterprises exceed the employee or a financial threshold - 2003 EC SME Recommendation**

The 2003 recommendation replaced the 1996 recommendation for the purposes of determining a company's SME status for accounting periods ending on or after 1 January 2005. The statutory instrument implementing this change (SI3267/2004) introduced a number of qualifications to the EC 2003 Recommendation into the R&D legislation at FA00/SCH20/PARA2(1) - now at CTA09/Ss1119 - 1120. Qualification 2 disapplies the transition period under the 2003 recommendation, if an enterprise exceeds the staff headcount, or financial ceiling as a result (broadly) of inclusion of figures from partner or linked

enterprises that in aggregate already exceeded the staff headcount or a financial ceiling.

For example, where a company breaches the staff headcount or a financial threshold because it has been taken over by a large enterprise, which can be a single large company or a collection of smaller entities which when taken together will be regarded as large, it will not qualify as an SME for R&D and VRR purposes for the accounting period in which the change occurred.

(Where such change occurred before 1 December 2008, as a matter of practice, we normally accepted that if a company was an SME at any time in an accounting period then it was treated as an SME for the whole of that accounting period. This was subject to the anti- avoidance rules in CTA09/S1084 which would come into play if large companies entered into arrangements to try to take advantage of the greater relief available under the SME scheme. ([CIRD97000](https://www.gov.uk/hmrc-internal-manuals/cird97000) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird97000>)) This practice is discontinued except in relation to changes occurring before 1 December 2008.)

[Top of page](#)

## **Change of status by reason of implementation of 2003 EC SME Recommendation**

There are differences between the definition of an SME in the 1996 EC SME Recommendation and the 2003 EC SME Recommendation.

Where for its first accounting period ended on or after 1 January 2005 a company is considered:

- to be an SME within the 2003 Recommendation, and
- would have been considered an SME within the 2003 Recommendation in the previous

accounting period (disregarding Article 4(2)),

it will acquire SME status for the first accounting period notwithstanding that it may not have been an SME in the previous accounting period within the 1996 Recommendation.

However, where a company was an SME in the previous accounting period within the 1996 Recommendation, but would not have been considered to be an SME within the 2003 Recommendation in that period (disregarding Article 4(2)), then it will lose its SME status for the first accounting period during which the 2003 Recommendation applies.

← **Previous page**

(/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird91900)

→ **Next page**

(/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird92100)



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