HM Treasury

HM Revenue & Customs

R&D Tax Reliefs Review

Consultation on a single scheme

January 2023

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ISBN: 978-1-915596-52-9

PU: 3271

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Foreword

The Government recognises the important role that research and development (R&D) plays in driving innovation and economic growth as well as the benefits it can bring for society. Even in extremely challenging fiscal circumstances the Government remains committed to supporting R&D, increasing public spending in R&D to a record £20 billion a year by 2024-25, a cash increase of around a third compared to 2021-22, and the largest ever over a Spending Review period.

At Autumn Statement the Chancellor announced that, as part of the ongoing R&D tax reliefs review, the Government would reform the R&D tax reliefs to ensure taxpayers' money is spent as effectively as possible to support innovation, improve the competitiveness of the R&D expenditure credit (RDEC) scheme, and to take a step towards a simplified, single relief based on the RDEC scheme. This is the focus of this consultation.

Government support for R&D through the tax reliefs will continue to increase, from £6.7 billion in 2020-21 to over £9 billion in 2027-28 - but in a way that ensures better value for the taxpayer. The R&D reliefs will support an estimated £60 billion of business R&D expenditure in 2027-28, a 60% increase from £38 billion in 2020-21.

The Government is committed to supporting SME R&D. We want to help unlock the potential of our SMEs. Over the Spending Review period, £2.6 billion has been allocated to Innovate UK to support business-led innovation in the UK by connecting companies to the capital, skills and connections needed to innovate and grow. From 2021-22 to 2024-25, this represents a 54% cash increase in Innovate UK's budgets. Additionally, Government is working with industry to understand whether further support is necessary for R&D intensive SMEs, without significant change to the overall cost for supporting R&D.

This consultation invites views on the design of a potential single R&D tax relief scheme. The Government would especially welcome views from businesses, representative bodies and accountants informed by experience with the existing R&D schemes.

Overall, the Government would like a system for supporting R&D which drives innovation and growth, is simple to use and administer and underpinned by the effective application of taxpayers' money.

I thank you in advance for your engagement.

Victoria Atkins

Victoria Atkins MP

Financial Secretary to the Treasury

Chapter 1
Introduction

Objectives of the R&D tax reliefs

1.1 The government is committed to sustained economic growth. Growth funds high quality public services, raises living standards and keeps down government debt. To create the confidence and stability needed to achieve stronger growth, the government took decisive action at the Autumn Statement 2022 to ensure sustainable public finances.

1.2 The UK has fundamental strengths that support growth. It has flexibly regulated labour and product markets, independent and respected institutions, it is a world-leading financial centre, and the UK hosts many innovative businesses and globally recognised universities.

1.3 However, the UK's productivity growth has slowed since the Global Financial Crisis and lags behind comparable economies. There are further economic headwinds which pose risks to UK prosperity. The effects of the COVID-19 pandemic and the war in Ukraine have also pushed up the price of energy and other commodities, and exacerbated supply chain issues across developed economies.

1.4 Over the last fifty years, innovation broadly defined as multifactor productivity drove around half of the UK's productivity growth. But the rate of increase has slowed considerably since the financial crisis, and more so than in other countries. This difference in multi factor productivity explains almost all our productivity gap with the United States.

1.5 Science and innovation are some of the UK's greatest strengths. With less than 1% of the world's population, the UK hosts 3 of the world's 10 best universities, has produced up to 13% of the world's most impactful research and has the second highest number of Nobel Laureates of any nation. The UK also ranks fourth in the Global Innovation Index. These remarkable achievements in R&D and innovation generate significant economic and social benefits for the whole of the UK and beyond.

1.6 Analysis from the OECD shows a link between overall R&D levels and productivity levels across global economies.[1] With R&D providing spillover benefits to firms technologically linked or geographically

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[1] R&D and productivity growth: Panel data analysis of 16 OECD countries., OECD, 2001

The impact of R&D investment on economic performance, OECD, 2015 nearby. The ratio of the social return to the private return from R&D has been found to be about four to one.[2]

1.7 Government spending on R&D plays a crucial role in stimulating private sector investment. Public spending on R&D will increase to £20 billion a year by 2024-25, a cash increase of around a third compared to 2021-22. This is the largest increase in R&D spend ever over a Spending Review period with 74% of Innovate UK funding going to SMEs.

1.8 While the government has an important role to play in supporting science and innovation, public investment cannot on its own be expected to drive productivity growth and make the UK the most innovative economy in the world. Private enterprises will create the technologies, products and services which reshape lives and livelihoods, and government is acting to create the conditions for private sector innovation to flourish.

1.9 To drive productivity growth, ultimately businesses will need to invest more in R&D and the UK's R&D tax reliefs have an important role to play in doing this in a fiscally sustainable way for the taxpayer. The objective of the R&D reliefs is to increase the overall levels of R&D in the UK economy to generate productivity growth by reducing the cost of investing in R&D. Analysis has shown that R&D tax reliefs can have positive impacts on spillovers both on regionally connected firms and technologically linked firms which increases total factor productivity growth.[3]

1.10 However, the UK has one of the most generous R&D tax relief systems in the world, spending, as a percentage of GDP, more than any other country in the OECD. Since 2007 spend has increased from 0.05% to 0.34% of GDP in 2019. Despite this, the level of investment in R&D by UK businesses has lagged other countries, even when considering recent revisions in ONS data.

1.11 Additionality in the SME scheme is lower than the RDEC, incentivising as little as 60p to £1.28 of additional R&D for each £1 spent, compared to as much as £2.40 to £2.70 additional R&D per £1 of RDEC. At the same time, the SME scheme costs more than RDEC and has grown at a faster rate than RDEC.

1.12 In the HMRC annual report and accounts: 2021 to 2022 the estimated the level of error and fraud within Corporation Tax R&D reliefs was £469 million or 4.9% of related expenditure in 2021-22. This comprises £430 million (7.3%) in the SME scheme and £39 million (1.1%) in the RDEC scheme.

1.13 The estimate is based on outcomes of compliance cases completed in 2020-21 and 2021-22 and assumptions on error and fraud within unreviewed cases. The rate is higher than the 2020 to 2021

[2] Have R&D Spillovers Declined in the 21st Century?, Lucking, Bloom, Van Reenen, 2020

[3] Do Tax Incentives for Research Increase Firm Innovation? An RD Design for R&D, Patents and Spillovers, Dechezleprêtre, Einiö, Martin, Nguyen, Van Reenen, revised 2022

estimate and reflects improvements in HMRC's risk identification process to better identify non-compliant cases.

1.14 The Government wants to ensure that the UK remains a competitive location for cutting edge research, that the R&D tax reliefs continue to be fit for purpose, boosting investment innovation, and working well for businesses whilst taxpayer money is effectively targeted.

1.15 The UK is unusual internationally in having two different R&D tax relief schemes, the SME scheme and RDEC. The SME scheme in particular is also unusual in providing a deduction for profit makers, as opposed to a credit. While the definition of an SME covers firms significantly larger than in other countries as its thresholds for company size, turnover and balance sheets are twice those of the UK and EU standard definition.

1.16 Following the changes at Autumn Statement the generosities of the two R&D tax schemes are broadly aligned. There is now scope to simplify the R&D tax system and merge schemes into one scheme modelled on the RDEC scheme.

The R&D tax reliefs review

1.17 At Spring Budget 2021 the Government launched a review of the two R&D tax relief schemes - the Research and Development Expenditure Credit (RDEC) and the small and medium enterprises (SME) R&D relief.

1.18 The objectives of the review were to ensure that the UK remains a competitive location for cutting edge research, that the reliefs continue to be fit for purpose and that taxpayer money is effectively targeted.

1.19 Alongside this, the Government published a consultation, which ran from 3 March 2021 to 2 June 2021. The consultation explored the nature of private-sector R&D investment in the UK, how that is supported or otherwise impacted by the R&D relief schemes, and where changes may be appropriate. It looked at:

- definitions, eligibility and scope of the reliefs, to ensure they are up-to date and competitive, and that they reflect how R&D activity is conducted now
- how well the reliefs are operating for businesses and HMRC, and whether this could be improved
- targeting of the reliefs, to ensure that for every pound of taxpayer support, the value of the beneficial R&D activity for the UK economy is maximised.

At Autumn Budget 2021, the Government announced reforms to R&D tax reliefs, to:

- support modern research methods by expanding qualifying expenditure to include data and cloud computing costs
- more effectively capture the benefits of R&D funded by the reliefs through refocusing support towards innovation in the UK
- target abuse and improve compliance.

1.20 Additionally, the Government at Spring Statement 2022, confirmed the following:

- From April 2023 all cloud computing costs associated with R&D, including storage, would qualify for relief
- That there are some cases where it is necessary for the R&D to take place overseas. Therefore, there would be legislation so that expenditure on overseas R&D activities could still qualify where there are:
  - material factors such as geography, environment, population or other conditions that are not present in the UK and are required for the research – for example, deep ocean research,
  - regulatory or other legal requirements that activities must take place outside of the UK – for example, clinical trials.
- Additionally, to support the growing volume of R&D underpinned by mathematical advances, the definition of R&D for tax reliefs would be expanded by clarifying that pure mathematics is a qualifying cost.

1.21 The Government is taking steps to tackle error and fraud, including increasing compliance resource and activity as set out in the Spring Statement 2022.[4] The specialist R&D team focused on SME compliance has more than doubled in size in recent years in response to the growing levels of error and fraud.

1.22 Specific measures to improve compliance within the R&D tax reliefs report were published as part of the Tax administration and maintenance: Autumn 2021 command paper.

1.23 The measures will be implemented from April 2023, HMRC will monitor the effectiveness of the new compliance measures.

1.24 Each measure is designed to contribute to reducing error and fraud as part of a package:[5]

- Requiring all claims to be made digitally will ensure that HMRC has information available, in digital form, to enable easier risk assessment of claims

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[4] Paragraphs 3.15 & 4.58, Spring Statement 2022, HM Treasury, March 2022

[5] Letter from Victoria Atkins MP, Financial Secretary to the Treasury to Lord Leigh of Hurley, Chair of the Economic Affairs Finance Bill Sub-Committee, November 2022

- The requirement that each claim should be accompanied by additional information will mean that HMRC has information about the claimed R&D and a breakdown of the types of expenditure, helping risk assessment
- Requiring each claim to be supported by a named officer of the company will address claims being submitted by agents without the company's knowledge or understanding
- Requiring details of any agent associated with the claim will allow HMRC to spot the involvement of agents with a track record of facilitating spurious claims
- The new claim notification requirement will limit the ability of agents who facilitate spurious claims to do so for earlier years where a company has correctly not previously claimed the relief. It will also provide information and time for HMRC to reach out, on an educational basis, to companies in sectors that we would not expect R&D to be taking place.

1.25 HMRC has agreed to provide a more accurate estimate of the error and fraud to the Public Accounts Committee by summer 2023. This will be alongside a clear action plan to reduce error and fraud. HMRC is therefore currently conducting a mandatory random enquiry programme to build a better understanding of error and fraud. The new estimate will be accompanied by a clear action plan to reduce error and fraud

1.26 Draft legislation was published in July 2022 and following a period of consultation draft guidance was published in December 2022. The Government has invited views on this legislation and guidance separately to this consultation.

Autumn Statement 2022

1.27 At the Autumn Statement the Chancellor announced that from 1 April 2023 the research and development expenditure credit (RDEC) rate will increase to 20% from 13%, the small and medium enterprise (SME) deduction rate will reduce to 86% from 130%, and the credit rate will decrease to 10% from 14.5%.

1.28 Following the changes at Autumn Statement the generosities of the two R&D tax schemes are broadly aligned and there is now scope to simplify the system and merge schemes. This consultation invites views from stakeholders on how that scheme should be designed.

1.29 The Chancellor also set out at the Autumn Statement that the Government will, ahead of Spring Budget on 15 March 2023, work with industry to understand whether and how to provide further support for R&D intensive SMEs, without significant change to the overall cost envelope for supporting R&D.

1.30 The government recognises the reform to the rates creates challenges for some R&D intensive SMEs and those in the life sciences sector inre3453 particular. The Government believes there is merit to the case for further support. Any further changes will be announced in the usual way, at a future fiscal event.

Merging R&D schemes

1.31 Within the R&D reliefs consultation 2021, the Government consulted on the balance of generosity between the two schemes and whether to merge them.[6]

1.32 In the consultation views differed on whether one scheme was more complex than the other and on whether to combine the schemes. Those in favour of unifying the two schemes gave several possible advantages:

- the UK is unusual in having two R&D tax relief schemes and unifying would help with overall tax simplification
- it would make the credit more visible for decision-makers if all companies received relief as an "above-the-line credit" (as is the case for RDEC)
- other respondents also pointed towards the fact that SMEs that make small profits cannot currently benefit from carried-forward losses from previous years – which could be helped by them getting an above-the-line credit.

1.33 Those that were against unifying were often concerned that this would involve equalisation of the rates of relief. Other respondents felt that the disruption that would be caused by unifying the two schemes would not be worth the effort.

Aim of the consultation

1.34 This consultation document sets out proposals on how a single scheme could be designed and implemented. It reflects responses received to the consultation launched at Budget 2021, which asked about the case for consolidating the two schemes into one. The Government is interested in feedback from a wide range of sources including individuals, companies, representative and professional bodies.

1.35 The Government especially invites comments from research and development intensive businesses and those representing them. For SMEs the new credit is intended to be simpler to administer and use with the above the line credit helping R&D tax reliefs play a more central role in business decision making. The views of those involved in this process will be important in helping shape the final proposal. The Government also particularly welcomes views on the operation of the existing RDEC scheme.

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[6] R&D Tax Reliefs: Consultation, HM Treasury & HMRC, 2021

Consultation process

1.36 Once the Government has decided whether or not to merge schemes and the potential design of the single scheme, a final rate will be decided within the cost envelope of the R&D reliefs and announced at a future fiscal event. This will not be consulted on. It is currently the Government's intention that, if implemented, the new scheme will be in place for expenditure incurred from 1 April 2024.

Chapter 2
Main features

Background

2.1 The small and medium enterprise (SME) scheme was introduced in 2000 followed in 2002 by a scheme for large companies. 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 transition period from April 2013 so that from 2016 all large companies claimed the new Research and Development (R&D) expenditure credit (RDEC).

2.2 The RDEC is calculated as a percentage of a company's qualifying R&D expenditure and is taxable as trading income. It is open to those who are not eligible for the SME scheme, that is large companies and certain SMEs. Regardless of whether a company makes a profit or loss, some or all of the RDEC is used to discharge its (or other group companies') corporation tax liabilities.

2.3 The SME R&D tax relief allows companies to:

- make an additional deduction against profits of (from 1 April 2023) 86% of qualifying costs, over and above the normal deduction of 100% of qualifying costs
- Surrender all or part of trading losses arising in the year in return for a tax credit (10% of the losses surrendered from 1 April 2023).

2.4 For the purposes of eligibility for the SME R&D tax relief, a SME is defined as a company with:

- less than 500 staff and either
- a turnover of under €100 million or
- a balance sheet total under €86 million

2.5 Companies may need to include the figures of other linked and partner entities when working out if they are a SME.

2.6 Companies cannot claim SME R&D relief if the project has received any notified State aid or if the R&D activities have been subcontracted to it by another company. However, companies may then be able to claim the RDEC instead.

Considerations

2.7 The Government is minded to merge schemes into a RDEC-like scheme for several reasons.

2.8 In some circumstances companies may make claims under both the RDEC and SME schemes for the same or different projects. Having a single scheme should therefore be simpler for such claimants as well as removing any boundary issues. There can also be uncertainty over which company should claim due to whether or not the R&D is subcontracted.

2.9 The RDEC provides certainty at an earlier point as to the exact cash value of tax credit, making it more attractive to investors. This can also mean it factors in more ahead of investment decisions, leading to higher additionality. For those claiming the SME tax relief, the exact generosity of the deduction can only be known with certainty after the end of the accounting period.

2.10 Finally, the UK is unique in having two different types of R&D tax relief. Having one scheme, as other countries do, with minimal or no differences between companies of different sizes would simplify the tax system.

2.11 The rate change announced at the Autumn Statement, was a step towards a simplified, single RDEC-like scheme. A final decision on whether to merge the schemes has not been taken and will be announced at a future fiscal event. The Government intends that a new merged scheme will be based on the RDEC scheme as much as possible but invites views on this.

2.12 Depending on the company's circumstances, companies may be entitled to a payment net of the main corporation tax rate regardless of the company's previous trading position. The Government is interested in stakeholders' views on this process.

Box 2.A Main features: Questions

1. Do you agree a new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?
2. Does the taxability and subsequent different post tax net benefits impact your decision making when allocating R&D budgets?
3. If you use RDEC now, is there anything in your view that should be changed?

Chapter 3
Detailed design

3.1 The Government's aim is for an above the line credit which is simple and removes boundaries between company size conducting R&D in the UK. Additionally, the Government intends for the credit to ensure value for money for the UK taxpayer. This section invites comment on design features between the two scheme and proposals.

Main differences

The below table shows the main differences between the SME and RDEC schemes on expenditure from 1 April 2023. The table is not exhaustive.

Table 3.A Main differences

Feature	SME scheme	RDEC scheme
What qualifies?	Same criteria for both schemes	
Which companies?	A firm with fewer than 500 employees with either: • An annual turnover under €100 million or • A balance sheet under €86 million	Any company but predominately large companies SME companies can also claim in some cases for expenditure not qualifying for SME scheme
Mechanism	Enhanced CT deduction: 186% (100% basic + 86%) For lossmakers, optional payable credit: can surrender up to the 86% loss at a rate of 10%	'Above the line' credit: 20% of expenditure Credit is taxable (CT)
Subcontracting	Can claim for a portion of payments to subcontractors	Only claim in-house expenses, unless activity subcontracted to qualifying bodies, individuals, or partnerships of individuals

PAYE / NICs cap	Limited exemptions. Cap set at £20,000 plus 300% of its total PAYE / NICs liability	No exemptions. Cap set at 100% of relevant PAYE / NICs liability
Other subsidies	Claim can be reduced if the R&D project is subsidised, or a grant is received in respect of it, and is totally barred if the project has received any State aid	No reduction for grant or subsidy, no State aid restrictions.
Limit on aid	Aid to any single project limited to €7.5m State aid.	No limit

Source: HMRC Corporate Intangibles Research and Development Manual

Subcontracting

Background

3.1 The schemes are currently designed to ensure that relief cannot be claimed on the same expenditure more than once. This means that where a claim can be made under the (currently more generous) SME scheme, RDEC cannot also be claimed.

3.2 For both the SME and RDEC schemes the expenditure must be R&D from the perspective of the claimant company. However, under the SME scheme it is possible to claim relief for 65% of a payment for qualifying work subcontracted to an unconnected party.

3.3 For RDEC, such payments are allowable under very limited circumstances, and relief would generally be claimed by the subcontractor. To avoid the possibility of double claiming there is also a restriction in the SME scheme where the R&D has been subcontracted to the claimant by another SME or where the R&D is subsidised.

3.4 In certain cases, in RDEC there are companies conducting subcontracted work as part of another company's R&D project whose work is 'routine' (not R&D) in isolation so that neither company can receive R&D relief.

3.5 Two solutions to this were proposed in *Research and Development tax credits: response and further consultation, June 2011.*:

- Certification – The customer would provide the subcontractor with a certificate to confirm that the work they were undertaking was part of an R&D project.
- Joint election – The subcontractor and the customer would state that for the purposes of determining whether work was R&D they

would be treated as part of the same group, and allow HMRC to request or disclose information as necessary for determining this.

3.6 However, respondents to the December 2011 consultation suggested that deviations from the existing rules would add unnecessary complexity to the system and add costs to business. Due to these responses the Government at the time did not change the legislation.

3.7 To simplify the new scheme and remove boundaries the Government intends to take forwards one rule for all claimants. The Government is interested in views from stakeholders on what approach the new single scheme should take.

Adopting SME scheme rules

3.8 If the new scheme adopted rules from the current SME scheme, large companies would be able to claim for qualifying payments to any subcontractor. This could be beneficial to some claimants within the RDEC scheme, for example to the life sciences sector, and make the RDEC scheme more generous by expanding the scope of qualifying expenditure because it would prevent the problem described in para 3.4.

3.9 If the SME scheme rules were applied within the new single scheme this would however prevent subcontractors from claiming, as well as those whose R&D is subsidised for example, by a grant.

3.10 In response to the Budget 2021 consultation some stakeholders identified that under the current SME rules, it can be time consuming 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 credits. Stakeholders argued that this could lead to an increase in incorrect claims.

Adopting RDEC rules

3.11 In their consultation response a stakeholder highlighted that their survey of SMEs said that simplicity was the most important factor in the design of the R&D relief (more important than headline rate of relief). If the rules were aligned for SMEs and large companies so that subcontracted or subsidised work is eligible for relief, this could simplify one of the more complex areas of the regime.

3.12 This could be achieved by adopting the rules from the current RDEC scheme. This would mean that claimants could not claim for payments to subcontractors, but the subcontractors could claim. This could also mean claimants whose R&D is subsidised, for example by a grant, were able to claim more easily.

3.13 The Government is interested to hear from stakeholders on which set of rules on subcontracting would best support companies undertaking R&D. The Government will work with stakeholders to identify the most appropriate rules, ensuring the scheme delivers the best value for money, creating the most economic growth possible.

Box 3.A Subcontracting: Questions

4. Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?
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?
6. Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?
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.

Cap on payable credits

Background

3.14 When the SME scheme was introduced in 2000 it contained a caps on the payable credit based on the company's Pay as you Earn (PAYE) and National Insurance Contributions (NIC) liability.

3.15 The cap limited opportunities for fraud, and prevented overseas companies with little or no UK presence from routeing activity through the UK simply to obtain the tax credit at a cost to the UK taxpayer.

3.16 A cap, similar to that in the SME scheme, was included in the RDEC, when it was introduced.

3.17 To simplify the SME scheme, following consultation, Budget 2011 announced that the PAYE/NICs cap would be removed for the SME payable credit alongside the removal of the minimum expenditure threshold. The PAYE/NICs cap was removed to benefit a number of companies, especially start-ups, that are R&D rather than labour intensive, or where much of the labour costs are incurred on EPWs.

3.18 The Research and Development tax credits: response and further consultation, June 2011 asked stakeholders whether they thought additional safeguards should be put in place to ensure the removal of the PAYE/NICs cap on the payable credit was not abused.[7]

[7] Research and Development tax credits: response and further consultation, HM Treasury, June 2011

3.19 The majority of respondents in 2011 felt that the removal of the NICs/PAYE cap would not significantly increase the risk of fraudulent claims.[8]

3.20 However, whilst the removal of the cap allowed some start-ups to claim more, HMRC started to identify an increase in abusive claims by companies that had no activity within the UK.

3.21 One example identified by HMRC was an overseas parent company which previously sub-contracted its R&D to its subsidiary in the same country. In 2016 it decided to insert a self-described 'virtual' company, located in the UK, between the existing parent and the existing subsidiary company. The new UK subsidiary then sub-contracted its R&D to the same overseas company doing the R&D. However, despite having no UK presence in 2017 it claimed £361,447 payable tax credit from the UK taxpayer. Without the PAYE / NICs cap HMRC were unable to challenge these types of claims.

3.22 To combat this abuse, following consultation the Government introduced a restriction on the tax credit payable within the SME scheme. It was in effect from 1 February 2021. This Pay as You Earn (PAYE) and National Insurance Contributions cap came into effect for accounting periods beginning on or after 1 April 2021. The new SME cap was higher than the previous one, and included limited exceptions, both intended to allow start-ups to still claim.

3.23 Below are the two PAYE / NICs caps.

RDEC cap

3.24 A payment under RDEC is capped at 100% of total PAYE and NICs liability for the period. The relevant liabilities are the company's staffing costs that consist of PAYE and NIC liabilities in respect of:

- the employees of the company who are engaged on R&D activity and;
- any externally provided workers who are provided to the company by another connected group company for the purposes of qualifying R&D of the claimant.

SME scheme cap

3.25 The SME scheme's cap is more complex than the RDEC cap but allows more relief as it has a higher R&D level and exemptions. A payment under the SME scheme is capped at £20,000 plus 300% of its total PAYE and NICs liability for the period, defined in the same way as above.

3.26 In the SME scheme a company is exempt from the cap if:

8 Research and Development (R&D) tax credits: response to further consultation, HM Treasury, December 2011

- its employees are creating, preparing to create or managing Intellectual Property (IP) and
- it does not spend more than 15% of its qualifying R&D expenditure on subcontracting R&D to, or the provision of externally provided workers (EPWs) by, connected persons.

Proposal

3.27 The Government intends to implement a PAYE / NICs cap in any merged scheme and is interested in stakeholder views on how this should operate. The Government is interested in views on how the current PAYE / NICs caps operates, and whether there are any simplifications that could be made within a new scheme.

3.28 There will be new restrictions on claiming R&D relief for some overseas activities for accounting periods from 1 April 2023. Draft guidance has been published and is currently inviting comments until 28 February. https://www.gov.uk/government/consultations/draft-guidance-research-and-development-rd-tax-reliefs

3.29 The Government is interested to hear views on whether this could mean a simplification of the SME PAYE cap could be taken forwards. The Government will assess the impact of any changes in the PAYE / NICs cap on fraudulent claims before making a decision.

Box 3.B Cap on payable credits: Questions

8. What are your experiences of the PAYE / NICs cap?
9. Are there any ways the Government could simplify the PAYE / NICs cap whilst ensuring there is protection against abuse?
10. Which of the SME and RDEC PAYE & NICs cap should the Government implement in the new scheme?
11. Should the Government change the way either cap is calculated if is taken forwards? And if so, how?

Additional support for different types of R&D or R&D intensive companies

3.30 Following the changes at Autumn Statement the generosities of the two R&D tax schemes are broadly aligned. The Government is therefore considering the case for a simpler scheme for all claimants regardless of size of company. However, there may be a case for additional targeted support, for example for different types of R&D, or for more R&D intensive companies within a merged scheme.

3.31 The Government previously consulted on targeting the R&D tax reliefs towards R&D with specific social value, for example green technology. Many respondents did not support disincentivising specific sectors, and instead suggested that incentivising certain areas of R&D should be achieved through a targeted higher rate of relief.

3.32 Other respondents wanted the R&D tax reliefs to remain sector agnostic and were opposed to any form of special treatment for certain types of R&D. It was noted that differentiated tax relief for specific R&D would increase complexity and compliance costs, widen the scope for abuse, and could be less effective than direct government spending.

3.33 Separately, and as set out above, at Autumn Statement the Government announced that it would, ahead of Spring Budget on 15 March 2023, work with industry to understand whether and how to provide further support for R&D intensive SMEs following the changes announced at Autumn Statement.

3.34 In that context, the government is interested in the views of stakeholders on the potential of a future merged scheme to include differentiated rates of support. Any variation in support for different companies in a merged scheme will need to account for the relevant subsidy control considerations.

Box 3.C Additional support for specific companies: Questions

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?

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

Within your answer, please include details of your sector and evidence supporting the impact the R&D relief has on your R&D investment and the impact that has on UK productivity.

Guidance and transition

3.35 The Government is interested in what assistance SMEs may require during this period to transfer to a new type of R&D tax relief.

3.36 Subject to the final decision to merge schemes, the Government proposes this is implemented for accounting periods beginning on or after April 2024.

Box 3.D Guidance and transition

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?

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

Other design features

Qualifying Indirect Activities (QIAs)

3.37 The Government previously consulted on qualifying indirect activities (supporting activities such as HR or maintenance). In 2009 HMRC accepted that qualifying indirect activities (which are activities which form part of an R&D project, but do not directly contribute to the resolution of the scientific or technological uncertainty) can be included in a company's R&D claim.

3.38 The majority of respondents to the Budget 2021 consultation identified that QIAs can be complex. Whilst some thought the scope of QIAs is currently adequate and should not be changed many believed there was a need to restrict or redesign them.

3.39 The lack of clarity on the definition of QIAs makes them prone to boundary pushing and as they are supporting activities, rather than direct ones, the Government is considering reforming the rules. However, the Government would like to hear from stakeholders on the impact of this proposal.

Box 3.E Qualifying Indirect Activities: Question

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

Within your answer, please include details of your sector and the impact claiming for qualifying indirect activities has on your R&D investment. Please also detail how much of your claim is defined as qualifying indirect activities, with appropriate evidence.

Threshold

3.40 When the SME scheme was introduced, there was a minimum expenditure level of £25,000, that is, a company had to incur more than £25,000 expenditure on R&D in a year order to claim any R&D tax relief for that year. The purpose was to help keep administrative and Exchequer costs down, to encourage businesses to increase R&D expenditure and to target businesses carrying out significant R&D. A reintroduced threshold would still meet these purposes as well as potentially helping tackle abuse.

3.41 The minimum threshold was first reduced to £10,000 and later, in 2012, removed as one of a series of changes over several years making the schemes easier to access and increasing generosity. This was successful, encouraging companies to start doing small amounts of R&D they may not otherwise have considered, because they would not have got relief.

3.42 However, since then the number of smaller claims has increased significantly. For example, over 50% of claims in 2019-20 were worth £25,000 or under.

3.43 Whilst HMRC has taken significant steps operationally to tackle error and fraud but given the large number of low value claims HMRC cannot solve this issue by additional resource alone.

3.44 In response to the previous consultation, some stakeholders suggested reintroducing a threshold to focus compliance resource on higher value R&D claims to reduce overall error and fraud. This would mean that claims based on expenditure less than the threshold would not be valid. However, this would negatively affect companies with small R&D claims, preventing them from claiming.

3.45 The Government is keeping this under review but is mindful of the impact this would have on some businesses and is interested to hear views from stakeholders.

Box 3.F Threshold: Questions

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

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

Chapter 4
Summary of questions

1. Do you agree a new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?
2. Does the taxability and subsequent different post tax net benefits impact your decision making when allocating R&D budgets?
3. If you use RDEC now, is there anything in your view that should be changed?
4. Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?
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?
6. Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?
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.
8. What are your experiences of the PAYE / NICs cap?
9. Are there any ways the Government could simplify the PAYE / NICs cap whilst ensuring there is protection against abuse?
10. Which of the SME and RDEC PAYE & NICs cap should the Government implement in the new scheme?
11. Should the Government change the way either cap is calculated if is taken forwards? And if so, how?
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?
13. In the event this were to be done, how might this best be achieved within an overall cost envelope?
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?

15. How can Government ensure SMEs are supported in the transfer into a new scheme?
16. Does claiming for expenditure on qualifying indirect activities influence your decision to undertake R&D?
17. Do you think a threshold should be implemented? If one was implemented what at what level should it be introduced?
18. What is the average amount of R&D expenditure per year per firm in your business or sector?

Chapter 5
Next steps

The consultation will run from 13 January to 13 March 2023.

Please send comments or submissions to RDTaxReliefs@hmtreasury.gov.uk by 13 March 2023.

We are unable to respond to letters sent in the post at the moment. Please use the email address provided above to ensure your response is taken into account.

When responding, please say if you are making a representation on behalf of a business, individual or representative body. In the case of representative bodies, please provide information on the number and nature of people you represent.

This consultation is being run in accordance with the government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

Processing of personal data

This section sets out how we will use your personal data and explains your relevant rights under the UK General Data Protection Regulation (UK GDPR). For the purposes of the UK GDPR, HM Treasury is the data controller for any personal data you provide in response to this consultation.

Data subjects

The personal data we will collect relates to individuals responding to this consultation. These responses will come from a wide group of stakeholders with knowledge of a particular issue.

The personal data we collect

The personal data will be collected through email submissions and are likely to include respondents' names, email addresses, their job titles, and employers as well as their opinions.

How we will use the personal data

This personal data will only be processed for the purpose of obtaining opinions about government policies, proposals, or an issue of public interest.

Processing of this personal data is necessary to help us understand who has responded to this consultation and, in some cases, contact certain respondents to discuss their response.

HM Treasury will not include any personal data when publishing its response to this consultation.

Lawful basis for processing the personal data

The lawful basis we are relying on to process the personal data is Article 6(1)(e) of the UK GDPR; the processing is necessary for the performance of a task we are carrying out in the public interest. This task is consulting on the development of departmental policies or proposals to help us to develop good effective policies.

Who will have access to the personal data

The personal data will only be made available to those with a legitimate need to see it as part of consultation process.

We sometimes publish consultations in conjunction with other agencies and partner organisations and, when we do this, this will be apparent from the consultation itself. When we these issue joint consultations, your responses will be shared with these partner organisations.

As the personal data is stored on our IT infrastructure, it will be accessible to our IT service providers. They will only process this personal data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we hold the personal data for

We will retain the personal data until work on the consultation is complete.

Your data protection rights

You have the right to:

- request information about how we process your personal data and request a copy of it
- object to the processing of your personal data
- request that any inaccuracies in your personal data are rectified without delay
- request that your personal data are erased if there is no longer a justification for them to be processed
- complain to the Information Commissioner's Office if you are unhappy with the way in which we have processed your personal data

How to submit a data subject access request (DSAR)

To request access to your personal data that HM Treasury holds, contact:

The Information Rights Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

dsar@hmtreasury.gov.uk

Complaints

If you have concerns about our use of your personal data, please contact the Treasury's Data Protection Officer (DPO) in the first instance at privacy@hmtreasury.gov.uk

If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner at casework@ico.org.uk or via this website: https://ico.org.uk/make-a-complaint.