



HM Treasury



HM Revenue
& Customs

Preventing abuse of the R&D tax relief for SMEs:

Second consultation – summary of responses

November 2020

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Contents

Chapter 1	Introduction	2
Chapter 2	Consultation responses	3
Chapter 3	Next steps	6
Annex A	List of Respondents	7

Chapter 1

Introduction

- 1.1 Research and Development (R&D) tax reliefs, including the small or medium sized enterprise (SME) scheme, support business investment in R&D and are a core part of the government's support for innovation. Budget 2018 announced that, to deter abuse, the amount of SME scheme payable tax credit that a business can receive in any one year will be capped at three times the company's total Pay As You Earn (PAYE) and National Insurance Contribution (NICs) liabilities. The government committed to consult on how the cap would be applied, to minimise any effects on genuine businesses.
- 1.2 On 28 March 2019, the government launched the formal consultation on the cap with the publication of a consultation document, "Preventing abuse of the R&D tax relief for SMEs". The consultation closed on 24 May 2019.
- 1.3 Following consideration of the consultation responses, Spring Budget 2020 announced that the introduction of the cap would be delayed until 1 April 2021, in order to consult on changes to the design of the measure.
- 1.4 The consultation was published on 19 March 2020 and was due to close on 28 May 2020. However, the government recognised that many sectors with an interest in this policy were affected by COVID-19 and therefore extended the consultation to 28 August 2020 to give stakeholders further time to submit their views.
- 1.5 The government received 40 responses. Those responding included individuals, industry groups, businesses across a number of sectors, individual accountants and agents and accountancy professional bodies.
- 1.6 The government has also met with several stakeholders, including trade bodies, businesses and accountants. Their views have been considered and expressed in this document. A summary of responses is set out in Chapter 2 and the next steps in the implementation of the cap in Chapter 3.

Chapter 2

Consultation responses

- 2.1 Respondents welcomed the government taking on board the views of businesses from the first consultation and making changes to the measure to minimise the impact on genuine UK businesses.
- 2.2 The government is very grateful to all those who took the time to respond to the consultations and give their valuable input.
- 2.3 It remains the government's intention that genuine companies undertaking R&D should not, as far as possible, be adversely impacted by the cap. The government therefore announced that the cap would be set at 300% of a company's PAYE and NIC's liability, rather than the 100% PAYE cap that was in place until 2012. The government has consulted extensively on the detailed design to ensure that the cap is well targeted.

Question 1

Does your business subcontract to a related party or use EPWs provided by a related party? Would it be useful to be able to include the PAYE/NICs attributable to these workers in your payable credit?

- 2.4 Many respondents stated that they or their clients used Externally Provided Workers (EPWs) which were provided by a related party. Many of the responses also welcomed the idea of using PAYE/NICs attributable to these workers in working out the amount claimable under the cap.
- 2.5 Some respondents commented that using related party EPW PAYE/NICs would adversely affect standalone companies and start-ups – but did not offer detail on what other factors to consider in calculating the cap.
- 2.6 A few respondents pointed to the Research and Development Expenditure Credit (RDEC) cap as a model. In the RDEC, the PAYE and NIC liabilities of a related party can contribute to the cap but only so far as they contribute to the claimant company's R&D activities.

Question 2

Would it be practical to obtain information on attributable PAYE/NICs from EPW providers in order to increase the level of your cap?

- 2.7 Many of the responses here suggested the information should be “readily” available where the EPW provider is connected.
- 2.8 However, there was general concern on data and privacy where EPWs were not connected and about the ease of being able to obtain this information. There were concerns about the additional administrative burden on smaller companies.
- 2.9 A few respondents put forward the idea that HMRC could provide a standard or proxy NIC/PAYE figure of apportionment per worker where accurate figures would not be easily obtainable.

Question 3

The Government welcomes views on the sorts of activities which are undertaken to manage IP, as well as the types of information and evidence on the active management of Intellectual property, which genuine claimant businesses would be able to provide in supporting their R&D tax relief claim.

- 2.10 Many responses agreed that active management of intellectual property (IP) is a marker of genuine business activities and felt they could provide evidence of this without undue burden.
- 2.11 Some of the activities mentioned included: correspondence with patent attorneys and IP lawyers, board meeting minutes, evidence of discussions and negotiations under non-disclosure agreements, business plans relating to the IP/patented product, patent searches and licensing agreements within group structures.
- 2.12 Some respondents commented that the definitions of IP and active management would need to be much broader than the definitions that exist under the patent box rules, to ensure they applied to development activity by start-ups and SMEs. There was also some concern that if the rules were to be aligned with the current patent box definitions then a smaller company would often not be able to provide the formal documentary proof of managing their own IP. Where it was available, the need to provide this information would also create additional administrative burdens. They also suggested that the existing costs of registering some forms of IP may deter start-ups and SMEs from registering their IP, making it harder for them to satisfy this sort of test.

- 2.13 Some respondents also raised concerns on whether the definition of IP would include 'know-how' rather than just registerable IP. Some expressed a view that this would be especially difficult to evidence, and that entities may need to seek professional advice around this.

Question 4

Does your business subcontract work to a related party (including using EPWs)?

- 2.14 Some respondents said that it was a regular occurrence for them or their clients to subcontract work to a related party. One suggested that this was common in group structures, whereby employees will be employed and paid by one group entity and work on innovation projects for other group companies.
- 2.15 On the other hand, some responses stated that it was much more common to use unconnected subcontractors or EPWs and that it was relatively rare to subcontract to a related party.

Question 5

Where your business does subcontract to a related party, does this represent less than 10% of R&D expenditure? If no, please provide an indication of the percentage your claim related party subcontracting does represent.

- 2.16 Having analysed all the responses, 52% of respondents stated that the cap would need to be higher than 10%, whilst 48% of the respondents either held the view that the cap was sufficient or did not express a view.
- 2.17 Some respondents were content with a 10% threshold, suggesting it was 'reasonable'.
- 2.18 Some respondents said that the threshold would be too low at 10%, with agents stating they had clients where between 30% and 100% of their R&D expenditure was on work subcontracted to a related party. There were a range of percentages between 20-50% suggested instead of 10%, which respondents felt were more appropriate reflections of the extent of related party subcontracting. One response stated that a 10% limitation would severely limit the ability of internationally structured SMEs to participate in the UK R&D tax relief system to a meaningful extent.

Chapter 3

Next steps

- 3.1 After considering all the views put forward, the government proposes that the cap should be introduced from April 2021. Those making small claims for payable credit below £20,000 will, as previously announced, not be affected by the cap.
- 3.2 To allow companies to maximise the amount of payable tax credit that can be claimed, companies will be able to include related party PAYE and NIC liabilities attributable to the R&D project specifically when calculating the cap (Questions 1 & 2) and these will be subject to the 300% multiplier. However, there will be a provision to stop any PAYE/NIC liability being counted for more than one company's cap.
- 3.3 As previously announced, to provide additional protection for genuine businesses, the government has included a mechanism to allow a company's claim to be uncapped, if it meets two tests.
- 3.4 These tests require that a company's employees are creating, preparing to create or actively managing intellectual property (IP) and that its expenditure on work subcontracted to, or EPWs provided by, a related party is less than 15% of its overall R&D expenditure.
- 3.5 This 15% figure is an increase from the 10% suggested in the consultation document, based on concerns expressed in some responses that 10% would be too low.
- 3.6 The definition of "intellectual property" for this purpose will be based on the definition at s195(6) ITA 2007, which includes patents, trademarks, registered designs, copyrights or design rights as examples of intellectual property.
- 3.7 "Actively managing" here means activities like assessing markets, negotiating contracts and planning manufacturing. These are things that a company that is genuinely developing IP to exploit itself would be expected to carry out.
- 3.8 The government has published draft legislation on implementing the cap and welcomes further views on this. Final legislation will then be included in the Finance Bill and the cap will be introduced in April 2021.

Annex A

List of Respondents

Aiglon Consulting

Association of Taxation Technicians

Ayming UK

BDO

Beavis Morgan LLP

BioIndustry Association

Catax

Confluence Tax

Crowe UK

Deloitte

Ernst & Young

Federation of Small Businesses

ForrestBrown

FTI Consulting

GovGrant

Haysmacintyre

Hazelwoods LLP

Institute of Chartered Accountants in England and Wales

Innovation Plus

James Cowper Kreston

Kingsley Brookes LLP

Leyton

London Society Chartered Accountants

Luca Colosimo

Mazars

Menzies
MMP Tax
Moore Kingston South
Oxford Vacmedix
Pronovotech
PwC
RSM UK
Saffrey Champness
Smith & Williamson
Southampton University
Tokamak Energy
White & Case LLP
Wilson Wright LLP

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