



Making R&D Easier

HMRC's plan for small business R&D tax relief

October 2015

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Foreword

Research and Development (R&D) is crucial for an economy's productivity and long-run growth. This is why R&D tax relief plays a key role in the government's objective for productive investment. R&D investment by smaller firms is vital for the performance of the UK economy, and Small and Medium Enterprises (SMEs) accounted for over 80% of all R&D claims in 2013-14.

I was delighted to learn from the recent statistics publication that the number of SMEs claiming tax relief in 2013-14 has increased by around 19% to over 15,000 with the total amount of support provided through the SME scheme at £800m. This shows that more and more small businesses are benefiting from the increased commitment from this government towards R&D tax relief.

Despite this increased take-up, there is more that can be done to make this relief accessible for the smallest companies, which is why I launched a consultation on further improvements to the scheme earlier this year. I would like to thank each and every respondent for taking the time to submit their views. I was really encouraged by the high number of responses, the wide variety of respondents and the innovative ideas put forward.

In this plan for R&D tax relief, we are setting out an administrative framework for the next two years and beyond. It makes clear the areas that HMRC will focus on in ensuring the scheme is as accessible as possible for all small businesses carrying out vital R&D investment. As we develop the detail of our initiatives and services, we want to carry on the conversation with smaller businesses and interested parties, including representative bodies. I hope you will get involved in developing this key feature of our tax and innovation landscape.



David Gauke
Financial Secretary

October 2015

1. Introduction

Science and innovation are at the heart of the government's Productivity Plan.¹ R&D tax relief plays a key role in this by reducing the costs of R&D.

There are separate R&D tax relief schemes for large businesses and small and medium enterprises (SMEs). The scheme for SMEs works by lowering the amount of corporation tax small businesses pay, allowing them to claim 230% of their qualifying R&D expenditure. This reduces the cost of R&D by 46%.

SMEs who make a loss can also claim, and have the option of instead receiving a payable cash relief at a rate of 14.5%. This reduces the cost of R&D by around 33%. These companies have a choice between an immediate benefit, or carrying forward the loss to set against income at a later time.

Following an announcement at Autumn Statement 2014, HMRC carried out a consultation on improving access to R&D tax relief for small business. At the March 2015 Budget, the government made a commitment to publish a document setting out further improvements to the scheme. This document builds on the ideas generated through the consultation, to set out the government's plans for the next two years.

The consultation aimed to help us understand the issues faced by small businesses in undertaking R&D and accessing the relief, and to inform future improvements. HMRC sought views from as wide a range of small businesses as possible. As well as providing a written submission, respondents could fill in a quick online survey, enabling time-pressed businesses to be able to contribute their views. In addition to this HMRC and HM Treasury officials met with many businesses and representative groups and held webinars with both businesses and agents. In total, over 200 people responded. All of these responses have been taken into account in the drafting of this plan.

The consultation was based on four themes that were identified as the key factors that influence access to R&D tax relief.

- **Awareness.** Are key decision makers in small businesses aware of the relief?
- **Design.** Are the rules appropriate for small businesses?
- **Understanding.** Do decision makers in small businesses understand the rules, how they apply to the company, and the claims process?
- **Administration.** Does the process operate smoothly (speed, and ease of use) for small businesses?

The great majority of respondents agreed that these four themes formed the right framework for understanding how the relief works and how it could be improved. We use the same framework in this plan.

¹ 'Fixing the foundations: creating a more prosperous nation' <https://www.gov.uk/government/publications/fixing-the-foundations-creating-a-more-prosperous-nation>

This plan draws on the feedback our consultation provided to outline a number of improvements to the way small businesses can access R&D tax relief.

2. Awareness

Businesses cannot access R&D tax reliefs unless they know about them, and they cannot obtain full value from the tax reliefs if they don't know about the range of innovative activity they support. We believe that R&D tax reliefs will be most effective in incentivising more R&D if businesses are aware of their benefits up front. This is why awareness is a key theme for this plan.

The focus of HMRC's communications on R&D tax relief is currently through specialist units in its Mid-Sized Business and Wealthy Compliance directorate, and the R&D specialists in HMRC's Large Business directorate, supported by guidance material on the GOV.UK website. The specialist units have regularly promoted R&D tax relief at events targeting small businesses, and the R&D tax reliefs have in the past been a key part of wider government campaigns to help small businesses, such as the GREAT campaign.²

In the consultation we sought help to understand where businesses go to access information and advice on this subject. We want to build on what we already do to find better ways of raising awareness amongst the business population (in particular small businesses) so that smaller and newer firms are able to access this support.

You told us that we need to reach new businesses early, and to use different ways to try and do that. Business owners want HMRC communications that are aimed at them, as well as working with their tax advisers. You expect us to work with other partners to reach a wide audience. There was a need to make clear that R&D tax reliefs are not solely targeted at pure research, but at a range of scientific and technological development activities.

The plan for awareness

In response to stakeholder demand for more direct communication between HMRC and customers, we will make more use of one-to-many communications such as email and Twitter to keep customers updated on R&D policy and technical developments. This will help us to talk directly to businesses that are already claiming, or thinking about claiming, R&D tax relief.

To ensure maximum awareness of R&D tax relief, HMRC will look at ways to use its own data, and to work with other government agencies, to identify companies that have carried out R&D, but that have not yet claimed relief. We have already started a project to use published data from Innovate UK about businesses that receive R&D support through grants.

We will launch an Advance Assurance service in November 2015, and will undertake publicity to raise awareness of that service, and R&D tax relief more generally, among small businesses and under-represented sectors. Advance Assurance will help the

² <http://www.greatbusiness.gov.uk/tax-relief-and-incentives-for-businesses-and-investors/>

smallest companies by providing them with greater certainty in making a claim - see page 12 for more about this new service.

Case study: working across government to increase R&D support

HMRC has recently started work on a new project to help it better understand the ecosystem of small businesses that do R&D. This project uses published data from Innovate UK that identifies businesses that already do R&D and receive grants. By cross-matching to HMRC data, we aim to identify businesses that may be eligible for R&D tax relief but that have not claimed before. We want to test why they do not claim; and we also want to see whether targeted information might improve take-up. This data will also be used to help companies claim the right level of relief - in some situations, businesses cannot claim both grants and the SME R&D tax relief, and this data will allow HMRC to engage with businesses to get their claims right.

Case study: Growth hubs and HMRC: understanding and awareness at the local level

An HMRC pilot programme that aims to identify and remove barriers to small business growth is already providing ways to spread awareness of R&D tax relief. The growth hub pilot has been established to provide for closer working between HMRC and five local growth hubs. HMRC will be involved in activity to provide education and support to growing businesses, testing different ways to provide business support, developing the capability of Growth Hub advisers and working with tax advisers and agents. All of these provide ways to try out new approaches to increase the awareness and understanding of R&D tax relief at a local level.

3. Design

The key design features of the R&D tax relief are:

- Research and development (R&D): the activity that the relief supports
- The types of R&D expenditure that qualify for relief (e.g. staff costs)
- How relief is given (via the Corporation Tax system).

This design works best for small businesses when it reaches the right companies, when it incentivises their innovative activity, and when it is easy for those businesses to apply the rules correctly.

Through the consultation we wanted to find out whether the definition of R&D worked well for small businesses, or whether there were design features that should be changed.

Respondents told us that the definition of R&D for tax purposes was not a barrier to claiming relief, and there was little support for the idea of aligning the accountancy and tax definitions of R&D. While a few respondents did support alignment, the majority felt there was little to be gained from moving away from a definition that has become a well-recognised part of the scheme. It was pointed out that the accountancy definition was more restrictive in respect to certain types of expenditure, and there were concerns around HMRC officers becoming the ‘arbiters’ of the application of the accounting definition.

Respondents put forward different ideas for changes to aspects of the rules such as widening the types of eligible costs and a separate scheme for micro-entities, but there was no consistent theme or themes that enjoyed wide support.

The plan for design

To provide continued certainty to companies the government has decided not to align the tax definition of R&D with the accounting definition. This reflects the strong consensus among stakeholders.

HMRC will continue to review the R&D tax relief schemes during the design and implementation of Making Tax Easier.³

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413975/making-tax-easier.pdf

The design and understanding of the rules around subcontracted R&D was a repeated theme of the responses to the consultation. Respondents told us that these rules were sometimes difficult to understand and apply, and it was sometimes difficult to determine whether a subcontracting relationship was in place. It was stressed that the decision by a small business to act as a subcontractor for R&D, or to contract out its R&D, was a key business lifecycle event where an understanding of the rules became important for future growth. We will review the treatment of subcontractors in the R&D tax relief schemes, with a focus on better guidance that helps smaller businesses understand how they are affected by the rules.

The tax definition of an ‘advance in science and technology’ extends on a spectrum from ‘...extend(ing) overall knowledge and capability in science’ through to the ‘use of science and technology to duplicate the effect of an existing process ... in a new or appreciably improved way.’⁴ Respondents told us that existing HMRC guidance does not provide enough focus on the ‘appreciable improvement’ and too much focus on extending overall knowledge in science. We will work on a wider range of examples and guidance that goes beyond ‘overall knowledge and capability in science’. This will help both new and smaller firms better understand the relief and feel more confident in claiming it.

⁴ <http://www.hmrc.gov.uk/manuals/cirdmanual/CIRD81900.htm>

4. Understanding

Businesses can currently access guidance on R&D tax relief via the online HMRC manual (the “Corporate Intangibles Research & Development” manual or CIRD), which attempts to meet a wide range of needs, from straightforward, practical questions to interpreting complex statutory requirements and their application to particular circumstances. In addition, simplified material appears on a dedicated GOV.UK page.⁵

To help all businesses understand the rules better, we have committed to improve the R&D guidance, including making changes suggested by the Office of Tax Simplification in their report on tax competitiveness.

We used the consultation to explore different ways of providing guidance, rather than simply upgrading the current material. Our aim is that external guidance be accessible, relevant and accurate. We asked respondents to tell us who used our guidance, what works well and what should change. We asked about different ways to provide guidance, such as webinars, video and online forums.

Respondents told us that the CIRD manual works well for advisers, but not so well for other users, and that the existing material on GOV.UK was not widely used. New guidance for small businesses should be based around significant business life events, rather than following the scheme of the legislation, and the format of the guidance should use non-text elements to better convey some complex areas. A minority of respondents felt that existing commercial products fulfilled the business need. While there was a clear demand for some new guidance media, such as webinars, there were perceived risks around tools such online forums, as HMRC would find it difficult to ensure that consistent and correct messages are conveyed.

The plan for understanding

To help innovative businesses make decisions on the most effective way to access government support, HMRC will issue improved guidance on the interaction of R&D tax relief and grant schemes in a state aid context.

As part of the programme of Advance Assurance, HMRC will ensure that first time claimants have a better understanding of how the R&D tax relief rules affect their business. This will help businesses that are new to R&D tax relief feel confident in making their claim.

We will issue bespoke guidance on R&D tax relief for smaller businesses. Breaking away from the traditional manual format, the guidance is currently under development with stakeholder involvement. The new guidance will be written with smaller companies in mind, concentrating on the aspects that they tell us they find difficult to understand.

⁵ <https://www.gov.uk/guidance/corporation-tax-research-and-development-rd-relief>

To help businesses that are new claimants, we will extend our current work on best practice in R&D reporting, to produce templates and guidance products to help smaller businesses to record their qualifying activity and qualifying expenditure.

To help smaller businesses that undertake software R&D, we will explore the best ways to provide upfront certainty about what they can and can't claim.

Case study: understanding and investigating software R&D

Understanding what is qualifying R&D in the context of software development can be challenging. Applying the criteria of 'an advance in science and technology' and 'appreciable improvement' can be difficult in a project where improvements in the end user experience that are achieved by science and technology, may not in themselves be advances in science and technology. A recent innovative partnership between HMRC's R&D tax specialists and HMRC's own software developers has boosted our capability to address these complex questions. By including software developers on case teams, HMRC has been able to settle complex cases more quickly, providing certainty and better targeting of resource. HMRC will look at how it can apply the lessons learned from this project to provide upfront certainty to smaller tech start-ups investing in software development, so they have a better idea of the R&D tax relief available to them.

5. Administration

The Government announced at Autumn Statement 2014 that HMRC will introduce a formal process of Advance Assurance for small companies claiming R&D relief for the first time.

The programme will provide greater certainty and enable businesses to plan their finances effectively. Both businesses and HMRC will benefit from reduced errors as assurances should minimise the need for later HMRC intervention.

We asked questions about the design of Advance Assurance. We asked about how an Advance Assurance might be used by businesses to attract finance, and also about other changes to the ways that tax relief claims are processed.

There was broad agreement with the outline design of Advance Assurance, and a consensus that Advance Assurance could help increase the quality and quantity of claims by smaller businesses. A majority felt that Advance Assurance should be for the smallest companies, while others took the view that we should look at potential growth not just current size. There was backing for the idea of linking Advance Assurance with access to finance, so that companies would use the Advance Assurance to attract further funding from other sources.

The administration plan

Advance Assurance will launch in November 2015, focussing on first time claimant smaller companies (turnover under £2m and fewer than 50 employees). A voluntary and non-statutory scheme, Advance Assurance is for companies that have already undertaken R&D, and also for those intending to do R&D. Advance Assurance is open to companies that have a tax adviser, but our comprehensive guidance means it will be just as accessible for companies acting without a tax adviser. Successful applicants will receive assurance that HMRC will allow their first three years of R&D tax relief claims without further enquiry.

HMRC will subsequently assess the demand for assurance services and our ability to extend it beyond the smallest companies.

HMRC will work with businesses and finance advisers to explore how Advance Assurance links to the financing of innovative small companies, and how that link could be strengthened.

Case study: paying tax relief faster

The Specialist R&D Teams in HMRC's Mid-sized Business Unit have reviewed their processes for paying tax relief claims. As the majority of customers now file their claims online HMRC will be introducing new digital solutions to automate parts of processing the payments and concentrating processing in one location to improve the speed, consistency and accuracy of HMRC's treatment of new claims for relief. In turn, this will free up expert resource to provide specialist advice and support to technical queries relating to claims.

6. Next steps

This plan highlights a number of initiatives that HMRC will lead to make access to R&D tax relief easier for small businesses. Our starting point is the launch of Advance Assurance, and we see this as the test-bed for a number of the new approaches to guidance and awareness.

Advance Assurance will feature a new guidance product to help applicants, and there will be dedicated publicity to steer first time claimants to this new service. We want to ensure that the publicity and guidance are having the right effect, so we will be carrying out survey work to test their effectiveness.

As we move to the next phase of our plan, we will be seeking the involvement of businesses to help us design and test our new guidance and other products. We would be happy to hear your ideas on ways to take this work forward. Please contact: aziz.yusuf@hmrc.gsi.gov.uk

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	This year	Next year	2+ years
Awareness	HMRC will launch Advance Assurance in November 2015, and will undertake a publicity campaign to raise awareness of Advance Assurance and R&D tax relief among small businesses and under-represented sectors.	In response to stakeholder demand for more direct communication between HMRC and customers, we will make more use of one-to-many communications such as email and Twitter to keep customers updated on R&D policy and technical developments.	To ensure maximum awareness of the R&D tax relief, HMRC will look at ways to use its own data, and to work with other government agencies, to identify companies that have carried out R&D, but that have not yet claimed relief.
Design	To provide continued certainty to companies the government has decided not to align the tax definition of R&D with the accounting definition. This reflects the strong consensus among stakeholders.	HMRC will continue to review the R&D tax relief schemes during the design and implementation of Making Tax Easier Stakeholders have told us they value case studies and examples of qualifying R&D activity that focuses on 'appreciable improvements' in existing products and processes through scientific or technological changes. HMRC will work on a wider range of examples and guidance that goes beyond 'extending overall knowledge and capability in science'.	HMRC will review the treatment of subcontractors in the R&D tax relief schemes, with a focus on better guidance that helps smaller businesses understand how they are affected by the rules.

Understanding	<p>HMRC will issue improved guidance on the interaction of R&D tax relief and grant schemes in a state aid context.</p> <p>As part of the programme of Advance Assurance, HMRC will ensure that first time claimants have a better understanding of how the R&D tax relief rules affect their business.</p>	<p>HMRC will issue bespoke guidance on R&D tax relief for SMEs. Breaking away from the traditional manual format, the interactive guidance is currently under development with stakeholder involvement.</p>	<p>HMRC will extend its current work on best practice in R&D reporting, to produce templates and guidance products to help SMEs record and qualify their qualifying activity and qualifying expenditure.</p> <p>To help smaller businesses that undertake software R&D, we will explore the best ways to provide upfront certainty about what they can and can't claim.</p>
Administration	<p>Advance Assurance will launch in November 2015, focussing on first time claimant smaller companies (turnover under £2m and fewer than 50 employees)</p>	<p>We will assess the demand for Advance Assurance and our ability to extend it beyond the smallest companies.</p>	<p>HMRC will work with businesses and finance advisers to explore how Advance Assurance links to the financing of innovative small companies, and how that link could be strengthened.</p>

