

GovGrant | Response to R&D single scheme consultation

Who are we?

GovGrant is a leading R&D and IP consultant with over 900 clients ranging from start-ups to the FTSE 250 across a variety of sectors and projects. For the vast majority of our clients, we assist with the preparation of the R&D tax claim with a real focus on the technical aspect of the R&D along with how they commercialise their Intellectual Property (IP).

Summary

We welcome the consultation to simplify the R&D tax scheme into a single scheme and believe it will serve as a platform for future development. Both domestically and considered against international regimes, R&D tax is an effective and efficient lever that Government can use to support growth and we welcome the continued confirmation that it remains a key part of the R&D investment strategy.

However, the approach and reasoning behind a number of the questions are misplaced and we are concerned that activity the UK wants to support and needs to be globally competitive with have been alienated by recent commentary. The statistical changes and the scapegoating towards various parties has created a sense of confusion and the move to a single scheme needs to be steadfast in its commitment to growth. To ensure the greatest level of buy in and confidence, we would encourage a delay to the changes announced in the November 2022 Budget due to come into force from April 2023 to coincide with the move to a single scheme in April 2024.

The drivers of a single scheme in our opinion should be:

1. Accountability and visibility of state aid R&D support where an above the line credit is required to be declared in statutory accounts
2. Recognition that the talent pool needed to enable R&D may exist outside of the company and the vital role of UK based supply chain expertise
3. Have sector agnostic applicability that considers the varying needs of R&D projects and recognition of the importance of indirect activities
4. Give greater support for transformative, knowledge intensive projects that exist across sectors
5. Appropriate administration of the scheme without compromise on standards
6. Greater scrutiny on conduct risk and advertising standards of advisors

This consultation does not specifically cover how abuse and fraud is addressed better and also the vital role Intellectual Property needs to play to lock in the spillover and additionality benefit of R&D subsidisation.

It is not correct to think that regulation is a solution, as where we see poor compliance and poor understanding of the scheme (that is not fraudulent) is through the many accountancy firms who support businesses with their R&D claims submission. They have been actively encouraged to be a proactive voice with their clients, yet professional bodies and firms themselves have not taken the technical compliance to the degree required by HMRC. As a percentage of the overall cost of the scheme it would be wholly reasonable to consider this group of advisors being involved in a significant percentage, and they now find themselves ill equipped. To be clear, we do not consider this the fault of the accounting profession and we are having numerous conversations with accountancy firms who were unaware of the level of technical detail expected by HMRC.

We welcome the increased scrutiny and the volume of compliance checks experienced in the last 6 months, but that data and outcomes must recognise the role of advisors and also the commercial considerations for businesses when dealing with a HMRC enquiry. We are seeing a trend that smaller businesses are doing compliant activity but the evidence and time commitment to satisfy the greater scrutiny does not warrant making a claim. This needs to be reflected in the summer report from HMRC so there is clear delineation from where there has been an inaccuracy found vs commercial pressure that is more important for the individual business.

Our call for the RDEC to be declared in the statutory accounts we believe will serve as one of the most effective tools to combat fraud at the claimant level as it will drive greater accountability and visibility for all, both of which are significant deterrents to fraudulent behaviour.

Intellectual Property has again not been considered and how there is better awareness and alignment of the Patent Box scheme to support Government's overall goals around the longer-term payback of the R&D tax scheme. When we consider how IP can help deal with some of the concerns in the R&D scheme, such as ownership between companies and subcontractors, transformative innovations of higher value if achieved and the attraction of IP rich businesses with the associated talent pools to the UK. A review of Patent Box would be welcomed and learnings from other international counterparts including Ireland and the Netherlands that can be additive to the overall R&D landscape.

Question 1	GovGrant Response
<i>Do you agree a new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?</i>	<p>We are supportive of an above the line credit as we believe this sets the right message that the scheme is there to support and encourage R&D and innovation rather than being driven by tax planning. We would also comment that it should be a declared item that is publicly disclosed to help mitigate the fraud and abuse risk.</p> <p>An additional benefit here may be a higher value placed on R&D intensive businesses across a multitude of sectors that likely aligned to the stated SIT critical technologies as the improvement to EBITDA may have a positive impact on valuation and future private investment.</p>
Question 2	
<i>Does the taxability and subsequent different post tax net benefits impact your decision making when allocating R&D budgets?</i>	<p>The deciding factor to invest in R&D is not driven by tax benefits nor other forms of state aid. What it does, which is critical in business planning, future budget allocation and domicile, is that it creates a longer runway for cash hungry R&D intensive businesses and accelerates the growth milestones as more funds to deploy, both in OpEx and CapEx.</p>
Question 3	
<i>If you use RDEC now, is there anything in your view that should be changed?</i>	<p>The rules on subcontractors under the current scheme precludes critical spend associated with qualifying R&D activities. We appreciate this consultation is looking to address this point and we will respond below.</p>

Question 4	
<i>Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?</i>	We agree the same rules should apply for all claimants.
Question 5	
<i>If so, where R&D activity is subcontracted, do you think that the customer should claim the tax relief, as in the SME scheme, or the subcontractor, the person carrying on the R&D, as in the RDEC?</i>	<p>We believe the customer should claim the tax relief as they are the driving reason for the R&D activity to occur and most likely taking more of the overall risk, both commercially and financially.</p> <p>We would suggest that the customer has the ability to seed the benefit to the subcontractor as part of the agreement to work with them and should be specifically stated in the contract/service agreement (alongside the Intellectual Property (IP) ownership clarification / definition). The purpose of this is to support engagement and negotiation between both parties and ensure that the generated IP remains within and is commercialised in the UK.</p>
Question 6	
<i>Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?</i>	We continue to be concerned that under the current SME scheme, it can be legally complex, creates uncertainty and act as an engagement barrier. This point links closely to the subsidisation rules so clarity here will also enable greater market understanding.
Question 7	
<i>Do you have an alternative model you think could apply all claimants in the new scheme? Please provide qualitative and quantitative evidence with your proposal.</i>	The RDEC scheme has proved to be successful and we would actively discourage the introduction of a new model as it is most likely to confuse signalling and get caught up in bureaucratic administration.
Question 8	
<i>What are your experiences of the PAYE / NICs cap?</i>	Under the current rules; our broad client base are very rarely affected, which would suggest the current caps are at an appropriate level for most UK based businesses.
Question 9	
<i>Are there any ways the Government could simplify the PAYE / NICs cap whilst ensuring there is protection against abuse?</i>	<p>We would not consider the cap as an obvious or likely mechanism to protect against abuse. We would suggest that a clearer, single approach akin to the current rules within the SME scheme of 3x times the PAYE/NIC contribution of the entire customer is most suitable, and the least labour intensive to administer.</p> <p>The unintended consequence of a cap tied to PAYE/NIC is where businesses rely on higher levels of third party expertise,</p>

	consumables or going forwards cloud computing and data costs, they will be placed at a significant disadvantage
Question 10	
<i>Which of the SME and RDEC PAYE & NICs cap should the Government implement in the new scheme?</i>	SME
Question 11	
<i>Should the Government change the way either cap is calculated if is taken forwards? And if so, how?</i>	<p>For customers (as referenced in Q9) where they may have a comparatively low number of employees but have a large number of other qualifying cost categories such as cloud computing and data costs, we feel it is unfairly targeting small start up companies that may be significantly investing in R&D and are adversely affected by the cap due to their low number of employees vs overall spend. In such cases we think a fairer mechanism would be to have a cap that is set to an overall % of the customers total qualifying cost incurred in the period, and we would suggest 75% of the total qualifying costs.</p> <p>So the cap would be determined by the higher of either the 3x the total customer PAYE/NIC cap, or 75% of the total qualifying costs, whichever is higher.</p> <p>In each circumstance, the Treasury should be within overall spend as with 75% of qualifying costs they must have been incurred on qualifying UK activities and contributed to the UK economy.</p>
Question 12	
<i>Do you consider the government should provide more generous support for different types of R&D or more R&D intensive companies relative to less R&D intensive companies?</i>	<p>We believe that the scheme needs to continue to be sector agnostic at principle as most R&D is not sector related, but technology related, that continues to move and best defined by the subject matter experts against the current rules.</p> <p>We are highly supportive of more generous support for R&D intensive companies particularly where they are aligned to wider economic strategy such as carbon neutral, green energy, AI & Robotics, Quantum computing and highly skilled manufacturing. The concern here is around the definition of those R&D intensive businesses and the types of science and technology that attract the more generous support.</p> <p>The current definition under EIS for knowledge intensive business could be used as a basis for the definition where an enhanced rate of RDEC is attributed if over 15% of overall employment costs are for Research and Development personnel.</p> <p>This does lead to a definition requirement for R&D personnel and we would strongly discourage this being led and defined by a type of higher education achieved vs those with less formal academic qualifications.</p>

	<p>Within our client base, and also more broadly represented in the economy, it is clear that some of the greatest innovators who have significantly driven economic growth were not university educated. It also creates a greater risk of institutional bias as the representation of minority groups holding the highest qualifications from well-known universities is not reflective of the wider workforce. This could also be interpreted as prevention of entrepreneurial ideas / innovations from less privileged backgrounds and areas where arguably innovation and entrepreneurial spirit should be actively encouraged and championed, not hindered.</p>
<p>Question 13</p>	
<p><i>In the event this were to be done, how might this best be achieved within an overall cost envelope? Within your answer, please include details of your sector and evidence supporting the impact the R&D relief has on your R&D investment and the impact that has on UK productivity.</i></p>	<p>The total cost allocation for the scheme is enough to cover an increase to R&D intensive companies, particularly as the lower R&D intensive companies claim values reduce. These funds should bravely be redeployed to ensure we achieve the spill over and additionality benefit that the UK economy needs to achieve to become a global leader.</p>
<p>Question 14</p>	
<p><i>If the schemes are merged do you agree the Government should implement the merged scheme on accounting periods starting on or after 1 April 2024?</i></p>	<p>Any changes would need to take effect for full accounting periods starting on or after 1st of April, however, in which year will depend on the timing of the announcements and publication of the final legislation with guidance.</p> <p>Businesses should be allowed sufficient time to make business changes such as re-shoring overseas activities, or in-housing subcontracted activities, re-locating a global R&D centre – without sufficient time to make these changes customers will potentially be unfairly targeted and could result in the opposite effect of customers consciously moving more of their R&D activities overseas.</p>
<p>Question 15</p>	
<p><i>How can Government ensure SMEs are supported in the transfer into a new scheme?</i></p>	<p>There is a strong advisory market active, including accountants, and Government's role should be to ensure the integrity of the scheme though better policing and process control from HMRC.</p> <p>It would be better for HMRC to be provided with greater abilities to take action against rogue R&D advisors and claim farms where poor advice / fraud is prevalent, and the reporting of such firms should also be made much easier.</p> <p>Although regulation is often spoken about we don't feel that's an effective answer as evidenced by the regulated profession of Accountants, there are still people operating outside of this regulated framework.</p>

	<p>Following the welcomed increase in compliance checks we have seen significant errors in some Accountant's understanding of the R&D scheme and not just from the technical compliance perspective, we have seen cases where there are significant errors in the financials. There is a real and obvious risk that the accountancy profession have, in good faith, provided services they were not adequately aware of. This, in part, has been driven by the professions concern regarding rouge advisors and may well have decided to assist clients to ensure the scheme was used more appropriately yet have inadvertently created the perception to stakeholders that the technical narrative and depth is secondary to the financial aspect of the claim.</p>
<p>Question 16</p> <p><i>Does claiming for expenditure on qualifying indirect activities influence your decision to undertake R&D? Within your answer, please include details of your sector and the impact claiming for qualifying indirect activities has on your R&D investment. Please also detail how much of your claim is defined as qualifying indirect activities, with appropriate evidence.</i></p>	<p>It is highly unlikely that the ability to claim QIA is a core driver of companies conducting R&D, very much the same as conducting R&D in the first place is not governed by the presence of a tax benefit alone.</p> <p>For QIAs it must be understood that R&D doesn't happen in isolation of the wider business. Whilst this may be the case for some industries such as bioscience and pharma, it is not true for many other sectors particularly SMEs.</p> <p>Having senior stakeholders being involved in the R&D activities and understanding the vital role they play increases the status, relevance and importance of ongoing R&D as the QIAs are usually people who can then champion the activity of the core R&D team to the wider organisation to maximise the R&D investment and eventual commercialisation of the R&D activity.</p> <p>In a situation where we just consider the core direct R&D activity as qualifying we put the commercialisation of that R&D at significant risk, along with the overall payback of public investment in R&D.</p>
<p>Question 17</p> <p><i>Do you think a threshold should be implemented? If one was implemented what at what level should it be introduced?</i></p>	<p>Following the recent compliance checks, we are supportive of a threshold being implemented and would suggest a level that would result in a minimum customer benefit of at least £6,500.</p> <p>Depending on where the eventual rates and scheme mechanics are agreed then this would be circa £40,000 of Qualifying Expenditure under the SME or RDEC rates coming into effect from 1st of April 2023 (assuming tax paying entities).</p> <p>The reason we believe this is that when faced with a compliance check, particularly when in a one-to-many campaign approach from HMRC, small businesses will decide on commercial grounds not to engage and defend the claim and instead prefer to 'withdraw' as the cost to the business in terms of their own time defending the claim is often far greater than the actual claim benefit originally received. They are, however, completely</p>

	<p>satisfied that they have compliant activity and accurately calculated qualifying expenditure, it is just too onerous to compile very detailed records for such low monetary returns.</p> <p>We would like to put on record that we are concerned that the statistics and intelligence gained from the current compliance checks will overlook this commercial consideration and the report will therefor over inflate the perceived inaccuracies and abuse of the scheme, where customers felt they had no choice but to withdraw a compliant claim on a time taken Vs benefit assessment.</p>
<p>Question 18</p>	
<p><i>What is the average amount of R&D expenditure per year per firm in your business or sector?</i></p>	<p>Across our client base, the average amount of R&D expenditure by an SME is between £100,000-£150,000 with a normalised range of £65,000-£350,000. There are of course businesses which incur much greater qualifying expenditure but for the sake of a view on averages the above will give a good indication.</p>
<p>Additional Comments</p>	<p>We grow increasingly concerned that many Accountancy firms who are the most likely agent for businesses claiming R&D and represent a greater proportion of the total R&D tax spend have not been adequately educated, trained, and checked when dealing with R&D for tax purposes. This is by no means entirely their fault and we beyond doubt believe most firms have acted in good faith, but they have been actively encouraged to offer R&D tax services by their regulatory bodies and have found through the compliance process that their understanding and approach is not in line with HMRCs requirements. We are working with a number of reputable accountancy firms to help address this knowledge gap they did not realise they had.</p> <p>We are further concerned that the easier story of rogue, spurious advisors is what has caused the integrity of the scheme to come into question. We again are an active voice against those advisors and they should be dealt with in the very strongest way, but they are the actions of the few and will not be the core contributor to poor compliance. We would encourage government to strengthen the role of advertising standards and the press in regard to tax services.</p> <p>We would also seek clarification that the RDEC scheme will also abolish the rules under the SME scheme regarding state aid subsidisation as this, particularly grant funding, can create great complication and barriers for businesses accessing the scheme.</p>