



**Submission to:**

HM Treasury: R&D Tax Reliefs Review Consultation on a single scheme

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## BACKGROUND

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AIRTO represents the Innovation, Research and Technology (IRT) sector in the UK. Its membership comprises approximately 60 organisations undertaking 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 Reliefs schemes. This experience ranges from strategic views of R&D funding, representative organisations with their own memberships complementary to AIRTO's, to longstanding and recent users of both the current schemes.

There was an overwhelmingly positive reaction expressed by our members in relation to the benefits of the R&D Tax Reliefs schemes, both for 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 achieve the government's ambition of being a 'science and technology superpower', supporting indigenous R&D and attracting innovative companies to the UK. To create maximum benefit from this, the UK's R&D Tax Reliefs scheme must be both internationally competitive in the support it provides, and straightforward and predictable to use.

AIRTO members frequently 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 and capacity building activities that benefit sectors and communities rather than individual organisations. The results of this type of activity are widely disseminated, giving economic and societal benefits to the UK. Secondly, 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 members promote and support innovation in individual companies and organisations.

The positive response to R&D Tax Reliefs was qualified by suggestions from our membership for a range of improvements to increase the efficiency of operation of the schemes. Amongst these suggestions was a specific request for actions in order that HMRC officials may gain a better understanding of the business models of IRT sector organisations, so that handling of claims may become easier. Cases were cited where this has already happened, resulting in significant benefits to all involved parties. However, there are also cases where IRT sector organisations do not claim relief because of the complexity involved, or have to rely on the use of third party advisors at significant cost.

Overall, AIRTO members welcomed the concept of having a single scheme for R&D Tax Reliefs, provided it results in a simple, more predictable process. Their view was that a single scheme could still provide different levels of relief for different types of organisations, such as SMEs, where appropriate. It was suggested that any merged scheme should not result in lower rates of relief although this has already been announced for SMEs, starting from 1st April 2023. This reduction in rate is discussed in the answers to the consultation questions below.

Lastly, it was suggested by members that any changes to the schemes, including merger to form a single scheme, should be announced with sufficient notice to allow time for preparation for the changes and for incorporating the effects of the changes into business plans and strategies.

## CONSULTATION QUESTIONS – AIRTO'S RESPONSES

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### **Question 1: Do you agree as new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?**

A single above the line credit will be of benefit under a merged scheme, provided it retains the provision for cash rebates where an organisation does not achieve sufficient profit or makes a loss. This is particularly important to new IRT organisations, and start-up high tech SMEs which can be customers and collaborators for AIRTO members.

The benefits of a single method of credit will be simplicity in using the merged scheme, and the clarity of the relief for non-tax and accounting specialists. The people within an organisation with responsibility for decisions on R&D strategy and planning are unlikely to have the specialist knowledge to fully understand the nuances of alternative credit methods.

A single method of credit will also eliminate the different values of credit that can occur under the current SME scheme depending on whether the organisation is profit making, loss making, or makes a profit that is less than the amount of credit which they are due.

### **Question 2: Does the tax ability and subsequently different post tax net benefits impact your decision making when allocating R&D budgets?**

The predicted net value of tax reliefs are important in allocating R&D budgets for AIRTO members, and hence important to overall organisational strategy as the majority of any members' activities are R&D related.

The structure and governance of the majority of AIRTO members means that the benefit of R&D tax reliefs can only be invested in the capabilities of the organisation and its internal, underpinning R&D programmes, which are of wide benefit to industry and society. There is always the requirement to undertake more underpinning R&D than financial resources permit, and R&D tax credits provide the finances for more of such work to be undertaken. Any increase in tax credit rates corresponds directly to an increase in underpinning research.

Changes to the rate of credit have immediate effect on AIRTO members. For those organisations claiming under RDEC, the alterations announced of an increase in credit level to a gross 20% from 1st April 2023 will offset the effect of the increase in corporation tax, indicating continuing support from government for large company R&D. However, the decrease in the SME rate will have a significant effect on smaller AIRTO members, decreasing their overall R&D budget. This decrease is compounded by the relatively short time between announcement and implementation. Ways of ameliorating this decrease for SMEs are discussed in the reply to question 15.

The points in the discussion above also apply to AIRTO members' industrial clients and collaborators but may be less significant depending on the level of R&D each organisation undertakes.

### **Question 3: If you use RDEC now, is there anything in your view that should be changed?**

Suggested changes to the RDEC scheme come under three categories:

- Technical scope of eligible activities.
- Eligible costs.

- Operation of the scheme.

The technical scope of eligible activities under RDEC has changed in recent years to match changing aspects of R&D. This has included the use of databases, cloud computing and pure mathematics. This increase of scope should continue as topics and techniques in R&D evolve. For example, economic and sociological modelling play a key role in life sciences and are becoming a part of net zero research. A regular review of the technical scope of R&D Tax Reliefs should be implemented.

The inclusion of capital costs has been proposed during AIRTO's discussions with members. This has to be considered along with other support for capital expenditure, such as the Research and Development Capital Allowance, the Annual Investment Allowance and the current Special Rate Allowance. Whereas support for capital will increase investment in facilities and equipment, a coordinated approach is needed to avoid confusion and duplication. A complication for many companies is the percentage of any capital asset that is used for R&D. However, this complication is not relevant to AIRTO members where their main or sole activity is R&D. With the proviso of a coordinated approach to capital expenditure, there may be a case for making it eligible in order to increase the resources available for R&D in the UK.

A similar consideration for organisations which mainly or entirely undertake R&D is the eligibility of overheads that are not specific to one particular project. Where an organisation's income is utilised for undertaking R&D, the inclusion of such non-specific overheads should be allowable.

AIRTO members are very supportive of changes to the operation of the current schemes to make the process of applying for and receiving R&D Tax Reliefs simpler, more predictable, and with faster certainty concerning what relief they will receive. Merging the two systems will eliminate the confusion over which scheme (or both) is appropriate for a particular organisation. A single on-line application for uploading the relevant information will be welcome, linked to other government databases so that only information specific to the claiming of relief needs to be entered.

There have been pilots for advanced assurance and advance clearance of claims, but the results of the pilots have not been published and no such system has been introduced. Merging of the two schemes presents the opportunity for this to be addressed.

AIRTO members who have had direct dealings with an HMRC office specialising in IRT sector organisations have found this beneficial in agreeing what costs are eligible before making claims. This ensures claims progress smoothly. IRT sector organisations have a range of governance and business models that differ from normal companies. Improving HMRC's understanding of IRT sector organisation would greatly benefit both parties. AIRTO is willing to facilitate liaison between the appropriate HMRC office and members to make such interactions a more efficient use of officials' time and improve the effectiveness of the relief application process.

**Question 4: Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?**

Yes, the same treatment for subcontracting should apply to all claimants in the merged scheme, and will be one of the simplifications that can result from the merger.

Although the justification for having a different scheme for SMEs has been cited as the way they undertake their research by outsourcing activities to specialist organisations, this equally applies to

some large companies. And conversely, some SMEs will undertake most or all of their own R&D activities.

Having a single, clearly defined treatment of subcontracting will be widely beneficial.

To avoid duplicate claims, it must be clear in the guidance which organisation (i.e., the supplier or subcontractor) has the primary right for claiming against costs of subcontracted activities. However, there must also be facility for organisations to jointly elect to use alternatives to this 'standard' treatment where all parties agree the variation.

**Question 5: If so, where R&D 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?**

There are merits to both approaches, but logic dictates that the organisation making the expenditure on the R&D (the customer) should be the default claimant of relief. However, as discussed in question 4, there should be the possibility of the parties involved to elect to avert from this.

**Question 6: Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?**

AIRTO members are usually the subcontractor for R&D activities, but may also subcontract specialist work to other organisations.

In either scenario, whichever party claims the R&D Tax Relief will be a part of any contract negotiations. Therefore, as long as the rules and exceptions are clearly defined, there should provision for any potential positive or negative impacts to be addressed in the negotiations.

**Question 7: Do you have an alternative model you think could apply to all claimants in the new scheme? Please provide qualitative and quantitative evidence with your proposal.**

See answers provided to above questions.

**Question 8: What are your experiences of the PAYE/NICs cap?**

As IRT Organisations mainly undertake R&D activities (of their own or on behalf of customers) with their own facilities and staff, the PAYE/NICs cap is not relevant to their R&D Tax Reliefs claims.

This also applies to large company and SME customers and collaborators.

There are two exceptions to this:

- Start-up SMEs where there are low staff numbers and much of their work is frequently subcontracted. In this case it is reasonable to have a lower cap for a number of years.
- Overseas organisations which set up offices in the UK, through which they fund R&D in the UK or overseas and claim UK relief. In this instance an alternative to the cap may be more

effective at avoiding abuse of the scheme, such as assessing the eligibility for relief on where the end beneficiary of the R&D is located.

**Question 9: Are there any ways the Government could simplify the PAYE/NICs cap whilst ensuring there is protection against abuse?**

There are two possible approaches:

- Maintaining the cap based on PAYE/NICs but decreasing the administrative burden on claimants. This could be implemented by having a time period of a number of years after a claimant has proved that they are operating under the cap by a significant margin. Ensuing claims for that number of years would be accepted without further proof demanded of PAYE/NICs data, but it would be incumbent on such claimants to inform HMRC of any breaches of the cap in that period.
- Abolish the cap and tackle abuses of the system by individual claimants, as discussed in question 8. This would require an in-depth understanding of the mechanisms that are deployed for actual or attempted abuses.

**Question 10: Which of the SME and RDEC PAYE and NICs cap should the Government implement in the new scheme?**

As it stands, AIRTO members' experience that the cap is irrelevant to most if not all large companies because of the high level of their PAYE/NICs, it is logical to maintain the cap at the level of the SME scheme in the merged scheme. However, HMRC's historic and future data on PAYE/NICs compared with claims fully accepted or capped, should be used to refine the allowable multiples of future caps and the ceiling level to ensure the scheme is supporting organisations for who it is intended, but also addressing abuse of the scheme.

**Question 11. Should the Government change the way either cap is calculated if it is taken forwards? And if so, how?**

The current methods for calculating the cap are sensible but, as discussed above, the factors used should initially be based on the current SME values, but then modified if necessary, as evidence for claims to the merged scheme is built up.

Ultimately with the data available, a realistic assessment can be made on whether any cap is necessary or if abuses of the scheme can be eliminated by different rules as discussed in questions 8.

**Question 12: 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?**

The objective of keeping the current and future R&D Tax Reliefs schemes as straightforward as possible, AIRTO does not advocate more generous support for different sectors, types of R&D or more R&D intensive companies. There are alternative vehicles for government support that address these categories.

There have been extensive discussions on introducing higher levels of support for 'green' technologies. Whereas AIRTO contends that there must be a significant focus on such technologies, it remains a fact that significant difficulties exist in defining what qualifies as a 'green' technology, which could add complications and uncertainty to relief applications. The government has many schemes for supporting 'green' technologies, and a coordinated approach is needed; it is for the government to decide whether enhanced reliefs are the only way of achieving its objectives in relation to supporting 'green' technologies, and therefore, if it can accept the increased complication associated with implementation.

An exception to the above is discussed in question 16, where an widening of the eligible indirect costs for IRT sector organisations is discussed.

**Question 13: In the event this were to be done, how might this best be achieved within an overall cost envelop?**

More generous support for different types of R&D or more R&D intensive companies will increase the budget required to support R&D Tax Reliefs, unless there are corresponding reductions in relief for other claimants. Without detailed proposals, it is not possible to forecast this increase in budget or reduction in relief. However, AIRTO considers that any reduction in relief will be against the objects of the scheme and changes should result in an increase in the overall budget for R&D Tax Relief. With the government's aspirations for UK R&D, and the overall budgets for R&D which have been announced (with renewed commitment made in the Autumn Statement 2022), an increase in the reliefs budget should be implemented.

**Question 14: 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?**

Implementation of changes to the R&D Tax Reliefs Scheme have significant consequences for any organisation that uses the current schemes and will continue to use the proposed merged schemes. Organisations will need to know the details of the resulting merged scheme and will need time to prepare for the changes. As well as the changes in the actual scheme, there are also implications for an organisation's R&D strategy and financial planning. Whether the introduction of the merged scheme from 1st April 2024 is feasible will depend on when the details of the merged scheme are finalised and announced. Unless this is possible within a few weeks, which seems highly unlikely, it is suggested that the implementation date for the merged scheme is 1st April 2025.

Recent changes to the current RDEC and SME schemes have applied to 'expenses incurred on or after' the relevant date. It is suggested that to avoid confusion the same principle applies to the introduction of the merged scheme.

**Question 15: How can Government ensure SMEs are supported in the transfer into a new scheme?**

Clear guidance and a simple application process will help both SMEs and large companies transfer to the new scheme. This should involve an awareness campaign involving both HMRC and Department for Science, Innovation and Technology, DSIT. As suggested in question 3, AIRTO is willing to facilitate liaison between its members and HMRC to improve understanding of both the current schemes for members, and for HMRC an understanding of the IRT sector. This proposed liaison would be beneficial to the introduction of a new merged scheme.

Of more significance and current concern to AIRTO members who are SMEs is the reduction in their relief rate in the Autumn that will come into effect on 1st April 2023. This will result in a significant drop in funding available for underpinning R&D for every year from now. As well as the short notice before implementation, the reduction has rendered business plans and R&D strategy invalid. This reduction in underpinning R&D is significant as it is the type of R&D that often supplies the UK's leading edge in the technology addressed by the member.

Therefore, AIRTO is suggesting that urgent actions are implemented to restore the levels of relief expected by SME members before the Autumn relief rate announcements take effect. This could be implemented by an enhanced rate for SMEs in general, for SMEs in the IRT sector, or for all organisation in the IRT sector, or by making reliefs exempt from corporation tax.

**Question 16: Does claiming for expenditure on qualifying indirect activities influence your decision to undertake R&D?**

As AIRTO members exist to undertake R&D activities as a core part of their missions, claiming for qualifying indirect activities cannot influence any decisions to undertake R&D. However, qualifying indirect activities do influence the level of underpinning R&D a member can undertake and as discussed in other questions, this underpinning R&D is vital to the technical competitiveness of members and hence the competitiveness of the UK's IRT sector, which has many world-class organisations. The eligibility of qualifying indirect activities is therefore vital to AIRTO members.

There is also a justifiable case for increasing the range of indirect activities that are eligible in IRT organisations' claims. All activities of IRT sector organisations support the undertaking of R&D, even those not directly associated with a particular project. The inclusion of these non-project specific indirect overheads will result in an increase in relief, which can only lead to an increase in underpinning R&D, in line with the aims of the R&D Tax Relief scheme.

**Question 17: Do you think a threshold should be implemented? If one was implemented what at what level should it be introduced?**

As suggested in the consultation document, implementing a threshold for relief claims will limit the amount of resource that HMRC needs to devote to ensuring compliance with the rules of the current schemes or the future merged scheme. However, it will significantly reduce the number of valid claims, particularly from small companies or companies with a relatively small levels of R&D activity. This effect will act directly against the aims of any relief scheme which are to encourage and increase in R&D activity across the full range of UK organisation.

AIRTO believes that such a threshold would be damaging to the aims of the scheme and should not be introduced. There are effective ways of ensuring compliance without compromising any scheme. Recent measures have been introduced and are planned to ensure compliance and these should be given time to demonstrate their effectiveness.

Activities to 'promote' the new merged scheme will also allow the understanding of the process of application to be disseminated to reduce the rates of error in applications.

A simpler, online application system will allow the automatic first vetting of applications.



**Question 18: What is the average amount of R&D expenditure per year per firm in your business or sector?**

AIRTO members range from small organisations (10 employees or less) to those with thousands of staff and international operations. Turnover, which is mainly or entirely relates to R&D activity, therefore ranges from <£1m pa to significantly >£100m pa.

## **ABOUT AIRTO**

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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 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 in the UK and overseas. Members cover a very wide range of industries from for example, agriculture and food, pharma and bio, energy generation and distribution, manufacturing and the built environment. They may be industry specific or have cross-sectorial expertise.

Members include Independence Research and Technology Organisations, Catapult Centres, Public Research Establishments, National Laboratories, university Technology Transfer Offices and privately held innovation organisations.

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