



## ICAEW TAX REPRESENTATION

### RESEARCH AND DEVELOPMENT TAX CREDITS: RESPONSE AND FURTHER CONSULTATION

Comments submitted in August 2011 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) to HMRC in response to the Consultation on changes to R&D tax credits issued in June 2011

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# RESEARCH AND DEVELOPMENT TAX CREDITS: RESPONSE AND FURTHER CONSULTATION

## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Research & Development tax credits: response and further consultation* published by HMRC on 10 June 2011 at [http://www.hm-treasury.gov.uk/consult\\_r\\_d\\_tax\\_credits.htm](http://www.hm-treasury.gov.uk/consult_r_d_tax_credits.htm)
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

## WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

## MAJOR POINTS

### Support for the initiative

7. We believe that since its introduction, the Research and Development (R&D) tax credit has been very successful as a means of encouraging R&D to be carried out in the UK. We do, however, believe that, with increasing globalisation, changes are required to ensure that the UK continues to remain an attractive location for carrying out R&D activities.

### Maintaining the value of the benefit

8. While we are fully supportive of the government's proposals to reduce the headline rate of corporate tax, this has the effect of reducing the value of the R&D tax credit to claimants. We therefore believe that the most important issue to address at the present time is to increase the percentage of the credit so that its value after the CT rate reductions is at least maintained at the 8.4% pre CT rate reduction level.

## RESPONSES TO SPECIFIC QUESTIONS

### Above the line credit

**Q1. What difference, if any, to levels of R&D investment in the UK would a move from the current superdeduction to an ‘above the line’ credit against tax make, if the level of benefit to the company, in terms of reduced cost of R&D, remained broadly the same?**

9. We do not have any evidence as to the likely effect on levels of R&D investment if the relief were to be given ‘above the line’ but we believe that it could have an impact for larger companies where the people involved in the R&D are likely to be more ‘disconnected’ from the accounting for the tax credits. We have always believed that if the R&D tax credit could be given in a way that directly impacts the budgets of those responsible for the R&D spend, then this should lead to an increase in the overall R&D spend. Providing the R&D tax credit as a payable or recoverable amount (which would itself be taxable) rather than as a superdeduction would provide the answer, if it would enable the credit to be accounted for “above the line”. However, it would appear that there is no consensus that a recoverable (against, for example, future CT liabilities) credit could be taken above the line and we can appreciate that a payable credit is not feasible in the current economic climate. We therefore believe that this issue should not be viewed as a current priority but should be revisited at an appropriate time in the future.

**Q2. What tax treatment would allow loss-making companies to account for the credit above the line? Given the potential complexity of offsetting the tax credit against other taxes apart from CT, would loss-makers need the credit to be payable if there was insufficient CT cover?**

10. No further comment

**Q3. If a payable credit was introduced for loss-making companies, should the benefit be less than that available to profitable companies, to recognise the value to the loss-makers of being able to utilise the credit immediately?**

11. See above. No further comment.

**Q4. Are there additional issues around added complexity to the schemes that should be considered?**

12. No further comment

**Q5. The majority of respondents in favour of the change were large companies. What separate compliance and complexity issues would arise if the SME scheme also moved to an ‘above the line’ credit system?**

13. We believe that the change to an ‘above the line’ credit system is less relevant to SMEs. However, there is likely to be little or no enthusiasm from SMEs for a possible change to an ‘above the line’ system, from which they would derive no additional benefit, while they would still suffer the inconvenience and cost associated with having a new system to absorb and implement.

## **Qualifying Indirect Activities**

### **Q6. Should the relief for Qualifying Indirect Activities be retained? Does it provide significant benefit to companies currently claiming QIA costs?**

14. Relief for qualifying indirect activities should be retained, as the tax benefit is significant when compared to the effort required to gather the requisite information. The definition of qualifying R&D is already quite restricted when compared to other jurisdictions. Removal of QIAs would effectively downgrade the benefits of the current scheme.
15. We are also concerned that seeking to avoid the difficulties encountered when trying to identify precisely what qualifies, by abolishing the category, would probably create a similar problem with the identification of Direct Activities, with little saving of time and cost.
16. If obtaining relief for QIAs is felt to be too complex, there should instead be a focus on improving the clarity of the guidance.

## **Subcontracted R&D**

### **Q7. Would either the certification process or joint election process (or an alternative process) be effective in delivering the intended certainty for both contractor and subcontractor to allow the subcontractor to claim the large company credit?**

17. We have always been concerned that, if an activity that would qualify for a credit if undertaken by the principal's (ie the party carrying out the project) employees is subcontracted to someone for whom it is of a routine nature, neither party will be able to claim the credit. It is, however, essential that there is an incentive for such activities to be carried out in the UK, so the credit should be available to one party or the other.
18. We would favour the credit being available to the principal rather than the subcontractor, provided the subcontractor's activity is carried out in the UK. If this is not felt to be appropriate then it should be available to the subcontractor. We favour it being available to the principal as, we feel that it will be a much simpler process for the principal to determine whether the activity qualifies for the credit and agree the position with HMRC. All that the principal would have to do would be to ascertain that the subcontractor's activities have been carried out in the UK.
19. If the subcontractor was able to claim the credit there would need to be transparency between principal and subcontractor.
20. We are not aware that much R&D is claimed by SMEs following subcontracts from large companies. This could potentially represent many lost opportunities, particularly for companies doing little else. This may be helped by large company customers having the ability to offer a certificate. The absence of one should not, however, preclude an SME from claiming, and such cases should continue to be judged on their merits.

## **Removal of PAYE/NIC cap**

### **Q8. Are there any particular safeguards that companies think would be effective but not add significantly to compliance burdens to ensure the removal of the PAYE/NICs cap on the payable credit is not abused?**

21. We believe that it is generally only the smallest companies which suffer from the PAYE/NIC cap on the payable credit. Para 3.28 corroborates this and their small number. We doubt there will be significant abuse which cannot be picked up by a review of a company's R&D activities.

## Going concern definition

**Q9. Would companies welcome reform of the ‘going concern’ definition so that it more closely matched that used for the EIS/VCT schemes?**

22. We would not welcome changing the current definition to one which appears much wider and much more subjective. In particular, many start up companies, even after their first three years of operation, may have lost more than half their registered capital and more than one quarter in the previous 12 months – through initial undercapitalisation – yet have realistic prospects of survival.

## Summary of other impacts

**Q10. The Government would welcome comments or evidence to support the assessment of the impacts of the changes under consultation.**

23. No further comment

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## **THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM**

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx> ).