Research and Development Tax credits: response and further consultation

Institute of Physics submission to a Treasury consultation

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5 September 2011
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Mike Crabtree  
CT Reform  
Corporate Tax Team  
HM Treasury  
1 Horse Guards Rd  
London  
SW1A 2HQ

Dear Mr Crabtree,

Research and Development tax credits: response and further consultation

The Institute of Physics is a leading scientific society promoting physics and bringing physicists together for the benefit of all. It has a worldwide membership of around 40 000 comprising physicists from all sectors, as well as those with an interest in physics. It works to advance physics research, application and education; and engages with policy makers and the public to develop awareness and understanding of physics. Its publishing company, IOP Publishing, is a world leader in professional scientific communications.

This submission was prepared in consultation with the Institute’s Business and Innovation Board, with input from small and large businesses that depend on physics.

The Institute welcomes the opportunity to respond to the Treasury consultation on Research and Development Tax credits. Detailed comments are provided in the attached annex.

If you need any further information on the points raised, please do not hesitate to contact us.

Yours sincerely,

Dr Norman Apsley FREng CEng FInstP  
Vice-president, Business and Innovation

John Brindley  
Director, Membership and Business
Research and Development Tax credits: response and further consultation

Q1. What difference, if any, to levels of R&D investment in the UK would a move from the current superdetection to an ‘above the line’ credit against tax make, if the level of benefit to the company, in terms of reduced cost of R&D, remained broadly the same?

Within larger companies, the disconnect between the choices and rationale for undertaking research and development, and the areas which benefit from the tax credit, means that there can be a clear disconnect between the R&D tax credit and the process which leads to research and development; the credit is seen as an accounting perk rather than an incentive to pursue R&D.

As such, it is clear that, in certain companies, there would be a benefit in making the change for the tax credits, targeting the incentive at those who make the decisions. An ‘above the line’ credit would be claimed by management functions and consequently could act as an incentive for them to undertake more R&D in the UK. This should be caveat by the fact that this would be a significant change to the current arrangements that would need to be carefully managed and evidenced.

It is not clear that there would be a similar positive impact in smaller companies where R&D is seen as a fully-integrated aspect of the business.

Q2. What tax treatment would allow loss-making companies to account for the credit above the line?

This could be seen to be particularly relevant to early-stage science-based businesses with establishing long-timeframes from product development to sales and ultimately profit. There should be a means for loss-making companies to claim R&D tax credits (whilst retaining the current rules on ‘going concerns’, especially in their early years in product development phase).

Any treatment could take account of either PAYE, or VAT but neither would be ideal.

Given the potential complexity of offsetting the tax credit against other taxes apart from CT, would loss-makers need the credit to be payable if there was insufficient CT cover?

Yes.

Q3. If a payable credit was introduced for loss-making companies, should the benefit be less than that available to profitable companies, to recognise the value to the loss-makers of being able to utilise the credit immediately?

While rewarding success is ultimately the aim of the programme, inflicting an indirect penalty on those on the way to success doesn’t seem sensible.

Q4. Are there additional issues around added complexity to the schemes that should be considered?
Again, while the change would be beneficial, it would be a significant change to the reporting structure, and there should be on-going monitoring of this -- reducing the administrative burden on smaller companies in particular should remain a goal.

Q5. The majority of respondents in favour of the change were large companies. What separate compliance and complexity issues would arise if the SME scheme also moved to an ‘above the line’ credit system?

Clearly the disconnect between those responsible for the tax performance, and those making managerial decisions on research and development is not as stark in smaller companies. However, that is not to say that there won’t be other unexpected impacts on smaller companies. In any change to the system, there would need to be a focus on not increasing any complexity or burden unduly.

Q6. Should the relief for Qualifying Indirect Activities be retained? Does it provide significant benefit to companies currently claiming QIA costs?

Yes. It seems counter productive to split relevant indirect costs from direct costs when considering the nature of investment in research and development. The issues raised in the previous stage of the consultation were related to the process involved in claiming on the indirect costs and this would be an area that would benefit from a review.

Q7. Would either the certification process or joint election process (or an alternative process) be effective in delivering the intended certainty for both contractor and subcontractor to allow the subcontractor to claim the large company credit?

No comment.

Q8. Are there any particular safeguards that companies think would be effective but not add significantly to compliance burdens to ensure the removal of the PAYE/NICs cap on the payable credit is not abused?

The proposed removal of the PAYE cap, which had a significant impact on some small and early-stage physics-based businesses, is a welcome development. However there may be a need for an anti-avoidance provision to remove the temptation or companies to ‘manufacture’ R&D expenditure to claim credits.

Such a process should involve assessors with specialist knowledge of the sectors involved, such as physics-based businesses.

Q9. Would companies welcome reform of the ‘going concern’ definition so that it more closely matched that used for the EIS/VCT schemes?

No comment.

Q10. The Government would welcome comments or evidence to support the assessment of the impacts of the changes under consultation

Within larger companies, typically tax is dealt with separately from management decisions surrounding R&D, the current arrangements can mean that R&D tax credits benefit the company as a whole but not the R&D department. Moving them to an ‘above the line’ credit, divorced from the tax system, would mean that R&D departments took over responsibility for
claiming them – this would mean that the incentive would be properly targeted within companies while not affecting the overall package of government commitment to R&D as seen from the outside.

However, with smaller businesses such a division is less likely to exist, with research and development treated as the core of the business, integrated into training and other aspects, rather than as a separate department. It is not clear that the current proposals fully take account of the different perspectives and positions of both small and large companies. Nor is there clarity in how a change to an ‘above the line’ scheme would relate to the current corporation tax relief available to loss-making companies.

An issue not addressed and perhaps related more to practice than structure is the perception from some physics-based businesses applying to the scheme that the assessors often have limited specialist knowledge of the processes that are involved in such organisations. If the scheme is to fulfil its potential as a driver of R&D in physics-based companies, it is essential that these companies have confidence in the scheme and those who operate it. We recommend that the training programmes of assessors be reviewed. This is an area that could perhaps benefit from greater interaction with the network of government Chief Scientific Advisers.
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IOP Institute of Physics
76 Portland Place
London W1B 1NT

Tel: +44 (0) 20 7470 4800
Fax: +44 (0) 20 7470 4848
Email: physics@iop.org
Website: www.iop.org
Registered Charity No. 293851