National Centre for Universities and Business

CONSULTATION

R&D Tax Credits Relief: Consultation on a single scheme

Submission by: National Centre for Universities and Business (NCUB)

March 2023

R&D Tax Credits Relief: Consultation on a single scheme

Submission by: National Centre for Universities and Business (NCUB)

Date: 13 March 2023

National Centre for Universities and Business

DC. 115, The Clarence Centre
6 St George's Circus
London SE1 6FE

T **+44 (0)20 7383 7667**
E **info@ncub.co.uk**
W **www.ncub.co.uk**

Introduction

1. The National Centre for Universities and Business (NCUB) represents a collective voice of leaders across business and higher education that promotes, develops and supports business-university collaboration across the UK.
2. This input is in response to HM Treasury's call for evidence to merge the two existing R&D tax schemes into one. Our response is based on policy positions set out in prior NCUB publications, research and engagement and the content of a discussion roundtable between businesses and universities which took place on Thursday, 2 March 2023.
3. We have chosen to comment on a selection of consultation questions relevant to NCUB.
4. In summary, NCUB understands the Government's intention to simplify the system through merging the two existing R&D relief schemes into one. Below, we highlight the main areas where a merger of the two schemes would be beneficial and caution where there is likely to be an adverse effect on existing legitimate claimants. Suggestions for how to simplify the system further to help ensure the UK remains globally competitive to attract business R&D feature throughout our response.

Response

Role of R&D tax reliefs in the research and innovation system

5. R&D tax reliefs are an important mechanism to encourage private investment and are generally valued by businesses. In the UK, science and innovation sits at the heart of the UK Government's economic growth strategy, an ambition reinforced by the recent launch of the new Science and Technology Framework[1]. R&D tax relief incentivises and enables businesses to invest in R&D that will boost the competitiveness and productivity of UK industry. In 2019, UK companies claimed tax relief on £47.5bn of R&D expenditure[2] .
6. Businesses reiterated to NCUB the importance of R&D tax relief to their strategic investment decision-making. It is therefore, increasingly important that the UK creates a tax system that plays to the key drivers that motivate businesses- particularly as companies become more cost conscious.
7. Global competition to attract R&D investment is increasing. In 2021, there was an increase of around 70% in OECD and 100% increase in EU countries that provided R&D tax relief to businesses relative to the year 2000. [3]. The UK's current system of R&D tax reliefs is more generous than many OECD countries and businesses we spoke to said they make the UK more attractive as a destination. A critical outcome from this consultation therefore, is ensuring the UK remains an attractive and competitive place for those activities.

Theme: Main features

Q1. Do you agree a new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?

8. Retaining the above the line credit is essential to the new scheme as it enables better profit visibility for investors and allows businesses to plan their longer-term investment decisions.

[1] https://www.gov.uk/government/publications/uk-science-and-technology-framework
[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1037348/RD_Tax_Reliefs.pdf
[3] https://www.oecd.org/sti/rd-tax-stats-database.pdf

National Centre for Universities and Business
DC. 115, The Clarence Centre
6 St George's Circus
London SE1 6FE
T +44 (0)20 7383 7667
E info@ncub.co.uk
W www.ncub.co.uk

Theme: Subcontracting

Q4. Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?

9. Yes, simplifying the reliefs system is the most important factor in the design of the R&D relief. If the rules are aligned for SMEs and large companies, this could simplify one of the more complex areas of the regime. To remove any uncertainty, there is a need for absolute clarity about eligibility.

Q5. 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?

10. Businesses participating in NCUB's roundtable were broadly supportive that R&D tax relief claims should be restricted to the contracting party, as in the current SME scheme. This, they said, rewards the business responsible for identifying subcontractors. Restricting the eligibility for tax relief to the contracting or purchasing party (funder) has also been found to be the most common approach internationally. In only a few countries (Colombia, France, Norway), firms are able to trade or exchange R&D tax benefits with third parties or use them as a security.[4]
11. Conversely, and to give some context, it is interesting to understand how the rules relating to subcontractors are administered in other European countries compared to the UK. The Irish regime, for example, contains a provision that R&D tax reliefs are restricted to one party only and the lead claimant is specified in the initial contract. This clarity can easily be included in the 'additional information' section of the new claims process and would also allow for flexibility for businesses.

Q6. Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?

12. The move to remove complexity in the multiple schemes is welcome. In particular, under the current SME rules, it is time consuming for SMEs to identify customer funded or subsidised elements of the R&D activity. This process can be complex and may discourage smaller businesses with limited resources from undertaking such a review and claiming R&D tax reliefs. This can also lead to an increase in incorrect claims and there is a risk that two partners will claim for the same expense.
13. If the current SME rules were to apply to the merged scheme, it is essential that subcontractor costs are included if the business is a loss-making company. This is currently the case with the SME scheme but not RDEC and is an important provision that should be retained to support new startups in high growth, high risk sectors.

Theme: Cap on payable credits

Q9. Are there any ways the Government could simplify the PAYE / NICs cap whilst ensuring there is protection against abuse?

14. To simplify the system, reforms must be introduced only if the aim of the reform is not achieved elsewhere. For example, with the removal of qualifying overseas costs within the reformed reliefs system, businesses at NCUB's roundtable questioned the necessity of including a PAYE/NICs cap at all as the risk of fraudulent claims will already be significantly reduced. In addition, there are concerns that companies with a relatively small workforce will still incur significant costs on prototype parts and other consumables, and will therefore be unfairly disadvantaged by the proposed PAYE cap rules.

[4] https://www.oecd.org/sti/rd-tax-stats-database.pdf

National Centre for Universities and Business

DC. 115, The Clarence Centre
6 St George's Circus
London SE1 6FE

T +44 (0)20 7383 7667
E info@ncub.co.uk
W www.ncub.co.uk

Q10. Which of the SME and RDEC PAYE & NICs cap should the Government implement in the new scheme?

15. As above, businesses we spoke to were not in favour of either of the scheme caps and instead commented that introducing a cap would be an unnecessary burden given the reforms already introduced.

Theme: Additional support for specific companies

Q12. 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?

16. Yes, in principle, a new R&D relief scheme could help the UK build a globally competitive offer to attract investment in areas of national priority and commercial opportunity through targeted reliefs. We propose the following areas for targeted reliefs:
    a. **High-intensity R&D industries:** In principle, NCUB supports the case for Government to offer a bespoke R&D tax relief for companies in sectors that fall within the 'families of UK strength and opportunity' as set out in the Innovation Strategy[5] or those which are identified as particular 'growth sectors' of strategic importance to the UK's economic future. The process for identifying high-growth industries needs to be clear, robust, strategic and long-term and could include increasing generosity in these areas alongside other strategic mechanisms such as grant funding.
    b. **Capital expenditure:** Although tax relief for qualifying capital expenditure is available under a specific form of capital allowance (an R&D allowance), the UK is relatively unusual in making such a distinction between revenue and capital costs, and this distinction should be removed. Generous allowances should be extended permanently or replaced by a system of full expensing which would give firms long-term certainty in their ability to offset investments against their tax bills. Evidence from OECD countries suggests that corporate taxes reduce investment in tangible assets and R&D; therefore, in theory, lowering the cost of capital via tax relief should make business investment more attractive[6]. In addition, the current "super-deduction" tax allowance expires in March 2023, at the same time that businesses will experience a significant increase in corporation tax. Together, these two proposals will leave the UK among the least competitive capital allowance regimes in the OECD. In comparison, both France and Ireland provide relief for capital costs of R&D under their tax credit regimes.[7]
    c. **Net Zero focussed relief:** Successive governments and specific government departments have articulated various priority areas for investment and activity. Most recently, Chris Skidmore's independent review of Net Zero[8], identified that tax relief for early-stage (and often SME-performed) R&D could incentivise investment into technologies in the earlier stages of their investment. NCUB has previously argued for additional tax relief within priority areas to incentivise investment[6]. During the recent NCUB roundtable, additional relief for investment related to Net Zero was suggested by participants.

Q13. In the event this were to be done, how might this best be achieved within an overall cost envelope?

17. Any additional generosity in particular areas should not adversely affect the availability of funding, or the generosity of tax relief for other legitimate claimants. This would therefore require modest increases to the overall cost envelope to achieve.

[5] https://www.gov.uk/government/publications/uk-innovation-strategy-leading-the-future-by-creating-it
[6] https://www.niesr.ac.uk/wp-content/uploads/2021/10/NIESR-DP-527-4.pdf
[7] https://committees.parliament.uk/publications/33732/documents/184361/default/
[8] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1128689/mission-zero-independent-review.pdf

National Centre for Universities and Business
DC. 115, The Clarence Centre
6 St George's Circus
London SE1 6FE
T +44 (0)20 7383 7667
E info@ncub.co.uk
W www.ncub.co.uk

18. NCUB urges caution that targeted reliefs should not discourage genuine claimants in other sectors from investing. The Government should actively monitor the extent to which a differentiated tax relief for specific R&D increases complexity and compliance costs, widen the scope for abuse, or be less effective than direct government spending. Therefore, offering targeted reliefs should be seen as part of an overall package (including grants and loans) to incentivise growth in certain industries.

Theme: Guidance and transition

Q14. 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?

19. It is advisable to implement a longer run up to the changes to allow SMEs to adjust. The proposed changes may mean SMEs will seek to relocate their R&D activities to the UK in order to continue to benefit from the reliefs. Many innovative UK businesses undertaking R&D work overseas will need time to adapt supply chains and restructure to accommodate these proposals in order to refocus innovation towards the UK. Others will be considering restructuring, new hires, staff relocation, training and support – along with all the associated legal and tax considerations for both the company and any employees relocating. Witnesses giving evidence to the recent House of Lords finance sub-committee suggested that "businesses might need to find around ¼ million new workers in the UK and that if "there is a cliff edge cut off, … it is possible that R&D activity will simply move offshore (to the detriment of the UK economy) rather than expertise being developed in the UK."[9]
20. The UK can learn from precedent. Following consultation in 2011, RDEC was introduced for large companies and SMEs ineligible for the SME scheme. The large company scheme was phased out after a three-year transition period from April 2013 to April 2016. The current proposals will give SMEs just over a year to adjust to the new proposals.

Q15. How can Government ensure SMEs are supported in the transfer into a new scheme?

21. It is important that these proposals signal to businesses that the UK remains an attractive place to invest and that businesses can rely on the stability of our system in the long term. With a number of reforms being made to the R&D tax credit system, businesses looking to invest in R&D told us they crave stability and long-term predictability. Furthermore, research from the OECD found that the use and impact of tax incentives can be influenced by the temporary or permanent nature of these programmes, as well as by how the business community expect R&D tax support to continue to be provided and under which terms.[10]
22. In some cases, SMEs operate to different tax year cycles; therefore, the transition to the new system should remain flexible to allow firms to claim against the old system for part of the transition year, and the new system for the remaining part of the year.
23. The reliefs system should be viewed in parallel with other measures to ensure that the overall R&D incentives package offered to businesses remains beneficial. The level of scrutiny applied to claims currently will inevitably mean that the cost of making a claim go up. Therefore, the government's plans to reduce the value of reliefs for SMEs may be detrimental in the long run. The Government should actively consider ways to ensure the system remains attractive and suitably tailored. Grant funding, innovation loans, modern apprenticeships and capital grants are all important schemes in place that support SMEs to incentivise R&D investment and can support SMEs where there are credit reductions.
24. A simplified system is essential to enable an easy transition for SMEs. Adopting a single portal approach is welcome in order to help simplify the system but it must be tailored to suit different types of businesses.

---

[9] https://committees.parliament.uk/publications/33732/documents/184361/default/
[10] https://www.oecd.org/sti/rd-tax-stats-database.pdf

National Centre for Universities and Business
DC. 115, The Clarence Centre
6 St George's Circus
London SE1 6FE
T +44 (0)20 7383 7667
E info@ncub.co.uk
W www.ncub.co.uk

Theme: Threshold

Q17. Do you think a threshold should be implemented? If one was implemented at what level should it be introduced?

25. Companies told NCUB that they were broadly supportive of introducing a minimum threshold as it may offer a way of targeting the relief to companies serious about R&D and will be successful in removing the additional 'noise' in the system. For smaller genuine R&D claimants, tax relief may not be the most effective incentive. To mitigate the effect that introducing a threshold might have on startups and SMEs, the government should, in parallel, introduce grants that help support set up costs and support access to shared infrastructure and facilities where benefits are lost. Businesses said that an ideal minimum threshold should sit at around £10k.

National Centre for Universities and Business

DC. 115, The Clarence Centre
6 St George's Circus
London SE1 6FE

T +44 (0)20 7383 7667
E info@ncub.co.uk
W www.ncub.co.uk