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R&D TAX RELIEFS REVIEW – CONSULTATION ON A SINGLE SCHEME

Response by Association of Taxation Technicians

1 Introduction

- 1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the HM Treasury and HMRC consultation *R&D Tax Reliefs Review – Consultation on a single scheme* ('the Consultation') published on 13 January 2023¹.
- 1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.
- 1.3 Overall, we do not support the introduction of a single, merged R&D relief scheme. This proposal does not take into account the very real differences between the activities and needs of smaller and larger companies. Combining the two schemes is not a proportionate way to tackle abuse and fraud, and risks sending the message that the UK values the innovative contributions of smaller companies less than that of their larger peers.
- 1.4 We also strongly believe that the proposed commencement date for a new scheme of April 2024 is not feasible.
- 1.5 Finally, as set out in our comments² on the draft R&D guidance published on 20 December 2022, the pace of change in the R&D relief regime in recent and coming years is causing difficulties for businesses and their advisers. Consideration should be given to pausing the administrative reforms set out in that guidance, pending the outcome of this consultation.
- 1.6 We have responded to the specific questions posed by the Consultation in Sections 2 to 7 below.
- 1.7 We would be pleased to discuss any aspect of this submission further. Relevant contact details can be found in Section 8.

¹ <https://www.gov.uk/government/consultations/rd-tax-reliefs-review-consultation-on-a-single-scheme>

² <https://www.att.org.uk/technical/submissions/draft-guidance-research-and-development-rd-tax-reliefs>

2 Main features

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

- 2.1 As a starting point, we do not believe that current Small and Medium Enterprise (SME) and Research and Development Expenditure Credit (RDEC) schemes should be merged into a single scheme.
- 2.2 We support efforts to simplify the tax system, and acknowledge that a single combined scheme would represent a significant simplification of R&D relief. However, for the reasons set out below, we believe that the potential disadvantages of this proposal outweigh the benefits which would arise from such a simplification.
- 2.3 As set out in our response³ to the R&D Tax Reliefs review published on 30 November 2021, the current differences between the two schemes reflect the very different natures and needs of SMEs and larger companies. Put simply, SMEs are not just large companies run on a smaller scale, but operate in a completely different manner and therefore need different support.
- 2.4 The simple to understand enhanced deduction and repayable credit offered by the SME scheme is of real value to SMEs who, by contrast, would benefit less from an 'above the line' credit under an RDEC-like scheme.
- 2.5 We understand that one of the drivers behind combining the two schemes is the level of error and fraud seen within the SME scheme. We share the Government's concern over abuse of the R&D relief schemes and strongly support efforts to crack down on such abuse and improve compliance. However, we do not believe that merging the two schemes is an appropriate way to achieve this. Changes to how claims are calculated and administered are unlikely on their own to prevent those determined to push the boundaries or otherwise abuse the R&D relief schemes from doing so. Instead, they will simply change their approach accordingly.
- 2.6 In our view, efforts would be better targeted at directly cracking down on the minority of 'rogue agents' that aggressively target SMEs, rather than making changes which will affect genuine claimants. This could include introducing a route for concerned advisers to report suspicions regarding inappropriate claims, advice or promotional material, as well as educational campaigns to improve awareness amongst claimants and their agents. In addition, better guidance, improved transparency and more support from HMRC would help to not just tackle abuse and fraud, but also reduce the number of inadvertent errors made by claimants.
- 2.7 Finally, we are concerned that merging the two schemes could be perceived as a reduction in relief for SMEs (or making it harder for them to claim) whilst on the other hand increasing support for those larger companies who already have more funds to carry out R&D and arguably need the support less. This risks sending the message that the UK values start-ups and small companies, and the R&D they perform and jobs they create, less than it does large, established companies.

Question 2: Does the taxability and subsequent different post tax net benefits impact your decision making when allocating R&D budgets?

- 2.8 Our members report that taxability and different post tax net benefits only really have an impact on decision-making where companies are large enough to have an in-house tax function capable of modelling and understanding them.
- 2.9 By contrast, for most businesses, the headline rate of relief and its availability in the first place are likely to be more important drivers than the mechanism by which relief is calculated and applied.

³ <https://www.att.org.uk/sites/default/files/220208%20R%26D%20Tax%20Reliefs%20Report%20-%20ATT%20comments.pdf>

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

2.10 We have no comments on this question.

3 Detailed design - subcontracting

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

- 3.1 As a preliminary observation, treating subcontracting differently for certain claimants would reduce the simplicity arising from having a single scheme in the first place. It would also open up arguments as to whether there are other areas of the rules where treatment should diverge for different types or sizes of company. This could lead, at an extreme, to effectively having two separate schemes again in practice, thereby negating the potential to simplify R&D relief offered by a new, single scheme.
- 3.2 Our preference would therefore be for the same treatment to apply to all claimants. However, as set out below, we believe that further work is needed to consider the impact of following either the SME or RDEC rules before any decision is made in this area.

Question 5: 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?

- 3.3 Whichever approach is followed there will, inevitably, be some companies that benefit and others that lose out as a result.
- 3.4 For example, applying the RDEC approach would affect those newer SMEs who rely on subcontracting whilst building up their internal expertise. It seems harsh to deny tax relief in situations where a start-up has a genuine R&D project, but is unable to carry out all of the work itself due to it not yet having the required staff in place.
- 3.5 By contrast, if the SME approach were to be applied, this would benefit larger companies who subcontract work, but would reduce the relief available to any SMEs who themselves act as sub-contractors for those large companies.
- 3.6 Ultimately, this is a complex area, and one requiring careful consideration. The Government should consult further on the impacts on specific business sectors, including using existing claims data to model the effects of either approach.

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

3.7 We have addressed this question in our answer to question 5 above.

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.

3.8 We do not have any suggestions for an alternative model.

4 Detailed design – cap on payable credits

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

- 4.1 Overall, our members report that the PAYE/NICs cap appears to be effective against abuse, whilst having a limited impact on genuine claimants.
- 4.2 The impact of the cap does vary by sector, and we have heard concerns that the software industry in particular can face problems due to its use of overseas developers. However, we note that giving relief for such expenditure is counter to the Government's wider aim of rewarding UK R&D activity.

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

- 4.3 We have no specific suggestions for simplification.

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

- 4.4 Whilst the RDEC cap is simpler in nature, we believe that it is currently set at too low a level for SMEs.
- 4.5 Many SMEs have relatively low staff costs. For example, start-up businesses often have very few employees. More established companies may also have low PAYE / NIC bills if the majority of their work is undertaken by director / shareholders who draw only modest salary, or they use schemes such as the Enterprise Management Incentive (EMI) scheme to reward key employees.
- 4.6 We therefore believe that a simple cap, similar in design to that used in RDEC but set at a much higher level, should be considered. However, we appreciate that this may increase the overall cost of the scheme if it results in some RDEC claimants no longer having their claims restricted. This is a further illustration of the difficulties that can arise from the merger of two schemes with very different claimants.

Question 11: Should the Government change the way either cap is calculated if it is taken forwards?

- 4.7 We do not have any comments on this question.

5 Detailed design – additional support for specific companies***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?***

- 5.1 Whilst we can see an argument for providing more generous support for certain businesses, we believe that any such approach would be extremely difficult to implement in practice.
- 5.2 For example, how would 'R&D intensive' be defined for these purposes? Any strict definition would create boundary issues, whereas a wider definition or allowing businesses to self-assess whether they were research intensive or not would open opportunities for abuse.
- 5.3 As noted above in our comments on the treatment of subcontracting (see paragraphs 3.1 and 3.2), providing different treatment for certain claimants would partially negate the simplification of having a single scheme, as well as opening up arguments that other areas of the scheme should apply differently to different companies.

- 5.4 We are also concerned that providing enhanced relief for R&D carried out by certain types of companies could have a negative impact on perception of the relief. It could be seen as sending a message that R&D carried out by, for example, an engineering company is less valuable than that carried out by a more R&D centred business. Both activities are genuine R&D and have a role to play in driving innovation and job creation in the UK. Valuing one more than the other when it comes to tax relief could indicate that the Government views one as 'good' but the other as 'less good' R&D.

Question 13: If this were to be done, how might this best be achieved within an overall cost envelope?

- 5.5 For the reasons set out above, we do not believe that it is a good idea to introduce the additional complexity of varying levels of relief within a single scheme. This is especially the case if increasing tax relief for some reduces that available to others, something which would directly feed into the risk of sending the wrong message regarding 'good' and 'less good' R&D set out in paragraph 5.4 above.
- 5.6 If there is a desire to encourage R&D activity in specific sectors and industries, then in our view that is better addressed through targeted grant funding than the tax system.

6 Detailed design – guidance and transition

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?

- 6.1 We believe that April 2024 is not a realistic date to introduce any new merged scheme.
- 6.2 Such a timescale would not allow for proper consultation, or for the required systems and processes to be put in place by business, agents, software providers and HMRC. Given the fundamental nature of the changes proposed, and the impact they may have on R&D activity in the UK, the process should not be rushed, but instead the appropriate time taken to ensure that any new scheme is well designed and operates effectively for all parties.
- 6.3 Whilst we appreciate the open nature of the Consultation, which explores areas of concern rather than asking for comments on specific proposals, it has come too late in the day for implementation in 2024. There are several key policy issues which need to be worked through and, as set out in our response to question 15 below, a significant awareness and education campaign will be needed ahead of any new scheme being launched.
- 6.4 We are also concerned that HMRC systems and software would not be ready in the timescale proposed. We have seen issues in the past where commercial software and the HMRC Corporation Tax online service have not been able to cope with relatively minor changes to the CT600L, leading to companies having to delay filing returns, or file on paper. Given this, it is unclear how a change as fundamental as is now being proposed could be successfully handled in the time available.
- 6.5 It is also unclear how this timescale would allow for the relevant legislation to be passed in time for commencement in April 2024. The Consultation closes two days before the Spring Budget date of 15 March, and therefore we would not expect any announcement at that event. In the absence of an Autumn Budget in 2023, this would mean that legislation would not be laid until next Spring – only a matter of weeks before the proposed commencement date.

- 6.6 A number of changes to the R&D relief regimes are due to take effect for accounting periods beginning on or after 1 April 2023. Alongside these, the rate of relief available under the SME regime is set to drop from 1 April 2023. As set out in our comments⁴ on the draft R&D guidance published on 20 December 2022, this represents a large amount of change for businesses and advisers to adapt to within a short period of time, as well as creating an overall feeling of uncertainty. Businesses and advisers are concerned about making changes to their processes to accommodate the administrative changes set out in the Draft Guidance, when the whole R&D regime could be replaced in a little over a year. Further, if the new combined scheme were to come into effect from April 2024, there would not be sufficient time to assess whether these changes have actually had any impact on fraud and abuse. We therefore believe that consideration should be given to pausing the administrative reforms set to take effect from April 2023, pending the outcome of this consultation.
- 6.7 Finally, we note that although this question refers to accounting periods starting on or after 1 April 2024, the introduction to the Consultation refers to expenditure incurred after April 2024. We would strongly encourage commencement to be linked to accounting periods rather than the date of expenditure; otherwise, straddling periods would (presumably) require a claim to be made under two different schemes.

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

- 6.8 SMEs will need significant amounts of education, guidance and support ahead of any new scheme launching. In particular, they will need sufficient clarity over how the changes will affect their business, and a sufficiently long lead-time to allow them to factor any change in their anticipated level of support into their plans and budgets. This will simply not be possible if the Government intends to introduce the new scheme from April 2024.
- 6.9 Whilst we can see an argument for allowing grandfathering of contracts or projects, such that a claim can continue to be made under the old RDEC or SME scheme until completion, we believe this will introduce undue uncertainty and complexity. In addition, it will be difficult for HMRC to monitor compliance. We would therefore recommend that all contracts / projects come into the new regime from the start of the company's relevant accounting period.

7 Detailed design – other design features

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

- 7.1 Our members report that the ability to claim relief for qualifying indirect activities does not generally influence decision making by businesses. Instead, many simply view this as a 'nice to have' addition to their claim.
- 7.2 We agree with the statement in section 3.39 of the Consultation that this is an area lacking in clarity, and therefore prone to boundary pushing. In our view, removing the ability to claim relief for qualifying indirect activities would present a simplification of the R&D relief scheme and reduce the overall cost of relief to the Exchequer, whilst having minimal impact on R&D activity in the UK.

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

⁴ <https://www.att.org.uk/technical/submissions/draft-guidance-research-and-development-rd-tax-reliefs>

- 7.3 Overall, we would not support the introduction of a minimum threshold for claims. This would put another obstacle in the way of genuine claimants in the name of attacking fraud.
- 7.4 Introducing a threshold also risks sending the message to small companies and start-ups that their contribution to the UK economy is not as valued as that of larger companies.
- 7.5 We would be open to the idea of having a minimum threshold if, in return, HMRC were able to commit the additional resources freed up by it to supply a better service to claimant companies and their agents. However, we would not like to see a threshold introduced with no accompanying commitment to improve service levels.

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

- 7.6 This question is not relevant to the ATT.

8 Contact details

- 8.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson on 07773 087111 or erawson@att.org.uk.

The Association of Taxation Technicians

9 Note

- 9.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 9,500 members and Fellows together with over 5,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.