



Submission to:

HM Treasury & HM Revenue & Customs:

R&D Tax Reliefs consultation: [Response to the call for written evidence](#)

Date:

27 May 2021

From:

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Background

AIRTO represents the Innovation, Research and Technology (IRT) sector in the UK. Its membership comprises approximately 60 organisations who undertake research, development and demonstration of new technologies, for industry, government and public benefit.

A short description of AIRTO is included at the end of this submission.

In preparing this submission, AIRTO has consulted with its member companies, and other organisations and individuals with experience of the R&D Tax Credit schemes. This experience ranges from strategic views of R&D funding, through organisations with their own membership complementary to AIRTO's, to longstanding and recent users of the current schemes.

There was an overwhelmingly positive response to the benefits of the R&D Tax Credit schemes in both supporting R&D activity and catalysing increased levels of private/industry support for such activity. It is seen as a vital part of the effort to reach the government's target of seeing 2.4% of GDP to be invested in R&D by 2027.

AIRTO members claim R&D Tax Reliefs, as do their UK clients and collaborators. The schemes therefore have a two-fold effect on the IRT sector. The direct claiming of R&D Tax Reliefs by AIRTO members allows them to invest in underpinning, generic research activities that benefit industrial sectors rather than individual companies. The results of this type of activity are widely disseminated to UK industry, giving economic and societal benefits to the nation. The ability of AIRTO members' clients and collaborators to claim R&D Tax Reliefs results in more funding of activities where the knowledge, skills and facilities of the members promote and support innovation in individual companies and organisations.

The positive response to R&D Tax Reliefs was qualified by suggestions of a range of improvements that increase the efficiency of and the national benefits from the schemes. These include the more effective operation of the schemes, increasing their scope to support more high risk/high return R&D, national/societal priorities and innovation activities. Specifically relevant to the IRT sector is the eligibility of a wider range of cost where the organisation solely undertakes R&D and has no other activities to support overhead recovery.

AIRTO members specifically requested actions in order that HMRC officials gain a better understanding of their business model and the handling of claims becomes easier. Cases were cited where this is already the case, and there were significant benefits for all involved parties.

Additionally, there was a universal request to simplify the R&D Tax Reliefs schemes, and certainly not to make any changes that increase complexity.

Details of these points are given in the responses to the specific consultation questions below.

Responses to the specific consultation questions

Structure and administration of reliefs

Question 1

Do you consider your company to be a research-intensive firm? How does your business benefit from the R&D reliefs (e.g. cash flow, 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?

All AIRTO members are research-intensive companies. Their main activities are R&D ranging from fundamental research, often with university collaborators, through applied research and development, to innovation and demonstration. The members may also have additional related activities such as training and consultancy.

The majority of members have a non-profit status (i.e., company limited by guarantee, charity, government owned etc.) which means the financial benefit of receiving R&D Tax Reliefs is invested in underpinning, generic research, either in the form of improving equipment and facilities or in programmes of work. This improves the capabilities of the member to support its customers and collaborators, and also provides for wide dissemination of results to UK organisations including universities, public bodies and industry. It also attracts overseas inward investment for R&D to the UK.

Much of AIRTO members' work involves high levels of applied research, development, and demonstrating innovative products and processes are ready to be used without risk. These areas of R&D activity are significantly more resource intensive than more basic research.

AIRTO members claim using both SME tax relief and Research and Development Expenditure Credit (RDEC), as appropriate to their size and the nature of their claim. This is also the case for members' customers and collaborators. Although the SME tax relief scheme offers a higher rate of benefit, many SMEs do use the RDEC scheme.

A key benefit for early-stage SMEs is the ability to get a cash return under the SME tax relief scheme, where they have yet to make a profit. This can provide essential cash flow for new, research intensive companies.

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?

There are merits to both schemes and rationalising the two schemes into one combined set of costs and reliefs could be detrimental to the benefits to applicants. These benefits include the higher levels of relief and cash payments for companies yet to make a profit when using the SMEs scheme, and different types of qualifying expenditure in RDEC.

However, combining the administration of the two schemes whilst retaining the key features of each would be highly beneficial to applicants. A single application process where an embedded algorithm identifies the most appropriate/beneficial route would be welcome.

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 lower levels of additionality between the two schemes could be a reflection of the different nature of R&D undertaken by SMEs and large companies, and the internal resources they have to support the R&D.

SMEs, and particularly recent start-up companies, are likely to be more focused on short-term goals for their R&D and to have greater restrictions on the resources. Large and established companies will have more systematic R&D programmes and clearly defined longer-term goals. They are also likely to have larger, pre-allocated budgets and are better placed to manage cash flow.

Ensuring the process for claiming R&D Tax Relief is straightforward, covers all eligible expenditure, and has a rapid response time will benefit all applicants, but will be particularly helpful to SMEs where cash flow can be a major restraint on investing in R&D.

The additionality achieved by the use of the R&D Tax Reliefs schemes by AIRTO members has a range of first and second order effects. Firstly, it enables the member to increase its capabilities for undertaken R&D and funds generic research programmes. This has a multiplier effect on the member's non-externally supported, own investment funds. Secondly, the increased capabilities, skills and knowledge result in increased investment by clients in bilateral or collaborative research programmes with the member and other of the member's collaborators. This second order effect is significant and exemplifies levels of additionality achieved by both of the two schemes that may not be captured in analyses of the benefits of the schemes. Because of these two effects, the additionality of both schemes will be increased if eligible costs for IRT organisations are widened and relief rates are increased as discussed later in this response.

Question 4

To what extent do the rates of relief available to you impact your investment decisions and/or your choice of location? Is there any evidence of significant deadweight where investment decisions would proceed without relief?

The structure and governance of AIRTO members means that the benefit of R&D Tax Reliefs can only be invested in capabilities of the organisation and its internal research programmes. There is always a requirement to undertake more internal research than financial resources permit, and the R&D Tax Reliefs allow more such research to be undertaken for the UK's benefit (see earlier narrative). Therefore, there is no evidence of 'deadweight' as the result in funding is all additional.

Higher rates of relief will increase the resources for investment, and therefore have a positive effect on investment capacity and decisions.

Aside from increasing resources for investment, which can lead to expansion in the UK, rates of relief do not affect the choice of location for AIRTO members' investments. However, a significant number of members now have overseas activities, and it is likely that future investments for these organisations will be influenced by the international competitiveness of the UK schemes.

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?

A departure from the ordinary Corporation Tax self-assessment system will be welcome and justified if it results in more effective operation of the schemes. This should involve clearer guidelines and criteria for the required information that can be provided earlier, a reduction in long, protracted enquiries, and a quicker final result that will assist companies in their financial and investment planning.

As discussed below (Q8), where required information has been agreed up-front with knowledgeable HMRC officials, the claims process does proceed more effectively and efficiently.

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?

Some AIRTO members have been claiming under the current schemes and their predecessor (the Large Company scheme) since inception in the early 2000s. These have generally been the larger organisations with their own in-house capabilities. Use of the scheme was prompted by obvious benefits to the resources and work programmes of the members.

More recently formed AIRTO members use or are preparing to use the schemes. Advice and support within the AIRTO membership is useful for those new to the schemes, and this includes participation in the AIRTO's Company Secretaries' and Financial Directors' Interest Group which meets regularly to discuss topics of mutual interest.

AIRTO members have used agents to assist in claims, but found that this involves significant activities to 'educate' the agent in the nuances of their governance and financial status.

Rather surprisingly, some members new to the R&D Tax Credits schemes have been advised by HMRC that they cannot provide any assistance in making an application, and the member should contact an agent.

One AIRTO member was erroneously advised by a public body that it was not eligible for tax credits under the scheme. This has subsequently been successfully challenged and steps to submit claims are now being taken. It does illustrate the benefits and value of discussions of best practice and experiences within the AIRTO membership.

Question 7

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

AIRTO members have suggested better contact with HMRC officials would significantly improve the claims process. Several have suggested that officials visiting to see how an IRT sector organisation operates, and discuss the finances and governance, would greatly improve understanding. This would make the process more efficient and effective for all involved.

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 discussed above (Q2), a single application process for up-loading the relevant information, which then identifies the appropriate scheme and amount of credit would be welcome. However, AIRTO realises that this is not a trivial undertaking.

AIRTO members who have had direct dealings with the HMRC office specialising in IRT sector organisations (e.g., via their Leicester Office) have found this beneficial in agreeing what costs are eligible before making claims. Ensuing claims have progressed smoothly. AIRTO is willing to facilitate liaison between the HMRC office and members to make such interactions a more efficient use of officials' time. This could take the form of facilitating a regular meeting with members, which is something AIRTO does with other bodies such as UKAS. However, we note that support for extensive interactions would carry a resource implication.

Qualifying expenditures and R&D definition

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?

The UK is rightly recognised for its excellence in academic research, but also for a relatively poor exploitation of this research. This has resulted in recent proposals to invest more heavily in innovation led applied research, development and demonstration (for example the AIRTO paper "[More D!](#)"). These more applied R&D activities can incur increasingly large levels of expenditure and risk, particularly when they involve large-scale demonstration of new technologies. However, such demonstration projects are a vital part of R&D, particularly when undertaken in the public interest by the IRT sector. It is therefore suggested that the scope of eligible areas of activity under the R&D Tax Reliefs schemes should include such 'higher TRL' activities, which have a clear benefit to the UK.

As discussed in Q1, applied R&D will often involve high risk/high return R&D activities, where levels of investment increase sharply. Ensuring such activities are eligible expenditure for R&D Tax Reliefs is important in supporting the exploitation of the UK's knowledge base, and providing users of new, innovative technologies the information they need to reduce or eliminate risk.

The recent review of eligible expenditure has identified data and cloud computing as cost that should be included under a widening of the scope of the schemes. This is welcome, as would be a regular review of areas for inclusion in an era of rapidly changing technology and innovation areas.

The widening of the schemes to cover pure mathematics is important, as increasingly some valuable R&D will have a more theoretical than empirical basis.

The inclusion of creative industries and social sciences can be justified in their own right, but there is also an increasing overlap between these disciplines and more traditional science and engineering areas of R&D. For example, areas of social sciences covering human behaviour will be critical to the introduction of net zero carbon technologies, and visualisation and simulation technologies from gaming and other parts of the creative industries are key to the understanding and presentation of complex technical data and results.

Furthermore, government policy is encouraging this kind of cross and inter-disciplinary working and the R&D Tax Relief system should play its part in supporting this evolving policy and anticipated aspect of the forthcoming innovation strategy.

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?

As discussed above (Q9), widening the scope of the schemes to ensure the more applied and demonstration aspects of R&D are covered will enhance the development and take-up of new technology. This is particularly relevant to green/net zero carbon technology where large-scale demonstration of new technology is necessary, and work to better understand public acceptance and behaviour is required. A higher rate of relief for R&D areas of specific social value will further incentivise the R&D needed to reach key targets such as net zero carbon by 2050.

In normal times, the use of a higher rate of relief to better incentivise specific areas of R&D should only be entertained where there is a clear national benefit, and a long-term need for the relevant R&D. It will need clear guidelines and knowledgeable enforcement.

Conversely, at times of national crisis, such as we are currently experiencing with the COVID19 pandemic, temporarily enhancing rates of relief would incentivise key areas of R&D when economic pressures commonly exert downward pressure on privately funded R&D spending.

Reducing the rate of relief could be used to disincentivise R&D in certain fields, although it is difficult to speculate where this could be necessary or beneficial. AIRTO strongly advises against such actions without a thorough consultation to understand the relevant R&D landscape, and the direct and indirect consequences that would occur.

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?

AIRTO members are located throughout the UK, with some organisations having multiple locations. These locations may be for historic reasons, for clustering with specific industries and collaborating organisations (including universities), for access to geographical features which are the subject of research, such as coastline, ports and wind and tidal flows, and for access to regional funding from UK sources and EU structural funds.

R&D tax reliefs benefit the development of AIRTO members' R&D capabilities in terms of equipment, facilities, and programmes of work, and may contribute to the development of activities in different areas of the UK. However, it is not thought that the R&D tax reliefs per se have an effect on deciding the location of enhanced or new activities.

Question 12

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

AIRTO and its members believe that there is a specific case for increasing the scope of eligible expenditure for IRT sector organisations.

Industry has its normal commercial operations to cover its general overhead costs, and it is logical that only those additional overhead costs incurred when undertaking R&D (materials and the relevant proportion of utility costs) are eligible expenditure for R&D Tax Reliefs.

For IRT sector organisations, where their sole or majority activity is undertaking R&D, there is no normal non-R&D commercial operation to cover general overhead costs. R&D is the normal activity that covers general overheads. Therefore, it seems logical that in these specific instances, general overhead costs should be included in qualifying expenditure (at the same proportion to that used for utilities) to ensure the R&D Tax Credit schemes cover all relevant expenditure. Without this provision for help with overhead recovery, the benefit of R&D tax reliefs will be proportionately less the higher R&D is as a fraction of the recipient's normal business.

The effect of being unable to include a full overhead rate in the eligible costs for R&D Tax Credits and other public funding, means that these costs have to be recovered from industry funded work, making the charge rates for this work less competitive. This can put the UK IRT sector at a disadvantage when bidding for projects against UK and overseas organisations who either can claim full overheads or have core public support for their operation.

As discussed above, this widening of eligible costs for IRT sector organisations would directly lead to an increase in internal investments in facilities, equipment and programmes for generic R&D, giving wide national benefit.

The inclusion of capital expenditure for R&D under the schemes would be welcomed by AIRTO members where they do not have sufficient Corporation Tax liabilities to benefit partly or wholly from the Research and Development Allowance scheme.

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?

The proportion of R&D expenditure that is treated as capital for the purposes of corporation tax by AIRTO members will vary depending on the level and priorities for investment of individual organisations' surplus cash. However, it is likely to be a relatively small percentage of the eligible R&D expenditure (typically less than 10%).

Increased relief for capital expenditure would directly increase R&D activities, provided the organisation has Corporation Tax liabilities and these liabilities have not already been nullified by the existing claimed reliefs.

Question 14

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

AIRTO members do claim Research and Development Allowances (RDAs) for capital expenditure, in order to reduce Corporation Tax liabilities. The higher rates under the scheme are welcome, but only benefit members where they have Corporation Tax liabilities as the scheme does not give tax repayments.

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?

As the main role of AIRTO members is to carry out R&D, they aim to undertake as much of their activities as possible within their own facilities. These facilities are either exclusively or largely UK based. Subcontracting R&D activities to overseas subsidiaries or third-party organisations only occurs when the resource needed to undertake such activities is not available in the UK.

The benefit of subcontracting is the access to additional facilities and skills. The drawbacks are a reduction in activities for the AIRTO member, and a potential lessening of control of the management and quality of the subcontracted activities.

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?

The differentiator is where there are necessary facilities and skills abroad that are not available in the UK, as discussed in Q15. This can be the facilities and skills do not exist in the UK, or they are not

available within the timescale necessary to meet the needs of a R&D programme. Applicants submitting claims should justify why the work has been done outside 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?

For the activities undertaken by AIRTO members and other IRT sector organisations, supporting activities for R&D can easily be defined as most or all of their activities are R&D. As previously discussed, some AIRTO members have found direct discussion with the relevant HMRC officials key to defining qualifying expenditure boundaries and ensuring claims progress effectively and efficiently. AIRTO suggests that any changes to qualifying expenditure should be subject to a similar direct discussion, which it is willing to facilitate for its members and HMRC.

For commercial organisations, keeping the eligibility rules and guidelines as simple as possible and having knowledgeable HMRC officials will be important. The assistance of agent organisations will be beneficial if they have a clear knowledge of the rules and guidelines, provided they are not over 'aggressive' in their interactions with clients or scope of claims. However, keeping the process straightforward will encourage companies to undertake their claims directly.

Some AIRTO members and other commentators have suggested two refinements of the schemes to improve the value of the R&D Tax Credit system and enhance the quality of the R&D undertaken. These are:

1. Fast tracking claims for commercial organisations where R&D organisations (IRT sector organisations or universities) are involved in their projects.
2. Paying companies a proportion of their R&D Tax Reliefs as vouchers to be used to contract services from R&D organisations.

These ideas for refinements to the schemes do need further analysis and AIRTO is willing to work with HM Treasury and HM Revenue & Customs officials on considering these further, if appropriate.

About AIRTO

AIRTO is the Association of Innovation, Research and Technology Organisations. Its membership comprises approximately sixty of the principal organisations operating in the UK's Innovation, Research and Technology (IRT) sector. The IRT sector has a combined turnover of £6.9Bn, employing over 57,000 scientific and technical staff (equivalent to the academic staffing of the Russell Group of universities) and, for comparison, it is significantly larger than the network of Fraunhofer Institutes in Germany both in size and its scope of activities. The sector contributes £34Bn to UK GDP. AIRTO's members work at the interface between academia and industry, for both private and public sector clients.

Members include independent Research and Technology Organisations, Catapult Centres, Public Sector Research Establishments, National Laboratories, some university Technology Transfer Offices and some privately held innovation companies.

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