



## R&D TAX RELIEFS

2 June 2021]

ICAEW welcomes the opportunity to comment on the consultation document on R&D tax reliefs published by HM Treasury and HMRC on 3 March 2021, a copy of which is available from this [link](#).

Overall, feedback we have received on the design and operation of the R&D tax schemes in the UK has been very positive. The main areas for further development that have been highlighted to us include the following:

- The definition of R&D should be updated to better reflect the technological and commercial reality of the 2020s.
- The schemes could be adapted to provide financial support closer to the time of expenditure, rather than after completion of the tax return submission process.
- R&D tax relief could be incorporated into the wider grant subsidies system, so it is easier for companies to monitor whether they have breached government funding limits.
- The SME advance assurance scheme could be expanded to give companies more assurance that they can continue to fund ongoing projects without needing to prove that they are still carrying on eligible R&D.

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## KEY POINTS

1. In preparing this response document, we held discussions with various ICAEW members who work in-house within companies that are carrying on significant R&D activities and making claims under the schemes concerned. Our response reflects the comments we received from them as well as selected advisers on R&D claims.
2. As a general point, the feedback we have received on the schemes has been very positive. Suggested ways for the schemes to incentivise R&D further are set out in the following bullet points and are expanded on in our response to the specific questions.
  - The definition of R&D should be updated to better reflect the technological and commercial reality of the 2020s.
  - The schemes could be adapted to provide financial support closer to the time of expenditure, rather than after completion of the tax return submission process.
  - This could take the form of more regular periodic payments, rather than one-off annual credits.
  - In the medium term, the schemes could be incorporated into the regime for making tax digital for corporation tax such that claims could be made digitally on a quarterly basis alongside the quarterly reports required by each company.
  - R&D tax relief could be incorporated into the wider grant subsidies system, so it is easier for companies to monitor whether they have breached government funding limits.
  - The SME advance assurance scheme could be expanded to give companies more assurance that they can continue to fund ongoing projects without needing to prove that they are still carrying on eligible R&D.
  - The scheme could offer higher incentives for particular industries and activities and adjusted on a regular basis according to the social, economic or environmental factors considered important by the government at the time.

## ANSWERS TO SPECIFIC QUESTIONS

Many of the questions raised in the consultation are written from the premise that the respondent is a company that is carrying on R&D activity and/or making claims under the R&D tax regimes. Our responses to these questions are based on input from members working in such companies.

***Question 1: Do you consider yourself to be a research-intensive firm? How does your business benefit from the R&D reliefs (e.g. cashflow, reduced tax liability)? If your company is an SME that claims under both the SME tax relief and RDEC, what is your experience of using each scheme and how do they compare?***

3. In the course of our research we interviewed representatives from a variety of established and new businesses about their experience of the R&D tax regimes. In general, their experience of the existing regimes is very positive. On the whole, the companies we spoke to take the tax relief or credits received into consideration when budgeting for future R&D projects and so the regimes are definitely an important incentive for them to continue this behaviour. However, many would appreciate more certainty around the availability of the relief and so a more comprehensive version of the existing advance assurance arrangement would be greatly welcomed.
4. Those companies still in their start-up phase commented that receiving cash back credits each year has helped them to stay liquid during the COVID-19 pandemic. In such a phase of a company's life, the R&D tax credit is often the only or main revenue the company generates.

5. Many interviewees greatly appreciated the stability and predictability of the regime. Although there have been some changes to the rates and anti-avoidance rules over the course of the SME regime's 20-year history, it has broadly stayed the same. Therefore, some warned against drastic change which could disrupt or confuse existing ways of working.
6. Additionally, many companies have appreciated that costs capitalised as intangible fixed assets (which are revenue in nature for tax purposes) can be included within R&D claims. It is notable that this is only available for intangible fixed assets, which can create anomalies where there is an accounting requirement to capitalise similar costs as tangible fixed assets.

**Question 2: Is there a case for consolidating the two schemes into one? What do you value about the design of the current schemes that might be lost if they were unified?**

7. We believe that simplification would be achieved by consolidating the two schemes into one. Many businesses have appreciated the fact that the RDEC tax credit can be shown 'above the profit line' in their accounts. In our experience, companies claiming under this regime are more likely to pass the benefit back to individual cost centres. While SMEs typically have less complex structures, applying an 'above the line' regime to them would also encourage them to link R&D credits to the underlying spend at least in the accounts.
8. Obviously, if the existing RDEC scheme was used for all claimants, this would significantly reduce the value of tax credits available to SMEs compared to the current scheme and we therefore recommend that changes were introduced to ensure that the new RDEC style credit available matched that provided under the existing SME scheme. Hence, we recommend that two different rates of relief remain even if the two schemes are consolidated into one.
9. We also believe that there is scope for simplifying the rules for determining how the RDEC credit can be repaid (s104N CTA 2009) which would make it clearer when and how the company will obtain the financial benefit of the credit.

**Question 3: What do you think explains the difference in additionality between the two schemes? How could the schemes be improved to incentivise the R&D your business does or might consider doing? Can you give evidence to support your suggestions?**

10. Some interviewees would welcome a system that incentivises R&D on more of a real time basis. They compared the UK system to the incentives they receive for R&D carried out in other territories. One noted, for example, that the Singapore government pays for half the salary costs of their engineers and a percentage of their training costs. Such incentives would be a major encouragement for companies to employ R&D staff knowing that at least part of the associated cost has been covered, without having to wait till the end of the year to make a claim for tax relief. By comparison, the UK credit or tax relief is seen as a cash bonus at the end of the process, rather than as driving hiring decisions. As such, it is less effective in driving R&D behaviour because of the time when the relief is granted and because it cannot be relied upon until the window within which HMRC could enquire into the return has closed.
11. One interviewee wondered whether HMRC could learn from the positive experience of administering the CJRS and whether a similar model of providing regular payments to support R&D activity could be provided. In order to prevent fraudulent claims, HMRC could use an enhancement of the SME advance assurance scheme to allow greater scrutiny and disclosure of information upfront to offset the risks of providing cash real time. Since uptake of the advanced assurance scheme has been low, this could provide incentive to increase use of this.

12. Indeed, given that HMRC is consulting on the potential move towards timely payment of corporation tax for companies outside of the quarterly payments regime, it seems to us that tax reliefs should also be provided on more of a real time basis to match this.
13. As well as improving cashflow, another potential benefit considered by some interviewees to come from a more 'real time' credit system would be the contemporaneous availability of information on which to base tax relief claims. Preparing R&D tax relief claims can be tricky where detailed information (particularly with regard to the time spent by staff on R&D activities) is not kept on an ongoing basis and retrospective analysis is sometimes required to calculate the relevant costs incurred.
14. Other interviewees considered that Making Tax Digital for Corporation Tax would provide HMRC with a great opportunity to make R&D tax relief claims more interactive and digitised. For example, rather than having to file a separate claim and accompanying report, a company could log into its online tax account, complete a series of fields with the required claim information and then have this reviewed by HMRC within, say, 30 days.
15. One of the issues frequently mentioned by interviewees was the complex interaction between SME R&D tax relief and the other state aid grants available to companies. Now that the UK has left the EU, this could provide the government with an opportunity to simplify this. We note that the government has recently consulted on designing a new approach to subsidy control in the UK but there was no mention in the consultation document of how tax reliefs interact with other subsidies. We believe that this should be addressed as part of any reform of the R&D tax regime. One possible approach could be to incorporate R&D tax reliefs into the grant subsidies system so that all claims in respect of a particular project are made at the same time and companies can then more easily determine all the incentives they have received in respect of individual projects.
16. Another alternative approach would be for a central register to be kept of all the government subsidies received by a company in respect of a particular project. Then, if an R&D claim exceeded the relevant limit, HMRC would be alerted and this could be communicated to the company. Better still, the company could have access to the list through its company tax account and so would know whether a prospective claim would take the company over its subsidies limit.
17. Some interviewees were concerned about how the R&D tax relief system could be impacted by the increase in the rate of corporation tax in 2023. Clearly, tax relief claims for profitable businesses would become more valuable to companies and expensive to the Exchequer and so there was a concern that reliefs would be scaled back as a result.

***Question 4: To what extent do the rates of relief available to you impact your investment decisions and/or your choice of location? Is the balance of relief between the two schemes appropriate? Is there any evidence of significant deadweight where investment decisions would proceed without relief?***

18. In our experience, the R&D regime does not impact smaller businesses on their choice of location of R&D activities, but this is an important factor for larger and more global businesses who can more readily move functions/activities internationally.

***Question 5: Would a departure from the ordinary Corporation Tax self-assessment system be justified? Should more information and assurance be required from companies at the point of claiming? Should a company providing more information upfront be treated differently?***

19. We also consulted with a R&D tax relief claim specialist who noted that, of the hundreds of claims his firm had made, only a handful had been enquired into. Whilst this could be testimony to the quality of the claims being made, it also does not provide much reassurance

that the project that is the subject of the claim has been 'approved'. This is important in particular for projects that last for more than one year because companies would benefit from knowing whether their continued expenditure on the project will continue to be partially funded by tax credits.

20. Some form of pre-approval process would therefore be useful as it would give companies more assurance that they can continue to fund their ongoing R&D projects in this way. In essence, this would be similar to the existing SME advance assurance scheme but would apply at the start of each project and would be available to companies even if they have made claims before. However, for this to work practically, HMRC would need to work with advisors and claimant companies to better design the advance assurance facility to be easier to use.
21. This greater upfront scrutiny may also help to ensure that the claims being made are valid and are not fraudulent. We have received comments from a number of our members who are concerned that companies are being targeted by organisations that make tax relief claims on their behalf that do not stand up to scrutiny. In our experience, the advanced assurance facility has not been widely used, and where it has been used there have been problems and confusion regarding the level of comfort provided by HMRC. Therefore, a more comprehensive scheme of assurance would be welcome.
22. On the introduction of Making Tax Digital for Corporation Tax, R&D tax relief claims could be built into this system such that claims could be made on a quarterly basis if the company so chooses.

***Question 6: When did you first claim, and what prompted you to do so? Do you use an agent? If so, why? What is your experience of how agents' fees are structured? How could the expertise and specialist knowledge of agents assisting with R&D claims be improved?***

23. In our experience, there is great variation in the quality of R&D advice available in the market. The PCRT update on R&D provided some useful clarification, though we continue to see agents in the marketplace who continue to provide advice that does not meet the standards set by the PCRT.
24. Many firms charge on a contingent fee basis (or 'no win no fee'). This can be a commercial arrangement that meets the needs of both the client and the agent (as clients can be assured that they do not need to pay anything if they do not obtain any tax relief). However, an unfortunate consequence of this is that some firms are unable to provide the necessary support and advice where their clients' R&D claims are under enquiry, leaving them unsupported. We are aware that some international R&D tax regimes require firms giving advice under these regimes to be authorised by the tax authorities administering them – eg Australia. Given the variation in quality of R&D practices, HMRC may wish to consider this as a way to protect taxpayers from poor tax advice in this area. This could be used in conjunction with the proposal for tax advisers to hold appropriate professional indemnity insurance.

***Question 7: How can the responsibilities of HMRC, agents and the company be better reflected in the claims process?***

25. One key practical point is that it is currently impossible to see what stage a claim is at within HMRC's internal systems. If additional functionality could be added to the HMRC portal so claimants could see if their claims have been processed, are approved/under review, and approved for payment this would be very useful.

26. If HMRC kept an internal log of the claims made by different R&D advisors this might allow them to identify themes and problems early on which could be tackled with specific advisors, helping claimants gain better advice.

**Question 8: What other changes might help claims to be dealt with more smoothly, while ensuring better compliance? Is there a way HMRC and advisers can work more effectively to improve the quality of external advice available to companies? If you claim R&D tax reliefs in other countries, how does the claim process differ and what are your views on this?**

27. The members we interviewed generally spoke favourably about their experience of dealing with HMRC in respect of their R&D claims. However, some considered that it would be beneficial for HMRC to invest in more Inspectors with specialist knowledge of the industries typically making R&D relief claims who could ask more searching questions to determine whether a project qualifies for the relief.
28. HMRC could improve its guidance on the regime, in particular details of qualifying expenditure and projects in common areas of R&D, such as software development. Indeed, if the definition of R&D were to be updated (see our response to question 10) then this would be essential.
29. Another area that companies and advisers alike find difficult to understand are the rules around subcontracted expenditure. Whilst we do not advocate further tinkering of the rules to simplify them, we do believe that guidance could be improved to help companies determine how much of the costs they have incurred are eligible for relief.
30. It is also particularly difficult to understand which elements of staffing costs are qualifying expenditure, especially the distinction between qualifying direct and indirect activities and the impact this has on the eligibility of the time spent by personnel on these activities. In some cases valuable time on R&D does not qualify as it is not classified as 'direct' or 'indirect' R&D time – for example time spent on regulatory or legal issues connected with R&D work.

**Question 9: Is there evidence to suggest areas of activity other than those currently covered by the R&D definition drive positive externalities which should be recognised by the tax system?**

31. Further support could be provided (or clarification given) on industries or activities that potentially fall on the margins of existing schemes.
32. The opportunity could also be taken to update the definition of R&D used for the purposes of the relief (the old DTI guidelines) which is now over 20 years old. Since 2000 there has been an explosion of internet-based technologies and industries, as well as many other technological and commercial developments. A thorough review of the definition would allow HMRC to focus the relief on the kind of R&D activities that are now prevalent and that it wishes to incentivise in the 2020s.

**Question 10: Do you think R&D tax reliefs could better incentivise R&D with specific social value, for example developing green technology? Could R&D tax reliefs be used to disincentivise R&D in certain fields?**

33. Our interviewees were broadly supportive of providing greater incentives to companies developing green technologies. Others considered that enhanced incentives could be fluid such that certain industries or technologies could be incentivised where there was an economic or social case for doing so. For example, pharmaceutical companies could currently be encouraged more to find treatments for COVID-19.

**Question 11: What is your experience of conducting R&D in different regions across the UK? How do R&D tax reliefs benefit these activities, and how could the offer be improved to better support these activities?**

34. We can envisage practical difficulties in targeting R&D reliefs at particular regions and so we recommend that alternative incentives are used to encourage investment and production in particular regions (such as enhanced capital allowances). For example, we believe that it would be difficult to track where R&D activities are being carried out.

**Question 12: Are there any other areas of qualifying expenditure that should be included within the reliefs? How would this influence your investment decisions?**

35. Specific types of expenditure we believe should be included as qualifying include the following:
- Data and cloud computing costs, as already consulted on by HM Treasury and HMRC.
  - Certain third-party costs continue to be ineligible for R&D relief in some cases because of the mechanics of the two schemes of relief. Some R&D projects require extensive testing (for example, drug discovery) or other work which in itself is routine but forms part of a wider R&D project. Where this routine testing or other routine work is carried out 'in house' or in a group of companies it can qualify for R&D relief. However, if it is contracted out to a third party by a large company then neither the R&D contractor nor the company undertaking the work can qualify. This creates an unnecessary difference between SME and RDEC claimants and group and third-party arrangements, and should be updated to ensure all relevant R&D costs can be included.
  - Regulatory costs associated with undertaking R&D in particular sectors – eg, drug discovery – are also a key cost of doing R&D which are often non-qualifying.
  - Rent/leasing costs – These are a key part of R&D work which we believe should be supported by the regime.

**Question 13: What proportion of your R&D expenditure is treated as capital for the purposes of corporation tax? What would be the impact on your R&D activities of increased relief for capital expenditure?**

36. Many SME R&D claimants are in a loss-making position while investing in initial R&D equipment and facilities and therefore the reliefs available for such expenditure offer no incentive (other than to increase the losses available for use in the future). Providing some form of R&D cash-back credit for depreciation (which is the case in France and some other R&D regimes) would therefore support such companies more successfully.

**Question 14: Do you currently claim RDAs? If not, why not? What do you like and/or dislike about RDAs?**

37. In our experience, profitable businesses undertaking R&D use these where the level of Annual Investment Allowance (AIA) does not provide sufficient tax relief for their capital expenditure. Whilst the AIA limit remains at £1m, this only tends to impact larger SMEs and RDEC claimants but may be of more relevance when the AIA is reduced to £200,000.
38. The major attraction of RDAs is that they cover a wider range of capital expenditure used in R&D activities, for example buildings. However, sometimes companies can forget the impact of the claw back of RDAs on sale, which can lead to unforeseen tax consequences.
39. On the whole, RDAs provide good support for more capital-intensive businesses and the system is easy to understand. We therefore support their continuation.



**Question 15: How much of the activity in respect of which you claim R&D in the UK is undertaken outside of the company, and how much of that is not undertaken in the UK? What are the benefits and drawbacks of subcontracting, whether overseas or domestically? What are your commercial/other reasons for carrying out work overseas rather than in the UK?**

40. For many international businesses, particularly knowledge or software businesses, we are seeing increasing international collaboration, with companies seeking to bring the right teams and combination of experience of people together across the business. Therefore, the location of internal resource and personnel is at least as important as the value of tax reliefs provided in each relevant territory.

**Question 16: How could the government distinguish between work that needs to take place abroad and which benefits the UK, and that which doesn't?**

41. In most cases, where work takes place abroad the project is nonetheless owned from the UK, such that the intellectual property generated is owned in the UK. Hence, even if the UK economy does not benefit from all of the expenditure incurred during the project, the UK Exchequer does benefit from taxation of the income streams attached to IP held in the UK.
42. Therefore, whilst we do not propose that a cap is introduced on overseas R&D spend, a new IP condition could be applied, similar to the SME PAYE/NIC cap recently introduced.

**Question 17: How can we identify the supporting activities which are most valuable for R&D, while providing a clear boundary to assist companies in claiming and HMRC in administering?**

43. The UK's qualifying indirect activities definition is very specific and HMRC's interpretation has been to require companies to analyse person-by-person or department-by-department to include qualifying indirect activities (QIAs). This can be very onerous from a practical and administrative standpoint.
44. However, the inclusion of QIAs is useful to businesses, since in many cases, the only reason for the QIA is support of R&D activities (for example recruitment of R&D team members or cleaning of an R&D laboratory).
45. By comparison, other international schemes offer similar benefits for supporting activities, but without the administrative burden of documentation and proof. For example, under the French R&D scheme an uplift amount is allowed on staffing costs.
46. We therefore propose that a similar scheme is introduced to support valid UK R&D work, reducing the admin burden on both business and HMRC.

APPENDIX 1

ICAEW 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 <https://goo.gl/x6UjJ5>).