

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

The Institute of Financial Accountants welcomes the opportunity to comment on the [Consultation](#) published on 13 January 2023.

We would be happy to discuss any aspect of our response and to take part in any further consultations in this area.

Established in 1916, the Institute of Financial Accountants (IFA) is an internationally recognised professional accountancy membership body. Our members work within micro and small to medium-sized enterprises or in micro and small to medium-sized accounting practices advising micro and SME clients. We are part of the Institute of Public Accountants (IPA) of Australia Group, the world's largest SME-focused accountancy group, with more than 49,000 members and students in 100 countries.

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Questions raised in the Consultation

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

1. Although it is simpler to have one scheme where the impact on a business is consistent regardless of profit or loss levels, the move to a single scheme will be unlikely to accomplish HMRC's stated aim of significantly reducing fraud and error unless it is accompanied by improved engagement and compliance support from HMRC. The recent Lords paper on R&D reliefs identifies this specifically: "We consider that legislative reforms of this nature will not be effective in isolation and that improvements to HMRC's compliance capability are also required."¹
2. If unification of schemes is achieved by movement to the RDEC above-the-line credit, this will disproportionately penalise SMEs by reducing the overall generosity of the scheme for them, with the above-the-line element being of less relevance than the reduced generosity to most SMEs.
3. The IFA strongly recommends retaining the distinction between SMEs and larger businesses when it comes to the numbers around R&D relief claims. If an above-the-line credit is deemed to be the preferred option for unifying the scheme, we would recommend a distinct rate for qualifying SMEs to maintain the relative generosity of the current additional deduction available under the SME scheme.
4. An alternative to maintaining different rates of relief for SMEs would be to introduce temporary exemption for innovative startups: for example, in the French tax system companies with "innovative startup" status receive 100% corporate income tax exemption for the first year they report a profit, and 50% exemption for the second year they report a profit.

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

5. We are an accountancy professional body specialising in SMEs and SMPs. From the perspective of SMEs engaged in R&D, the relative generosity of the scheme is an incentive for SMEs to continue (or startup SMEs to begin) innovative R&D with attendant potential upside in terms of GDP growth. Decreased generosity in the form of reduced post-tax net benefits, which would be achieved for SMEs through a move into the RDEC credit approach to R&D relief, would reduce the incentive for SMEs to focus on R&D.
6. HMRC's study on the SME scheme concludes that "the scheme generates direct, indirect, and spillover effects benefitting not only businesses that claim under the R&D tax relief scheme for SMEs but the economy as a whole."² Incoming cuts to the SME scheme will reduce incentives for SMEs to invest in R&D: any further reduction to SME-focused R&D relief will exacerbate this.

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

7. N/A

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

8. Yes.

¹ House of Lords Economic Affairs Committee, "Research and development tax relief and expenditure credit", 31 January 2023, p. 3.

² HM Revenue and Customs Research Report 598, "Evaluation of the Research and Development Tax Relief for Small and Medium-sized Enterprises", September 2019, p. 53.

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?

9. The IFA strongly suggests that the SME scheme approach to claiming for subcontractor costs should be utilised in a potential unified scheme. This allows the company commissioning and utilising the R&D, and bearing the cost and financial risk, to be sole claimant for R&D relief. The subcontractor in such an arrangement should not be able to claim relief at the expense of the commissioning company.
10. The IFA would also encourage a review of the current allowance under the SME scheme for claiming 65% of eligible subcontractor costs (assuming the two companies are not connected). If both subcontracting company and subcontractor are in the UK, and all other conditions of eligibility for relief are met, allowing a greater proportion of subcontractor costs to be paid could encourage innovative domestic start-ups.

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

11. There will be a negative impact on SMEs if either the RDEC above-the-line credit approach is generalised for R&D relief claims, or if the RDEC approach to claiming for subcontracted R&D is generalised.
12. The negative impact on SMEs for the above-the-line credit is covered in the answer to question 2 (paragraph 5).
13. The negative impact on SMEs if the RDEC approach to subcontractor claims was generalised would arise from the fact that SMEs are less likely to have full in-house R&D capacity, and are therefore disproportionately likely to subcontract R&D compared to larger businesses. Disabling them from claiming for subcontracted R&D would further disincentivise SME R&D, unless they were able to agree for tax savings realised by subcontractors to be passed on or shared (something a large business has more power to insist upon as a term in any subcontracting agreement).

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

14. N/A

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

15. The current SME scheme PAYE cap could be described as the proverbial "sledgehammer to crack a nut", with startup SME claimants disproportionately disadvantaged in the name of tackling fraud and abuse.
16. As mentioned under question 6 (paragraph 12), SMEs engaged in R&D might have relatively low staff costs compared to their R&D costs, by virtue of utilising subcontractors, and therefore face losing out.
17. The intellectual property (IP) exemption is niche, qualitative and difficult to substantiate.
18. The IFA questions whether the compliance benefits of the PAYE cap outweigh the cost to a subset of SME claimants.

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

19. In general, simplification should reduce the scope for potential abuse. The IFA would suggest that the class of abuse identified as being perpetrated via R&D relief schemes could be better tackled under the rules for overseas intermediaries, without unfairly and disproportionately disadvantaging some potential SME claimants.

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

20. Neither (see question 9, paragraph 18).

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

21. If taken forward, the calculation should be amended to take subcontracted R&D into account in some workable fashion, so that SMEs with few staff on payroll are not unduly disincentivised from commissioning and funding innovative R&D via subcontracting.

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?

22. Offering more generous support for specific types of R&D would increase the administrative cost of the scheme, and would increase ambiguity and opportunities for exploitation by unscrupulous parties. There is a high risk to identifying and offering more generous support for specific types of R&D for these reasons.

23. There are ways to incentivise investment in specific areas which are relatively unambiguous and quantitative; but whether they come under the scope of a unified R&D relief scheme is another question. The 130% super-deduction capital allowance on plant and machinery investments is an example of this, which could be adapted to encourage investment in specific types of R&D.

24. R&D-intensive companies could be more objectively identified and targeted for additional support, and this would be consistent with inviting the GDP growth and associated benefits innovative research brings.

25. Quantitative metrics for identifying R&D-intensive companies would include receipt of grant funding and being in a pre-trade position.

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

26. Supporting specific R&D or R&D-intensive companies cannot be at the detriment of other claimants, and should not be at the cost of reducing the overall generosity of the scheme (particularly so for SMEs, given the most recent reduction to the SME scheme generosity and the potential further reduction that would come should the SME scheme be collapsed into the RDEC one).

27. Something similar to the temporary corporation tax exemption referenced under question 1 (paragraph 4) could offer a way to incentivise innovative R&D startups without cutting away from the R&D relief scheme directly.

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?

28. The consultation paper is inconsistent on this point: 1.36 refers to expenditure from 1 April 2024, while 3.36 refers to accounting periods beginning on or after 1 April 2024.

29. The IFA recommends that April 2024 is too soon for implementing any potential merged scheme: with an increase in R&D claim compliance checks, Autumn Budget changes to the SME and RDEC schemes coming into effect from April 2023, and tax year 23/24 being a transitional year for basis period reforms, April 2024 represents an unnecessarily challenging deadline for SME and SMP accountants to comply and communicate the impact of further changes to their clients.

30. April 2025 for tax year 25/26 would be more reasonable, giving 2 years instead of 1 for the Autumn Budget changes to the R&D relief schemes to be implemented, and giving HMRC more time to develop their messaging and support offer to industry and agents to help improve compliance.

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

31. There has been historically low oversight and enforcement in the R&D relief claim space, accompanied by little training and support on offer from HMRC to industry and agents. Oversight and enforcement are now being scaled up with an increase in checks and challenges, but this does not at present seem to be matched by any increase in support on offer.
32. In addition to increasing enforcement and compliance capacity, HMRC should develop an education programme for claimants and be prepared to offer support as well as challenge.
33. HMRC should also engage accountancy professional bodies (and other relevant professional bodies) to improve awareness, skills and professional standards, as part of an enhanced communications strategy.
34. A transitional period of at least 1 year would enable SME and SMP agents to adapt their processes and communicate the changes (and their impact) to their clients.

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

35. Qualifying indirect activities (QIA) are essential to R&D work, as they are to most operational work in most businesses.
36. The ability to claim for QIA expenditure is unlikely to provide the sole motivation for any of our members' clients to undertake R&D, as QIA will typically be a small proportion of the total R&D-associated cost. However, disallowing QIA from R&D relief claims might discourage some SMEs and startups from beginning or continuing R&D, by increasing their financial risk exposure.

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

37. The SME R&D we are keen to safeguard in our response to this consultation will typically make up the majority, if not the entirety, of a given SME or startup's total expenditure. Very small claims are also disproportionately costly in terms of administrative burden.
38. There are however several risks to implementing a threshold, perhaps particularly from the point of view of SMEs and their agents.
39. Deserving claimants who would perform innovative and beneficial R&D could miss out: if SMEs do end up disproportionately disadvantaged, what complementary scheme or schemes (such as accessible grant funding) will provide necessary balance?
40. Small-scale startups doing exploratory and/or experimental R&D may be disproportionately disadvantaged.
41. A threshold does not necessarily reduce exposure to fraud risk, as companies whose R&D expenditure is close to the threshold will be incentivised to find ways to increase their claims past the threshold. In turn, this may unfairly disadvantage companies submitting claims close to the threshold by increasing their likelihood of facing a compliance check.
42. One alternative to a minimum expenditure threshold for qualification could be a percentage-based proportion of total costs. This could be implemented alongside a minimum value threshold (e.g. £25,000 or 25% of total costs).

Contact details

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