

IOP Institute of Physics

IOP response to HM Treasury's R&D Tax Reliefs: consultation summary

At Budget 2021 the government announced a review of R&D tax reliefs, informed by a consultation with stakeholders. Building on the 2020 consultation, which looked at bringing data and cloud computing costs into the scope of the reliefs (see [IOP response](#)),¹ this consultation explored the nature of private-sector R&D investment in the UK, how it is supported or otherwise influenced by the R&D relief schemes, and where changes may be appropriate.

This is an important issue for the IOP and its members: the reformed reliefs will be part of activities designed to reach the 2.4% target. R&D tax reliefs have a key role in incentivising investment in R&D by reducing the costs of innovation. It is therefore essential to ensure that the reliefs are effective and easy to use for physics-based R&D. The IOP has responded to this consultation, presenting the views of IOP business and innovation group (BIG) members; this document summarises the response.

Executive summary

STEM organisations that carry out R&D benefit from R&D tax breaks in many ways. The support facilitates their STEM R&D activities, enabling these to continue, and promotes the re-investment of costs into continued and further innovation activities. However, reforms to the system are essential to ensure that the reliefs are effective and easy to use for physics-based R&D companies.

Consolidating the RDEC and the SME schemes

Consulted IOP members support a move to consolidate the schemes into a streamlined and simplified system, which should be available to all those carrying out R&D and reflect the full scope of modern innovation activities. If the schemes are combined, it is important that the new scheme maintains the benefits each currently affords, and no organisation completing R&D becomes ineligible.

Improving the schemes

IOP members recommend a number of improvements to the schemes:

- Simplifying the language to reduce reliance on agents

Many find the system difficult to navigate, and others find it hard to engage with due to the use of patents phraseology, which can be inaccessible. This is particularly the case for SMEs, which are less likely to employ specialists in tax, law or accounting. The complexity leads to many seeking specialist agencies to complete the claim on their behalf through either a pay-for service or a no-win-no-fee basis.

¹ IOP Consultation Response (2020) <https://www.iop.org/sites/default/files/2020-10/RD-Tax-Credits-qualifying-expenditures-consultation-IOP-response.pdf>

Agents help R&D companies complete claims successfully, however, there is consensus that the system would be improved if it were simplified, as this will enable companies to make their claims directly, and therefore ensure they receive the full sum of the reliefs, without paying a service fee to agents.

If a claim is successful, agencies can take up to 30% of the awarded relief. Moreover, they cost companies significant time, as staff are required to run through projects with consultants to identify what activities are eligible. Because of the time costs already placed on companies, often the same amount of time is directed to the claims process within the company whether agents are used or not.

- Clarifying and increasing the scope

There should be a simple definition of what does, and what does not, fall within the scope of the reliefs. For example, organisations who complete R&D require greater guidance on the definitions of which activities are classified as research, and which are development. There must also be guidance on which technology readiness levels (TRLs) these activities correspond to, so organisations can accurately classify their activities. This will provide much needed certainty: currently, in the STEM community questions remain over the eligibility of some activities, such as software development, late-stage product development and manufacturing. Increasing the scope to include these activities will leverage greater investment in R&D, boosting the return to the Exchequer in the coming years as companies yield greater success rates from their innovation activities, resulting in economic benefits and direct return through tax.

- Upskilling and retraining staff

Retraining or upskilling staff costs should be included in R&D tax claims, where the training is directly contributing to the R&D according to paragraph 31 of the BEIS R&D guidelines. This would ensure that businesses which grow in, or move to, areas which are targeted in the [Levelling Up Fund](#)² will employ locally and the economic benefits will be funnelled directly into the region.

Support for training staff may be needed in greater levels in regions which have historically been under-resourced, or which are not yet completing high levels of R&D. In order to develop and retain the skills the STEM sector needs in levelling up target regions, thought should be given to how the costs of upskilling is met by business, employers and government. This is an issue which will require larger incentivisation: there could, for example, be further support through instruments such as the apprenticeship levy.

- Improving the cohesiveness of the ecosystem

The reforms of the tax credit system must be designed to increase investment into R&D, as part of the strive towards achieving the investment of 2.4% of GDP into research and development. However, the review should go beyond this to ensure that spending at this level converts to impact and economic gain, in order to ensure public money is invested in areas which create economic returns and social benefit, such as on innovation in STEM sectors.

The reliefs are just one of a suite of R&D incentives, and they should not be considered in isolation. Reviewing the system as a whole would allow inefficiencies to be mapped. Consideration should also be

² <https://www.gov.uk/government/publications/levelling-up-fund-prospectus>

given to how different groups use the reliefs, beyond SMEs and larger industry, also considering academic innovation activities, and how these exist with the other grants and supports, such as those available from Innovate UK, UKRI and the Catapults. This will reduce deadweight investment from the Treasury, as collaborations and grants can be factored into the ecosystem. No single solution will work alone.

- Addressing the cashflow difficulties

An issue facing many organisations working in R&D, particularly start-ups and SMEs, is cashflow. Many businesses simply do not have the cash up-front to invest in projects, given that the whole cycle, from work carried out, to claiming, to receipt of funds, can take up to two years. It is further costly to claim, or to complete audits, which increases the upfront expenses. After these costs, businesses face uncertainty over any refund as there is no guarantee a claim will be accepted, nor of success in the following year, which is particularly harmful for long-term investment in STEM areas such as deep technology, which have long development timeframes.

Members report waiting up to 14 months for relief, which is an unsustainable timeline for SMEs who front the cost with little cash or capital, or who are pre-profit, and means they are more likely to accept relief which is not the full value they may have otherwise received. Long timelines are red tape to organisations, pushing some towards using agencies and in-turn reducing the total sum of relief they receive. Reducing bureaucracy will remove this barrier.

If businesses were able to claim back money during the life of a project, it would make a significant difference to their ability to deliver products to market, benefitting the Exchequer through the long-term increase in profit tax. Such mechanisms exist for the VAT and PAYE schemes.

- Allowing R&D reliefs for capital expenditure

R&D tax is a revenue expenditure scheme. While there are allowances for R&D in the capital expenditure scheme, it's not useful for most R&D businesses. It offers the same benefits as the annual investments allowance which is not significant. Section 13/08 of the Corporation Tax Act 2010 allows claims for intangible assets under R&D where they are revenue in nature. However, the guidance on this in the Business Income Manual is vastly out of date, citing the Millennium Bug as an example. There should not be a differentiation between revenue expenditure and capital expenditure as the organisation is developing IP and gaining value from it. It should not be a revenue argument, but a capital and revenue argument.

Supporting the levelling up agenda

Moving across national borders allows companies to break even or move into profit more quickly, due to variable writing down allowances (WDAs). This could be used to deliver and enhance the levelling up agenda, by encouraging local businesses to invest in R&D, and attracting others to move there to do business. Regional R&D assistance programmes could be rolled out in the regions, and emphasis should be placed on growing local business.

To maintain a thriving R&D landscape across the UK's regions, there must be the necessary infrastructure in place to ensure these benefits are driven back into the local economy. This can be an

important element for achieving the levelling up agenda. A full package of support is needed in the areas targeted by the [Levelling Up Fund](#)³, including:

- Adding training costs in the relief packages, to ensure the necessary skills are available and created locally.
- Ensuring any supporting infrastructure is in place to complete R&D, including a talent pipeline through the education system.
- Ensuring the system is timely and simple, so that these organisations receive the full benefits of reliefs without having to use specialist tax agencies.

International competitiveness

IOP members have experience of completing R&D both in the UK and Ireland and further abroad, and have colleagues and peers who have also experience in this. The primary concern is that the UK must remain an attractive and compelling nation in which to undertake R&D, to attract overseas investment and ensure UK-based organisations complete their activities domestically. This will be key to achieving the government's ambition of 2.4% investment in R&D.

The review must look at the UK on the global stage, comparing the system to that of other nations, to ensure it is attractive. In order to be attractive, it requires simple processes, and the time it takes to both complete the claim and receive the cash should be short. Without this, the UK risks losing out to other nations with simpler and quicker systems, where R&D is cheaper to undertake. This would limit the UK's ability to achieve the 2.4% target, and stall its competitiveness on the global innovation stage.

More information

Contact: Danni Croucher, Senior Policy Adviser danni.croucher@iop.org

Contact us for the response in full.

See our policy work in this area: <https://www.iop.org/policy/policy-statements-and-consultation-responses>

³ <https://www.gov.uk/government/publications/levelling-up-fund-prospectus>