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HMRC internal manual

Corporate Intangibles Research and Development Manual

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CIRD92500 - R&D tax relief: SME definition: control for the purposes of EC SME Recommendations European context

The question of control is important in the European Recommendation because it can be the deciding factor in determining whether a company is an SME.

Under the 1996 EC SME Recommendation the threshold for ownership by a large company that

disqualifies an SME from that status is 25% (CIRD91300 (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird91300>)). This threshold can be exceeded where the ownership is by venture capital companies, institutional investors and public investment corporations so long as they singly or jointly exercise no control over the affairs of the company.

The EC Recommendation does not offer any definition of control, nor of what 'exercising no control' amounts to. Although we define control in a variety of places for UK purposes none of these are directly relevant for European purposes. We should not interpret control in a way that would treat companies as SMEs that would not be so treated under a European interpretation. We take the wording 'exercise no control' as meaning that any significant manifestation of control would be sufficient to deny the benefit of this exclusion from the SME definition for these types of investor.

In general terms we have come to the conclusion that the word 'control' must be interpreted broadly to mean any arrangements whereby a party can secure that a company will operate in accordance with its wishes. So we would regard all the methods described in ICTA88/S416 and ICTA88/S840 as being potentially applicable. In reaching this view we have been mindful of the following recital in the 1996 Recommendation.

“Whereas in respect of the independence criterion, the Member States, the EIB and the EIF should ensure that the definition is not circumvented by those enterprises which, whilst formally meeting this criterion, are in fact controlled by one large enterprise or jointly by several large enterprises’.”

This provides a clear steer towards a purposive rather than a narrow interpretation. So we need to be in a position of examining each case on its facts, and then considering it against the Recommendation. But we can say that we regard

all of the following as constituting control, without intending this in any way as an exhaustive list:

- Possession of a majority of the voting share capital.
- Being entitled to acquire the majority of the voting share capital.
- Being able to appoint or dismiss the majority of any supervisory or executive officers.
- Being able to control key aspects of the business, or prevent any material exercise of discretion in such areas by the executives.

Joint control & joint ownership

There is no definition of joint ownership or joint control in the recommendations, but we do not consider it sufficient simply that 25% or more in aggregate should be owned or controlled by enterprises that are non-SMEs. So it would not be enough to fail the 25% test if three non-SMEs owned or controlled 10% each if they did so independently of each other. They have to act in concert with a joint aim with regard to the company. Such a joint aim would have to go beyond the natural interest of each party that the company should do well so that its shares will increase in value.

So, the fact that they independently decide to vote in the same way would not create a joint ownership or joint control. An example that we might treat as joint ownership would be where two large companies are in a partnership, or a joint venture, and in consequence have a collective stake of 30% in another company. In these circumstances we would be likely to regard the collective holding as being a joint ownership, even if the collective enterprise does not have a separate legal personality.

Exercising control

Some companies have argued that although they possess the majority of the share capital, they do not exercise control as they remain passive and let the directors run the company. We take the view for these purposes that the capacity to exercise control, even if not actively asserted, constitutes the exercise of control. The exercise of control can after all be delegated. The reference to exercise of control in the recommendation should be interpreted as indicating that control can be by practical as well as legal measures.

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