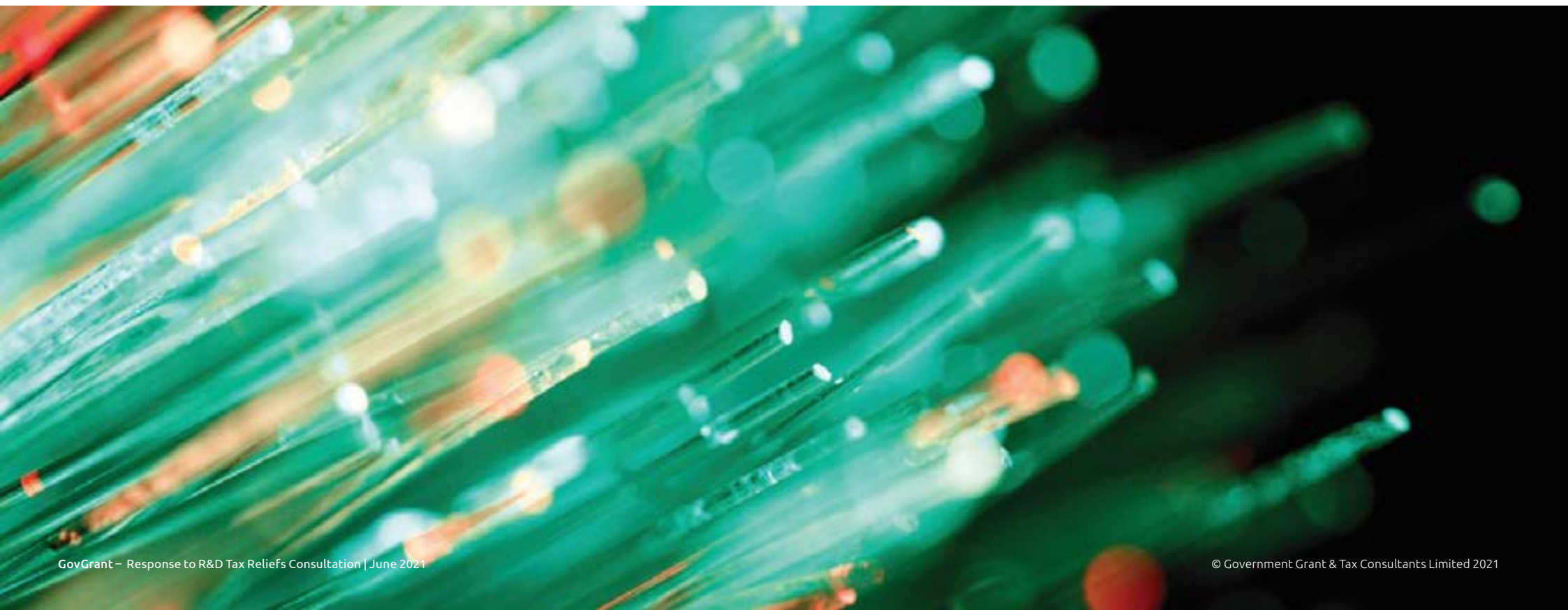


# Response to R&D Tax Reliefs Consultation June 2021



# Forward

GovGrant are one of the prominent R&D specialists working with over 1,000 clients of various size and from every sector. Our views presented are reflective of our practical interactions with our clients and our wider commitment to the R&D ecosystem.

Following the release of the **HM Treasury's Budget 2021 R&D Tax Reliefs Consultation**, we welcome this comprehensive review and believe it is at a critical time to ensure that is appropriate, reflective of the wider R&D agenda and globally competitive.

The global positioning and importance of Government support for innovation has accelerated and we can learn from other countries on what mechanisms are most effective.

Key to the R&D regime is the resultant effect on the intellectual property that the R&D projects create and more importantly which country ultimately owns this. We find that some of our clients do not see the UK as the best option when it comes to the commercialisation of R&D which of course will have a significantly detrimental effect on the spillover payback that is expected from the R&D tax cost. Whilst Patent Box is not in scope of this consultation, we believe that it is fundamental in creating a government investment strategy regarding innovation. Our recent work with CBI Economics, **Prosperity Pending**, demonstrates the need for change.

## Forward continued

We further welcome the focus on standards of agents as we have seen standards plummet and new opportunist entrance since the pandemic. This however we believe is a greater challenge as regulation from accounting and tax bodies may not be the solution due to the technical nature needed for R&D. We would also highlight that contingent fee arrangements in isolation is not the problem and still, we believe, the most appropriate risk/reward remuneration model for supporting companies with R&D tax claims. The commitment to quality and longevity through infrastructure, quality assurance, learning and development should be the driving force with regards to solving this issue.

## 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?

From discussions with our clients, we at **GovGrant** understand that **R&D** tax relief enables them to continue to finance their **R&D** activities. This is because these activities at this stage of the development do not provide any financial benefit to the company. They are incurring the risk without any of the financial rewards. Therefore the **R&D** tax relief provided by this scheme, in the form of either a reduced tax liability or **R&D** tax credits, are key to their cash flow and further investment in the **R&D** activities that they undertake.

The situations where our clients are claiming under both schemes, normally occurs where they have received Notified State Aid. Other than the rate being lower, the main disadvantage to our clients is that they can not claim Subcontractors (limited companies) in the **RDEC** claim. This cost could be fundamental to the **R&D** claim for an **SME** as they do not have this expertise in house.

## 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?

We would be supportive of consolidating the two schemes into one. This would provide the common administration of accounting for the RDEC “above the line”.

However, the simplicity of the treatment of the tax benefit of the current SME scheme is key to why it works so well and it would be essential to ensure that if the two schemes were consolidated that the generosity of the SME scheme is preserved. For example, could a higher rate of RDEC be applied to SMEs? We would recommend that the scope of the qualifying expenditure is also amended so that qualifying expenditure that is genuine subcontracted R&D of the SME would continue to qualify for relief.

### 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?

The schemes could be improved by focusing the relief at areas that the government wants to support. For example, provide an enhanced rate for R&D work in relation to green energy, carbon emissions, plastic packaging, addressing health challenges or sustainability could be used to encourage investment in R&D in these areas. We have a number of clients that are investing significant amounts of money in reducing the amount of plastic used in packaging and trying to move away from single use plastic. The R&D claim is fundamental to this continuing investment.

The value of R&D tax benefit is also directly linked to the level of the corporate tax rate, which when the corporation tax rate is reduced so is the benefit the company receives from the R&D claim. Maybe a solution could be a hybrid claim where the company has the option of a reduction in the payroll taxes, as opposed to a corporation tax reduction could be considered.

Whilst the Advance Assurance scheme has not been popular, businesses do want better clarity prior to making investments that they will benefit from R&D tax incentives. In our research, **Innovation Nation**, respondents stated up front or advancement of the R&D tax credit would encourage greater early stage investment

We would also suggest that an 'enhanced allowance' is included for both schemes to reflect the fact that R&D represents a risky investment in knowledge assets. At present under the RDEC scheme an element of the R&D qualifying costs are in affect initially disallowed in the tax computation.

## 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?

The availability of R&D relief is extremely important when a company is deciding if it will undertake an R&D project. As set out above, this is factored into companies' cashflows. One way of encouraging investment in particular locations, could be to provide additional enhanced relief if the R&D takes place in set defined locations e.g. enterprise zones, deprived areas.

However this would probably only apply to companies within the SME scheme as it may not be practical for the larger companies (under the RDEC scheme). This is because, for a lot of our clients, the location of the R&D centres is historic and many of them have different locations within the Group. The R&D costs are therefore either recharged to one company or come within the Group tax regime. It may therefore be difficult to account for the specific location of the R&D centre in practice.

Some R&D investment decisions may proceed without the relief, however from discussions with our clients, this would mean that the investment would take a significantly longer time to develop as there is little investment opportunities from third parties to invest in R&D projects as they are perceived to be high risk. R&D tax relief is therefore fundamental to more investment in R&D projects.

## 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?

We would recommend that it is a statutory requirement that a detailed technical report setting out why a project qualifies along with a breakdown of the qualifying expenditure should be submitted to HMRC for each R&D claim. If certain hallmarks are met, for example size of the company, submission of a technical and financial report to HMRC, these could result in that claim being processed faster than other claims.

Our clients have advised us that advanced assurance was a lengthy and time consuming process that they did not consider worthwhile. Business plans can also change rapidly and R&D is unpredictable, making the previously assurance that had been provided by HMRC worthless. As a result, we do not consider that advanced assurance is beneficial for the amount of investment by our clients and it should be scrapped.

We would also suggest that as in other countries the company has the option of providing their key R&D employees with a tax incentive against their personal employment income. This may help companies to encourage/engage their staff in the R&D activities as they can also see some financial benefit.



## 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?

In our experience contingent fee models work as they are risk based. The utilisation of fixed fee structures can result in R&D claims being inaccessible to some companies. Our experience is that some firms will significantly undercut fees in order to win the work but are then unable to provide the level of service necessary to produce a strong supportable claim, hence the importance of some regulation as to what a R&D specialist has to provide to support the R&D claim.

## Question 7

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

We would strongly recommend that a code of conduct is set up for agents to comply with when preparing R&D claims which includes advertising standards. The purpose of this would be to ensure that all agents are preparing the claims in line with the legislation and guidance and to ensure fraudulent claims are not submitted to HMRC.

It is clear when a company or agent has inflated the claim or interpretation of the legislation is highly questionable so we would advocate HMRC having greater powers to issue penalties to third parties.

We would recommend that agents should be subject to penalties if they are knowingly or fraudulently involved in 'overclaiming' qualifying expenditure or qualifying projects.

## 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?

As set out above, it should be a statutory requirement that a detailed technical and financial report is submitted to HMRC for each R&D claim. Providing HMRC with the powers to audit anyone promoting to be an R&D specialist could also ensure better compliance.

Where there are a number of larger boutique advisors, it would be efficient for them for their processes and procedures to be assessed by HMRC to help shape a common understanding and give HMRC a more active role in driving agent standards.

## 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?

We would recommend that the costs for data and cloud computing should be allowed as qualifying expenditure. The previous consultation and recommendations we welcome, and all moves towards supporting digital innovation must be encouraged. We would also recommend that the costs of hiring a piece of equipment necessary to carry out the R&D work should be qualifying expenditure.

## 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?

R&D relief should be strongly aligned with the wider industrial strategy for the UK. As set out above, providing enhanced relief for areas such as green technology would be extremely beneficial.

## 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?

Many companies have their head offices based in London which can confuse the location of where R&D is actually carried out.

When companies are starting up, it is common for directors or key individuals in the company to take no, or little, salary or dividends. One way that this “sweat equity” could be included in the claim would be to allocate a notional salary for this work which could be included in the claim. Germany for example does provide an allowance for Director costs if they are not paying themselves in the development phases.

## Question 12

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

We accept that the acquisition of capital assets to be used for R&D can not be claimed as these assets may be subsequently disposed of or used for other purposes.

However, where the asset has been capitalised as Tangible Fixed Assets and are revenue in nature and used solely for R&D purposes we feel that in this situation then these costs should be eligible for the R&D claim.

## 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?

A lot of our clients already capitalise the R&D costs as Intangible Fixed Assets. By doing this they are not affecting the profit/loss of the company for that particular period, as the R&D costs can be a significant investment/ cost to the company. However, they can still include these capitalised costs in the R&D claim. These costs are also subject to the GAAP rules and therefore there is an additional check to ensure that they comply with the 'development' rules.

## Question 14

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

There is currently no incentive to make an RDA claim for many SMEs due to the size of the Annual Investment Allowance and the new super deduction for capital allowances. We consider that more companies would claim RDAs if this also had a super deduction which was potentially larger than the super deduction that has recently been introduced for tangible assets.

## 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?

The benefits of subcontracting are that a company does not need to take on fixed costs, it provides the company with access to expertise and there may only be a short term need for this within the company such that they would not want to recruit a team of individuals.

We agree that the qualifying costs for an overseas subcontractor should be capped as it should be possible to find a subcontractor in the UK. The main reason that our clients use overseas subcontractors is that they are cheaper than subcontractors in the UK and the UK may not have the relevant skillsets . We would suggest that the 65% cap on the qualifying expenditure on a subcontractor should be removed for UK subcontractors. This would encourage companies to utilise subcontractors in the UK.



## 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?

Work should only need to be carried out abroad if the skillset is not available in the UK. If overseas subcontractors are to be recharged to the UK and therefore included in an R&D claim, a new requirement should be introduced that the UK company making the claim should have Sales/ Income that is taxed in the UK.

## 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?

Indirect activities are essential for many of the R&D projects carried out by our clients and should be included as qualifying expenditure, although we accept at a much lower percentage.

We would recommend that HMRC's R&D Inspectors include specialists with specific expertise in that industry.