



HM Treasury



HM Revenue  
& Customs

# The scope of qualifying expenditures for R&D Tax Credits: consultation

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July 2020



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# Chapter 1

## Introduction

**1.1** Research & Development (R&D) is a significant global factor in driving innovation, productivity gains and economic growth. At its best R&D can advance the frontiers of human understanding. Given the scientific and economic importance of R&D to the United Kingdom, since 2017 the government has been committed to an ambitious target for economy-wide R&D investment to constitute 2.4% of Gross Domestic Product by 2027.

**1.2** The government is working towards its aims through a combination of direct and indirect support for R&D. Some research projects are funded through direct grants, whilst business R&D is primarily supported through R&D tax credits, which have existed in one form or another since 2000. Economic theory and academic evidence suggest that the social returns of R&D investment often exceed the private benefits accrued to firms.<sup>1</sup> The ‘spillover’ effects of R&D investments can deliver significant social benefits, through e.g. medical advances, that are not fully captured by businesses.

**1.3** As the economy evolves and we face new global challenges, the environment in which firms conduct R&D is also changing rapidly. The government is aware of this trend and that it is more important than ever to ensure that R&D tax credits continue to provide excellent targeted support to research and development activities undertaken in the UK.

**1.4** That is why, alongside the [UK’s R&D Roadmap](#) and increasing the Research and Development Expenditure Credit (RDEC) rate from 12% to 13%, the government is consulting on potential changes to the scope of qualifying expenditures for R&D tax credits.

## Objective

**1.5** The subject of this consultation is the scope of qualifying expenditures for R&D tax credits, and especially whether expenditures on data and cloud computing ought to qualify for relief. Please note that the government is not inviting views on the internationally agreed definition of R&D itself as this would generate undue uncertainty.

**1.6** The last formal consultation on the scope of qualifying expenditure for R&D was published in November 2010. Government considers that the time is now right

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<sup>1</sup> Zvi Griliches, *R&D and Productivity: The Econometric Evidence* (National Bureau of Economic Research, 1998), pp.252-4.

to reassess the reliefs to ensure they are well optimised for present and future R&D practices, while continuing to deliver good value for money for the taxpayer.

**1.7** With thanks to stakeholders who have already made informal representations to the government on this topic, we now invite formal responses from a broad range of stakeholders on the R&D trends are aware of, either for their own firm, or for their industry in general. This will help inform the government as it develops its R&D tax credit strategy to ensure that the scope of qualifying expenditure remains appropriate in the years ahead.

# Chapter 2

## Background to R&D Tax Credits

### R&D definition and guidance

2.1 Research and experimental development (R&D) is defined in the OECD's Frascati manual as "creative and systematic work undertaken in order to increase the stock of knowledge – including knowledge of humankind, culture and society – and to devise new applications of available knowledge".<sup>1</sup> This work generally refers to activities carried out by academic bodies, firms and other organisations or individuals in the pursuit of advances in science or technology.

2.2 In the UK, R&D is defined in section 1138 of the Corporation Tax Act 2010 as "*activities that fall to be treated as research and development in accordance with generally accepted accounting practice.*"<sup>2</sup> This is subject to any regulations made by Her Majesty's Treasury, and the detailed guidance provided by the Department for Business, Energy and Industrial Strategy (BEIS). With regard to what activities constitute R&D for the purpose of obtaining tax relief, BEIS guidance considers R&D to have taken place "*when a project seeks to achieve an advance in science or technology. The activities which directly contribute to achieving this advance in science or technology through the resolution of scientific or technological uncertainty are R&D. Certain qualifying indirect activities related to the project are also R&D. Activities other than qualifying indirect activities which do not directly contribute to the resolution of the project's scientific or technological uncertainty are not R&D.*"<sup>3</sup>

### How do R&D tax credits currently work?

2.3 The two principal tax reliefs available to companies undertaking R&D in the UK are as follows:

- **Research and Development Expenditure Credit (RDEC):** a payable tax credit (subject to tax) equivalent to 13% of qualifying R&D costs claimed

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<sup>1</sup> *Frascati Manual 2015: Guidelines for Collecting and Reporting Data on Research and Experimental Development, The Measurement of Scientific, Technological and Innovation Activities*, OECD Publishing, Paris, OECD (October 2015), p.44.

<sup>2</sup> *Corporation Tax Act 2010*, s1138.

<sup>3</sup> *Guidelines on the Meaning of Research and Development for Tax Purposes*, Department for Business, Innovation and Skills (December 2010), pp.1-2.

- **Research and Development tax relief for SMEs:** a 230% deduction of qualifying R&D costs from a profitable company's yearly profit; or a tax credit worth up to 14.5% of the surrenderable loss of loss-making companies

2.4 Combined these schemes provided £4.4bn of support to over 7000 businesses in 2016-17. To qualify for relief, expenditure on R&D must be incurred on particular types of activity, currently limited to staffing costs (employees and agency workers), consumable or transformable materials (such as water, fuel and power of any kind), certain types of software, payments to clinical trials subjects and, depending on the scheme, some subcontracting costs.

## Scope of consultation

2.5 This consultation will cover:

- how HMRC-administered tax credits have supported R&D to date
- how the scope of qualifying expenditure for R&D tax credits ought to evolve to reflect modern trends in research and development

2.6 This consultation will not cover:

- other government R&D interventions, e.g. research grants, the Research and Development Allowance (RDA) capital allowance
- the proposed R&D SME Tax Credit PAYE/NICs cap (this is the subject of a separate consultation, published on 19 March 2020) or other anti-avoidance measures
- The Department of Business, Energy and Industrial Strategy (BEIS)'s definition and guidelines on research and development

## Who should respond to the consultation?

2.7 The government is interested in receiving representations from all interested parties and stakeholders. We are especially interested in responses from:

- research intensive firms
- firms otherwise making R&D tax credit claims
- academic institutions (universities, scientific research bodies)
- business groups

# Chapter 3

## Qualifying expenditures and activities

3.1 Any expansion of the scope of qualifying expenditures increases the cost to the Exchequer and adds complexity to the R&D schemes. The more categories of costs there are, the more rules are needed to define them – rules which need to be understood by companies and agents. They make the schemes more complicated and may create additional scope for abuse.

3.2 Therefore, whilst the government welcomes views on areas where particular R&D costs ought to be made eligible for relief, it must stress that any alterations to the scope must be delivered in a cost-efficient manner that maximises the additionality of relief by driving decisions to make new investments.

### Data

3.3 In recent years some stakeholders have proposed that more of the costs incurred in the generation, processing or analysing of datasets should be eligible for relief under the R&D tax credits regime. As outlined above, consumable and transformable materials incurred in R&D activities already qualify for relief. In some cases, despite holding residual value beyond initial R&D projects, data can already be regarded as a consumable item used in the R&D process or related activities. The government is therefore keen to understand more about how businesses classify and use datasets when undertaking R&D activities.

#### Question 1a

Are there uses of data that contribute to R&D but which do not currently attract relief through the RDEC and SME schemes? Please provide examples to support your response.

#### Question 1b

To what extent are datasets employed in the R&D process consumed? To what extent do they retain value? Please provide examples to support your response.

## Software (cloud computing)

3.4 Software is another prominent asset class in the digital economy, whether it is acquired by companies or developed in-house. At present, some software costs relating to assets developed for internal use qualify for R&D tax credits.

3.5 However, there are some other costs, typically incurred alongside software costs where the software is leased from external parties, that are not currently relievable. This is typically called part of 'cloud computing' and payments will cover a range of activities, including use of software, storage rental, support and processor running time. Businesses will often purchase packages which are used to facilitate activity across their business operations as well as R&D activity.

3.6 Government would like to understand whether these wider costs should qualify, alongside traditional software costs

### Question 2a

Do you already claim for software costs under the current definition? If so, what was your experience of separating out the R&D specific costs for the purposes of the claim?

### Question 2b

Are there any software costs that currently qualify for R&D tax credits, that could be limited or excluded from relief without materially affecting R&D projects? Please provide examples to support your response.

### Question 2c

Are there any software costs, partially or wholly for R&D purposes, that do not currently qualify for R&D tax credits, that should be if the regime is to better reflect the nature of modern R&D? Please provide examples to support your response on whether these costs could be separated out straightforwardly.

3.7 The government also welcomes reflections on the broader questions related to data and cloud computing below.

### Question 3a

What experience do you have of claiming R&D tax credits in other jurisdictions, where expenditures pertain to data or cloud computing?

### Question 3b

What evidence can you provide that a scope expansion in these areas would drive additional investments in research and development.

### Question 4

Would changes to the R&D tax relief rules in the areas outlined above lead to any change in the commercial relationships between companies, insofar as expenditure is outsourced to a third-party provider?

## Indirect activities and routine work

**3.8** As highlighted above, whilst the government is open to expanding the scope of qualifying expenditures for R&D tax credits, it seeks to do so in a way which emphasises value for money for the taxpayer. It is therefore important that where respondents suggest changes that could incur additional Exchequer costs, they identify where cost savings could be achieved through the restriction or limitation of relief in other areas.

**3.9** Expenditures on qualifying indirect activities are one of the areas the government is keen to gather views on. If there are costs which do not contribute to genuine innovation but are currently eligible for relief, the government would be interested in exploring ways to recycle this relief into expenditures that genuinely advance R&D and contribute to the 2.4% target.

### Question 5a

Are there expenditures on indirect activities which should be limited or excluded from eligibility for relief? Please provide examples to support your response.

### Question 5b

Are there other expenditures on routine work which should be limited or excluded from eligibility for relief? Please provide examples to support your response.

# Chapter 4

## Summary of questions

### Question 1a

Are there uses of data that contribute to R&D but which do not currently attract relief through the RDEC and SME schemes? Please provide examples to support your response.

### Question 1b

To what extent are data sets employed in the R&D process consumed? To what extent do they retain value? Please provide examples to support your response.

### Question 2a

Do you already claim for software costs under the current definition? If so, what was your experience of separating out the R&D specific costs for the purposes of the claim?

### Question 2b

Are there any software costs that currently qualify for R&D tax credits, that could be limited or excluded from relief without materially affecting R&D projects? Please provide examples to support your response.

### Question 2c

Are there any software costs, partially or wholly for R&D purposes, that do not currently qualify for R&D tax credits, that should be if the regime is to better reflect the nature of modern R&D? Please provide examples to support your response on whether these costs could be separated out straightforwardly.

### Question 3a

What experience do you have of claiming R&D tax credits in other jurisdictions, where expenditures pertain to data or cloud computing?

### Question 3b

What evidence can you provide that a scope expansion in these areas would drive you to make additional investments in research and development.

#### **Question 4**

Would changes to the R&D tax relief rules in the areas outlined above lead to any change in the commercial relationships between companies, insofar as expenditure is outsourced to a third-party provider?

#### **Question 5a**

Are there expenditures on indirect activities which should be limited or excluded from eligibility for relief? Please provide examples to support your response.

#### **Question 5b**

Are there other expenditures on routine work which should be limited or excluded from eligibility for relief? Please provide examples to support your response.

# Chapter 5

## How to respond

5.1 This consultation will run from 21 July to 13 October 2020.

5.2 Responses should be sent by email to:

[rdtaxexpenditures@hmtreasury.gov.uk](mailto:rdtaxexpenditures@hmtreasury.gov.uk)

5.3 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.

5.4 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.

### Consultation Privacy Notice

#### Consultation Principles

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

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

5.7 If you have any comments or complaints about the consultation process please contact:

5.8 John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

5.9 Email: [hmrc-consultation.co-ordinator@hmrc.gov.uk](mailto:hmrc-consultation.co-ordinator@hmrc.gov.uk)

Please do not send responses to the consultation to this address

5.10 This notice sets out how HM Treasury & HM Revenue and Customs as joint data controllers, will use your personal data for the purposes of the second consultation on 'Preventing abuse of the R&D tax relief for SMEs', and explains your rights under the General Data Protection Regulation GDPR and the Data Protection Act 2018.

#### Your Data

5.11 The personal information relates to you as either a member of the public, parliamentarians and representatives of organisations or companies

#### The data

5.12 We will process the following personal data:

Name

Email address

Postal address

Phone number

Job title

### **Purpose**

**5.13** The personal information is processed for the purpose of obtaining the opinions of members of the public and representatives of organisations and companies, about departmental policies, proposals, or generally to obtain public opinion data on an issue of public interest. – the particular consultation is Preventing abuse of the R&D tax relief for SMEs: Second consultation

### **Legal basis of processing**

**5.14** The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation the task is consulting on departmental policies or proposals or obtaining opinion data in order to develop good effective government policies.

### **Special categories data**

**5.15** Any of the categories of special category data may be processed if such data is volunteered by the respondent.

### **Legal basis for processing special category data**

**5.16** Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: the processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a government department.

### **Who we share your responses with**

**5.17** Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).

**5.18** If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.

**5.19** In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

5.20 Where someone submits special category personal data or personal data about third parties, we will endeavour to delete that data before publication takes place.

5.21 Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at: <https://www.gov.uk/government/organisations>.

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

### How long we will hold your data (Retention)

5.23 Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.

5.24 Personal information in responses that is not published will be retained for three calendar years after the consultation has concluded.

### Your Rights

- You have the right to request information about how your personal data are processed, and to request a copy of that personal data
- you have the right to request that any inaccuracies in your personal data are rectified without delay
- you have the right to request that any incomplete personal data are completed, including by means of a supplementary statement
- you have the right to request that your personal data are erased if there is no longer a justification for them to be processed
- you have the right in certain circumstances (for example, where accuracy is contested) to request that the processing of your personal data is restricted

### How to submit a Data Subject Access Request (DSAR)

5.25 To request access to personal data that HM Treasury holds about you, contact:

HM Treasury Data Protection Unit  
G11 Orange  
1 Horse Guards Road  
London  
SW1A 2HQ  
[dsar@hmtreasury.gov.uk](mailto:dsar@hmtreasury.gov.uk)

### Complaints

5.26 If you consider that your personal data has been misused or mishandled, you may make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office  
Wycliffe House  
Water Lane  
Wilmslow  
Cheshire  
SK9 5AF  
0303 123 1113  
[casework@ico.org.uk](mailto:casework@ico.org.uk)

5.27 Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

### Contact details

5.28 The joint data controller for your personal data is HM Treasury. The contact details for the data controller are:

HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ  
London  
020 7270 5000  
[public.enquiries@hmtreasury.gov.uk](mailto:public.enquiries@hmtreasury.gov.uk)

The contact details for HM Treasury's Data Protection Officer (DPO) are:

The Data Protection Officer  
Corporate Governance and Risk Assurance Team  
Area 2/15  
1 Horse Guards Road  
London  
SW1A 2HQ  
London  
[privacy@hmtreasury.gov.uk](mailto:privacy@hmtreasury.gov.uk)

5.29 The data joint controller for any personal data collected as part of this consultation is HM Revenue & Customs, the contact details for which are:

HMRC  
100 Parliament Street  
Westminster  
London  
SW1A 2BQ

5.30 The contact details for HMRC's Data Protection Officer are:

The Data Protection Officer  
HM Revenue & Customs  
7th Floor, 10 South Colonnade  
Canary Wharf  
London  
E14 4PU  
[advice.dpa@hmrc.gov.uk](mailto:advice.dpa@hmrc.gov.uk)