



**Response to HM Treasury's R&D Tax Reliefs Report (published November 2021)**

**Submission to:**

HM Treasury: Response to [HM Treasury's R&D Tax Reliefs](#) Report (publication date 30 November 2021)

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**From:**

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## Background

AIRTO represented 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 response document.

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 just individual companies. The results of this type of activity are widely disseminated to UK industry, and provide the specialist core skills, knowledge and facilities that IRT sector organisations need to provide world leading expertise to their collaborators and clients. Both of these outcomes enhance the economic and societal benefits provided to the nation by the IRT sector.

The ability of collaborators and clients of IRT organisations to claim R&D Tax Reliefs results in increased funding of activities where the skills, knowledge and facilities of members promote and support innovation in individual companies and organisations.

As discussed in [AIRTO's previous response to the HM Treasury's consultation](#) in May 2021, members have an overwhelmingly supportive response to the benefits of the R&D Tax Credit schemes, but this support is qualified by suggestions for a range of improvements that will increase the efficiency of and national benefits from the schemes. Some of these improvements are included in the proposed changes outlined in HM Treasury's November 2021 report. These are welcomed by AIRTO, as are the government's plans to continue and improve the administration of the two systems. Other key improvements previously suggested by AIRTO are not discussed in the report and it is proposed that these should be revisited as changes are finalised for implementation in April 2023. Principal amongst these is the need to increase the eligible overheads of IRT sector organisations.

AIRTO's response to HM Treasury's R&D Tax Reliefs Report published in November 2021 is given in detail as follows:

### Data and Cloud Computing Costs

1. The inclusion of data and cloud computing costs in qualifying expenditure is welcome.
2. The scope of these activities needs to be carefully considered to ensure the implementation accurately reflects how data and cloud computing are used in R&D activities in the UK.
3. Similarly, what constitutes eligible costs and, more importantly, what is ruled out must be clearly defined based on discussion with all the relevant stakeholders. Nuances in the commercial agreements and contracts for both schemes must be taken into account in preparing clear, unambiguous eligibility rules.
4. A regular review of new areas of technology and support services should be undertaken to ensure that the eligible costs for R&D Tax Reliefs keep pace with developments in R&D practice. The review should have a wide scope to include such topics as pure mathematics, social sciences, and creative industries which are playing an increasing role in mainstream R&D.

### Refocusing the reliefs towards innovation in the UK

5. The policy of limiting eligible costs for R&D Tax Reliefs to those incurred in the UK is understandable.

6. However, it must be ensured that unforeseen consequences and valid exceptions are taken into account when drawing up the relevant regulations.
7. Where companies operate globally, it must be ensured that the exclusion of overseas R&D costs does not result in complete programmes of work being moved from the UK to countries where essential parts of programmes are located, or where there is a more 'liberal' R&D tax credit regime.
8. Additionally, there will be UK based programmes that have to undertake part of their activity overseas. Likely reasons for this are:
  - a. Skills, expertise or facilities are not accessible in the UK, either because they do not exist or because they are not available in a timescale that is necessary for the programme.
  - b. Geographic, climatic, environmental or demographic/societal needs of programmes are not present in the UK.
  - c. Regulatory requirements that specify local testing.
9. It is therefore proposed that the regulations incorporate the claiming of exemptions where undertaking relevant R&D is not possible in the UK. The definition of what constitutes an exemption, and how it is justified and claimed, must be an unambiguous part of future rules of the schemes.
10. There is also the possibility that aspects of a R&D programme subcontracted to a UK organisation are undertaken outside of the UK, without the organisation placing the subcontract knowing. This is particularly relevant where the subcontract is placed with a multinational organisation, or where part of the subcontracted work is further subcontracted to another party. Clear guidance will be necessary in future regulations to ensure companies are not unknowingly submitting ineligible costs.
11. There is an alternative or additional strategy that HM Treasury should consider. This involves providing incentives for organisations to place out-sourced R&D activities with the UK infrastructure of IRT providers and universities. This will support the ambition for the UK to be a leading global player in research, development and innovation – 'a science and innovation superpower'. Such incentives could be higher rates of tax credit, paying a proportion of higher rate tax credit in the form of vouchers to be used to contract services from UK R&D providers, and/or a simplified process for such claims.

#### Abuse and compliance

12. The aim of reducing fraudulent R&D claims is welcome.
13. This will require additional resources which should target both an efficient submission process that ensures claims are correct before payments are made, and thorough investigation of potentially fraudulent activity.
14. The use of a digital portal for claiming R&D Tax Reliefs is welcome, provided it is thoroughly tested by officials and users before full implementation.
15. The use of a single portal for both schemes is also welcome, particularly if the portal identifies the scheme that is most appropriate to the applicant.
16. The requirement to have a senior company official to endorse any claim has a guarded welcome, but it will be important to understand how this differs from existing requirements and what benefit it will bring.
17. The requirement to specify any agent used on an application is welcome, although full details will be needed to show the benefits of this.
18. Some AIRTO member organisations have found direct discussion with the relevant, specialist HMRC officials key to defining qualifying expenditure boundaries and ensuring claims progress effectively and efficiently. AIRTO would welcome further direct contact with HMRC officials for its members and is willing to work with such officials to facilitate this. Some

increased effort in early-stage discussion will have significant long-term benefits for all involved.

#### Additional recommendations

19. It was disappointing that AIRTO's recommendation (made in its May 2021 submission) to include some special case measures for IRT sector organisations was not included in the proposals for change in HM Treasury's November 2021 report.
  - i. Such proposed special measures would involve a wider inclusion of overheads in eligible costs.
  - ii. Industry typically makes provision in its core commercial operations to cover its general overhead costs, and it is logical that only those additional costs incurred when undertaking R&D are eligible expenditure for R&D Tax Reliefs.
  - iii. 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 the specific instance of organisations solely performing R&D, general overhead costs should be included in qualifying expenditure to ensure the R&D Tax Reliefs schemes cover all relevant expenditure.
  - iv. The effect of being unable to include a full overhead rate in the eligible costs for R&D Tax Reliefs means that these costs must be disproportionately recovered from client funded work, making the rates for such work less competitive. This can put the UK IRT sector at a disadvantage when competing for projects with overseas organisations which can claim full overheads or are supported by core public funding of their operation.
  - v. This widening of eligible costs for IRT sector organisations will directly lead to an increase in internal investments in facilities, equipment and programmes for generic R&D, giving a direct national benefit.

#### About AIRTO

AIRTO, the Association of Innovation, Research & Technology Organisations, represents the UK's extensive Innovation, Research and Technology (IRT) sector, which employs 57,000 highly skilled people, has a combined annual turnover of £6.9Bn and contributes £34Bn to UK GDP. Organisations in this critical sector work with industry, government and academia to promote and implement innovation, and provide technical solutions to challenges and crises. Members include independent Research and Technology Organisations (RTOs), Catapult Centres, Public Sector Research Establishments, National Laboratories, and some privately held innovation companies.