



HM Treasury

# R&D Tax Reliefs

## Report

---

November 2021



# R&D Tax Reliefs: Report

---



© Crown copyright 2021

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit [nationalarchives.gov.uk/doc/open-government-licence/version/3](https://nationalarchives.gov.uk/doc/open-government-licence/version/3).

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at: [www.gov.uk/official-documents](https://www.gov.uk/official-documents).

Any enquiries regarding this publication should be sent to us at [public.enquiries@hmtreasury.gov.uk](mailto:public.enquiries@hmtreasury.gov.uk)

ISBN: 978-1-911686-48-4

PU: 3176

# Contents

Chapter 1	Introduction	2
Chapter 2	Policy Decisions	4
Annex A	Summary of Responses	11

# Chapter 1

## Introduction

- 1.1 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. 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. Alongside this, the government published a consultation, which ran from 3 March 2021 to 2 June 2021.
- 1.2 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, we maximise the value of the beneficial R&D activity for the UK economy
- 1.3 The government is grateful for the 183 responses received. Those responding included individuals, industry groups, businesses, accountants, agents and accountancy professional bodies. Some respondents surveyed their members or customers and shared the outcomes with us. The government is also grateful to all those who met officials to expand on their contributions or provide more detail on specific points.
- 1.4 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 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
- 1.5 These changes will be included in Finance Bill 2022-23, to take effect from April 2023. The government stated that further details of these changes, and

next steps for the review, would be set out as part of the government's tax administration and maintenance announcements later in the autumn. This report sets out that further detail with associated next steps. It also provides a summary of responses to the consultation.

- 1.6 The government continues to consider other areas for reform as part of the ongoing review. As set out at Autumn Budget 2021, UK companies claimed tax relief on £47.5 billion of R&D expenditure in 2019, but the ONS estimates that businesses only carried out £25.9 billion of privately financed R&D in the UK. While this gap is partly explained by companies being able to claim for activity taking place overseas, this does not account for the full difference.
- 1.7 The latest evaluations published by HMRC show that while the RDEC scheme generates £2.40-£2.70 of additional R&D expenditure for each £1 of tax relief claimed, the SME scheme generates £0.60-£1.28.<sup>1</sup> At the same time, the SME scheme costs more than RDEC and has grown at a faster rate than RDEC<sup>2</sup>, and the R&D reliefs are forecast to continue growing. The OBR predicts the reliefs will increase from £7.7 billion in 2021-22 to £11.9 billion in 2026-27.<sup>3</sup>
- 1.8 In considering other reforms the government's objectives remain 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.
- 1.9 Alongside this document, the government is also publishing the findings from research into customer experiences of preparing and submitting claims for R&D tax reliefs. As part of the review, the government commissioned an independent research organisation to conduct this research. The research sought to explore companies' behaviours and decision-making processes when preparing claims for the reliefs.

---

<sup>1</sup> [Evaluation of the research and development tax relief for small and medium-sized enterprises](#), HMRC, November 2020

[Evaluation of the research and development expenditure credit](#), HMRC, November 2020

<sup>2</sup> [Research and Development Tax Credits: Main tables 2021](#), HMRC, September 2021

<sup>3</sup> [October 2021 Economic and fiscal outlook – supplementary fiscal tables: receipts and other](#), OBR, October 2021

# Chapter 2

## Policy Decisions

- 2.1 Tax reliefs are a key feature of the UK tax system and the tax reliefs for R&D are an example of reliefs that are designed to support government policy by encouraging businesses to change their behaviour. The tax reliefs for R&D provide generous support to encourage companies to conduct R&D activity. The reliefs are worth 0.25% of GDP in 2018 compared to an OECD average of 0.1% of GDP. However, UK business investment in R&D is significantly lower than the OECD average.<sup>1</sup>
- 2.2 This chapter sets out more detail on the reforms announced at Autumn Budget, including their implementation.

### Data and cloud computing costs

- 2.3 At Autumn Budget 2021 the government confirmed that, following the earlier consultation on qualifying expenditure in July 2020, qualifying expenditure for both reliefs will be expanded to include data and cloud computing costs. This modernisation will ensure the reliefs better incentivise cutting edge R&D methods which rely on vast quantities of data that are analysed and processed via the cloud.
- 2.4 The following new categories of expenditure will be brought into scope:
- licence payments for datasets
  - cloud computing costs that can be attributed to computation, data processing and software
- 2.5 The following sections explain what kinds of costs the government intends to bring into scope and why. They also set out some clarification on staff costs.

### Licence payments for datasets

- 2.6 The government has heard clearly that datasets are an essential R&D input for companies in many sectors, particularly where the most cutting-edge computational R&D techniques are being used. Respondents to both the 2020 and 2021 consultations have told us that datasets are as vital an ingredient as any raw materials or labour inputs which may be employed in the process of R&D. Therefore, expenditure via licence payments on

---

<sup>1</sup> [OECD Main Science and Technology Indicators database](#), OECD, Research and Development (R&D) – Gross Domestic Spending on R&D, latest data published September 2021



purchasing datasets which are used directly for R&D in a qualifying R&D project will qualify for relief.

- 2.7 Companies will not be able to claim relief for the cost of datasets that can be resold or have a lasting value to the business beyond the duration of the project. This will ensure that relief can be claimed only for costs incurred solely for R&D and not for costs that can be reimbursed. An end-user access agreement or licence between the claimant and the owner of the data will not qualify if it grants:
- any rights of resale over the data
  - the claimant any right to publish, share or otherwise communicate the raw data within the dataset to a third party
  - any ongoing rights of use, beyond the expected term of the R&D project being undertaken by the claimant.
- 2.8 Where the end user access agreement covers multiple datasets, not all of which are to be used in a qualifying R&D project, or where access to data is granted as part of a wider package of services, the claimant will be required to apportion costs.

## Staffing costs for creation of datasets

- 2.9 Companies doing R&D often need to collect data for use as part of an R&D project.
- 2.10 Where companies need to conduct fieldwork to do so they should already be able to claim relief for the relevant staff costs, as long as this data is not collected for sale or other commercial purposes and directly contributes to an advance in science or technology through the resolution of scientific or technological uncertainty. This includes costs for staff-related expenditure for the purpose of collecting, cleansing and analysing data, provided these costs are incurred for a qualifying R&D project.
- 2.11 The government intends to make this position clear through revised guidance.

## Cloud computing and software

- 2.12 Where research is data intensive, businesses have told us they rely on third party processing capacity and analytical tools to interrogate this data. These capabilities are accessed via the internet, or 'the cloud', since this is the most effective, and sometimes the only way, to achieve the required results.
- 2.13 This is why the government will allow businesses to claim relief for the cost of cloud computing services used directly for R&D. For example, costs which can be attributed to computation, data processing, analytics and software. We welcome views on any other types of costs that are incurred while doing computational R&D on the cloud.
- 2.14 At the same time, the government recognises that not all the costs that are commonly included in a cloud computing package relate to the categories

above, for example they may relate to general overheads relating to servers and data storage. As far as possible, the government wishes to maintain the principle in the current schemes, whereby relief is not available for general overheads (such as rental costs) and therefore intends to exclude any similar costs incurred as part of a cloud computing package.

- 2.15 We would be interested in views on how this distinction could operate in practice, and on whether there are any other costs that might be billed in a cloud computing package that should be excluded in line with the wider principles of the reliefs.
- 2.16 Where qualifying services are provided as part of a package alongside other costs that do not qualify, claimants will need to identify and claim for only the qualifying elements of the payment, either based on billing from the supplier or by doing an appropriate apportionment. The government welcomes views on the ease of doing this.

## Next steps

- 2.17 The government welcomes views from stakeholders which it will consider in the next phase of the review.
- 2.18 The government will publish draft legislation in the summer of 2022 and invite views from stakeholders on the detailed implementation of these measures.
- 2.19 The legislation will then be included in Finance Bill 2022-23 and take effect from April 2023.

## Refocusing the reliefs towards innovation in the UK

- 2.20 Under the current rules for both schemes, companies are able to claim relief on R&D activity that is conducted overseas.
- 2.21 Under RDEC, companies are able to claim relief for:
- some direct costs of R&D – staff costs, payments for externally provided workers and for clinical trial volunteers, and the cost of software and consumable items
  - certain payments for subcontracted R&D activities – those made to individuals or partnerships of individuals or to charities, universities, and health service bodies
  - contributions made to charities, universities, and health service bodies for their own research
- 2.22 Under the SME scheme, companies are able to claim for:
- the same direct costs of R&D as under RDEC (see above)
  - payments for subcontracted R&D activities in general (the amount they can claim depending on whether they are connected with the subcontractor)

## Proposed changes to the reliefs

2.23 The government intends that:

- where companies subcontract R&D activity to a third party, they will in future only be able to claim relief for that expenditure where that third party performs the work within the UK. The rules for subcontracting will not otherwise change. This will apply to the SME scheme, and a similar principle will apply in RDEC, where subcontracting occurs and where a company claims for contributions it makes for independent R&D of a qualifying body
- under both schemes, where companies incur expenditure on payments for externally provided workers (EPWs), they will only be able to claim relief on such expenditure where those workers are paid through a UK payroll

2.24 If a company subcontracts work for performance overseas, it would not be able to claim R&D tax reliefs on that expenditure – but it would still be able to deduct those costs from taxable profits in the normal way. In addition, companies will still be able to claim R&D tax reliefs on the costs of software and consumables sourced overseas, as well as payments for clinical trials volunteers overseas and payments for data and cloud sourced overseas, as these are considered inputs to activity in the UK.

2.25 While the government will refocus reliefs towards innovation in the UK as set out above, it is interested in views from stakeholders on whether there is a case for any narrow exceptions to allow claims on some overseas activity. However, these would not include allowing claims for overseas activity on the basis that it is less expensive than in the UK.

## Next steps

2.26 In the next phase of the review, the government intends to explore with stakeholders how these principles could be reflected in legislation.

2.27 The government will then publish draft legislation in summer 2022 and invite views from stakeholders on the detailed implementation of these measures.

2.28 The legislation will then be included in Finance Bill 2022-23 and take effect from April 2023.

## Abuse and compliance

2.29 Concern over abuse and boundary-pushing involving the R&D tax reliefs has grown in recent years. In 2019-20 the National Audit Office extended the qualification in HMRC's accounts to include R&D tax relief, due to the estimated level of error and fraud. The accounts estimate error and fraud across both schemes as 3.6% of total relief cost, or £311 million.<sup>2</sup>

---

<sup>2</sup> [HMRC annual report and accounts: 2020 to 2021](#), HMRC, November 2021

- 2.30 This concern has been echoed by comments made in responses to the consultation, and in meetings with stakeholders.
- 2.31 The R&D reliefs are claimed by companies in their Company Tax (CT) return, following the same processes as other parts of CT. However, the reliefs present particular risks that the government thinks require additional measures. For example, a payable credit is available, making them attractive for possible abuse. We have seen a recent emergence of R&D advisers, who are typically not members of professional bodies, cold-calling Small & Medium Enterprises (SMEs), suggesting they could make an R&D claim.
- 2.32 These advisers, many with no background in tax, take advantage of customers who are unfamiliar with claiming for R&D, often charging on a commission basis, and submit numerous dubious claims. The commission basis can lead companies to view a claim as cost-free and some are willing to accept questionable claims.

## Next steps to improve compliance

- 2.33 HMRC has already allocated additional resources to R&D tax relief compliance and is undertaking work to better understand the nature and scale of the error and fraud associated with the reliefs. As part of the next stage of this strategy, HMRC will further increase the resource for R&D tax credit compliance, with the creation of a new cross-cutting team focussed on abuse.
- 2.34 Additional resource alone cannot address the underlying problems here – the number of claims has increased substantially over the past few years, rising, for example, from 35,565 in 2014-15 to 85,900 for 2019-20.<sup>3</sup> The government believes that HMRC needs additional measures to provide adequate assurance over the use of taxpayer funds.
- 2.35 In responding, the government needs to address the root of the problem, designing out abuse and boundary-pushing, while – so far as possible – limiting the impact on compliant businesses.
- 2.36 The government therefore intends to make the following changes:
- all claims to the R&D reliefs – either for a deduction or a tax credit – will in future have to be made digitally (except from those companies exempt from the requirement to deliver a Company Tax Return online)
  - these digital claims will in future require more detail – for example, on what expenditure the claim covers, the nature of the advance sought, the field of science or technology, the uncertainties overcome
  - each claim will need to be endorsed by a named senior officer of the company
  - companies will need to inform HMRC, in advance, that they plan to make a claim

---

<sup>3</sup>[Research and Development Tax Credits Statistics 2021, HMRC](#)

- claims will need to include details of any agent who has advised the company on compiling the claim

## Next steps

- 2.37 These changes are necessary to protect the integrity of the reliefs. The government is considering further measures in particular to discourage unscrupulous agents from exploiting the SME scheme. The government would be interested, during the next phase of the review, in hearing further views from stakeholders on this, as well as on the detailed implementation of the measures set out above.
- 2.38 The changes set out above are planned to come into effect from April 2023 and HMRC will now be working to deliver them. Any necessary legislation will be published in draft in summer 2022 for comment from stakeholders and will then be included in Finance Bill 2022-23.

## Addressing anomalies and unforeseen consequences in the R&D tax relief legislation

- 2.39 The R&D review has also considered features of the legislation which create anomalies, unfairness or impede efficient operation of the reliefs. The government will bring forward proposals to address these, as set out below.
- 2.40 The government will change legislation to:
- allow companies to make or increase a claim for RDEC where HMRC makes certain types of assessment, as allowed by paragraphs 61-65 of Schedule 18 to Finance Act 1998. Currently RDEC cannot be claimed in this situation, unlike SME relief
  - allow companies to claim RDEC if they had previously incorrectly claimed SME relief on that expenditure
  - clarify that expenditure generally qualifies where a payment is made within two years of the end of the accounting period in which the expenditure was incurred. This is in response to a Tribunal finding of 2016<sup>4</sup>
  - amend the time limit for making a claim to two years from the end of the period of account to which they relate, rather than 12 months from the statutory filing date as defined by paragraph 14 of Schedule 18 to Finance Act 1998. This will prevent companies which do not receive a notice to file, either because they fail to register or notify HMRC that they are dormant, from benefiting by having more time to make a claim
  - support businesses growing and transitioning from the SME scheme to RDEC, by providing that where an SME within a group becomes large, all companies in the group will retain SME status for one year afterwards. Under the current legislation, while that company retains its status, other companies in the same group lose their SME status straight away

---

<sup>4</sup> TC/2015/06833

- amend the rule restricting relief for a company which is not a “going concern” so that it focusses on those that are unviable, rather than those not a going concern because a technical requirement of the accountancy standard has been triggered (for example, by the transfer of a trade)

## Next steps

- 2.41 The government will publish draft legislation for the changes set out above in the summer of 2022 and invite views from stakeholders on the detailed implementation of these measures. Legislation will then be included in Finance Bill 2022-23 and the changes will come into effect from April 2023.

## Next steps for the review

- 2.42 This document provides more detail on the reforms announced at the Autumn Budget and sets out areas where the government is seeking views to inform the draft legislation that will be published next year.
- 2.43 To contribute your views, please send written submissions to [RDTaxReliefs@hmtreasury.gov.uk](mailto:RDTaxReliefs@hmtreasury.gov.uk). The deadline for contributions is 8 February 2022.
- 2.44 The government will publish draft legislation in the summer of 2022. Final legislation, taking account of any comments received, will then come into effect in April 2023.
- 2.45 As set out in the introduction, the review is not concluded, and while it is implementing the reforms announced in the Autumn Budget, the government continues to consider other areas for reform as part of the ongoing review.

# Annex A

## Summary of Responses

### Structure and rates

- A.1 Q1- Do you consider your company to be a research-intensive firm? How does your business benefit from the R&D reliefs (e.g. cashflow, reduced tax liability)? If your company is an SME that claims under both the SME tax relief and RDEC, what is your experience of using each scheme and how do they compare?
- A.2 We received responses from companies who carried out research themselves, as well from trade associations representing members who did so. The pharmaceutical and life-sciences sectors were well-represented.
- A.3 In general, most respondents felt comfortable in making claims under the R&D tax relief they used most frequently and were sceptical of the need for rule changes. However, they noted a number of areas where the scheme rules were unclear, and where the rules of one scheme did not match those in the other. Examples given include:
- how claims can be put in for R&D work that is ultimately funded by a customer rather than being self-funded. Some respondents said this was a grey area and can mean multiple companies claim for the same expenditure. One respondent also noted the key area of complexity for SME claims is in relation to the treatment of funded R&D more widely
  - identifying qualifying costs due to differences between the two schemes, (specifically whether costs are subcontractor payments or payments for externally provided workers (EPWs))
- A.4 Q2 - Is there a case for consolidating the two schemes into one? What do you value about the design of the current schemes that might be lost if they were unified?
- A.5 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
  - if all companies received relief as an “above-the-line credit” (as is the case for RDEC), this would make the credit more visible for decision-makers

- 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
- A.6 Those that were against unifying were often concerned that this would involve equalisation of the rates of relief. They felt that the current higher rate of relief offered to SMEs within the SME scheme was appropriate.
- A.7 Other respondents felt that the disruption that would be caused by unifying the two schemes would not be worth the effort. Some argued that the current schemes “simply work” and there was an understanding of the rules and the current system and that unification would mean extra time spent on understanding new rules. One agent was concerned that “companies could try to claim themselves which could increase fraudulent or erroneous claims”. Others felt that if government wanted to maintain higher rates of relief for SMEs (which they supported), this would mean reintroducing complexity to prevent that benefit going to large companies.
- A.8 **Q3 - What do you think explains the difference in additionality between the two schemes? How could the schemes be improved to incentivise the R&D your business does or might consider doing? Can you give evidence to support your suggestions?**
- A.9 Few respondents questioned the findings from the government’s external research that the RDEC scheme seemed to stimulate private research investment more successfully than the SME scheme.<sup>1</sup> However, those respondents that did comment felt that the difference in additionality between the two schemes was because of the different nature of R&D undertaken. SMEs tend to have shorter term goals whereas large companies have larger budgets. Some respondents felt that the SME scheme is more widely abused.
- A.10 Some suggested alternative methods of assessing the impact of R&D tax relief. One respondent suggested assessing the additional benefit to the economy from the activity which would include factors such as more intellectual property located in the UK; increased marketing and professional support undertaken in the UK as a result of the R&D happening in the UK; and increases in high skilled R&D employment activity in the UK.
- A.11 **Q4 - To what extent do the rates of relief available to you impact your investment decisions and/or your choice of location? Is the balance of relief between the two schemes appropriate? Is there any evidence of significant deadweight where investment decisions would proceed without relief?**
- A.12 A general theme in responses to this question was the belief that the rate of relief and the choice of location for an R&D investment was more relevant to

---

<sup>1</sup> [Evaluation of the research and development tax relief for small and medium-sized enterprises](#), HMRC, November 2020

[Evaluation of the research and development expenditure credit](#), HMRC, November 2020



larger companies than to smaller companies. A few responses also noted that large international businesses would not locate R&D in the UK without R&D relief. One multinational which has global R&D facilities commented that R&D tax relief is an extremely important factor for them and something they keep under constant review.

- A.13** However, there was a consensus that the rates of relief do also influence SME investment decisions. Respondents noted that for SMEs and loss-making companies R&D credits were critical for financial planning and continued support from investors. A few respondents also noted that the RDEC rate will have increased importance once the Corporation Tax (CT) rise takes effect. They went on to argue that with the increased CT rate the post-tax benefit will reduce so the RDEC rate needs to be increased.
- A.14** In terms of balance between the two schemes, some respondents feel that the SME scheme is world-leading whilst RDEC lags behind. Some respondents felt that the balance was skewed towards the SME scheme which gives significantly higher benefit than RDEC. One respondent mentioned that it would be good if the gap could be closed a little between the two schemes.

## Claims process

- A.15** **Q5 - Would a departure from the ordinary Corporation Tax self-assessment system be justified? Should more information and assurance be required from companies at the point of claiming? Should a company providing more information upfront be treated differently?**
- A.16** There was a strong preference in responses for the R&D reliefs to remain part of CT Self-Assessment (CTSA) process as it is well understood and allows claimants to make claims as part of their annual cycle. There was some support in moving away from the CTSA process if it reduced the administrative burden on companies or meant that cash payments to claimants were speeded up.
- A.17** There was not a strong consensus on whether more information should be required from companies. However, one idea that was supported by a few respondents was having “white space” on the CT600/L. Those in favour of more information being submitted did generally caveat this with having clarity from the government on exactly what would be required. Those respondents who did not agree with more information being provided believed that enough information was already supplied and to give more would become an administrative burden.
- A.18** Some respondents suggested an incentive for companies who voluntarily provide more information up front, but many respondents thought that no company should be treated differently because it had done so. Some respondents who opposed mandating more information from companies would be willing to provide it if this resulted in greater financial benefit.
- A.19** **Q6 - When did you first claim, and what prompted you to do so? Do you use an agent? If so, why? What is your experience of how agents’ fees are**

**structured? How could the expertise and specialist knowledge of agents assisting with R&D claims be improved?**

- A.20** There were many reasons given as to why companies use agents such as:
- R&D is a complex area and companies wish to reduce the risk of an inquiry from HMRC
  - positive experiences from engaging agents adding “robustness” to claims
  - current government guidance means that companies turn to agents to claim.
- A.21** There was little comment on how the expertise of agents could be improved although some respondents expressed the hope that Professional Conduct in Relation to Taxation (PCRT) would improve standards. Some respondents suggest that all/most claims should be “audited” – at least before payment of any credit is made.
- A.22** Several respondents commented favourably on the idea of a pre-approval or pre-notification scheme, with one going as far as proposing a form of “rate card” which companies could use to calculate the claim.
- A.23** Overall, there appeared to be support for measures which would either identify people/organisations or raise the quality of claims. Examples included:
- requiring any R&D agent or other specialist to be identified
  - both agent and company should sign off the claim
  - R&D agents should be accredited, as many specialist agents are not currently part of accrediting bodies. A few respondents also mentioned that HMRC should themselves become an accrediting body
- A.24** **Q7 - How can the responsibilities of HMRC, agents and the company be better reflected in the claims process?**
- A.25** There were many suggestions made in response to the question on how to improve communications between the government and the claimant, which included:
- frequent updates from HMRC to companies on progress of claims
  - better training for HMRC staff
  - a process for companies to obtain pre-approval for claims, although many differing versions were proposed
  - greater digitalisation of the R&D claims process.
- A.26** **Q8 - What other changes might help claims to be dealt with more smoothly, while ensuring better compliance? Is there a way HMRC and advisers can work more effectively to improve the quality of external advice available to**

companies? If you claim R&D tax reliefs in other countries, how does the claim process differ and what are your views on this?

- A.27 Other suggested improvements to the process included a minimum expenditure per claim to reduce numbers and allow HMRC staff to spend more time on more sizeable and complex claims. This suggestion was proposed by several different respondents, although there was no consensus on what level the minimum should be set at.
- A.28 On the question of comparisons between the UK schemes and those of comparable countries, respondents were relatively positive. A common theme amongst respondents was that the administrative burden of applying for the UK scheme is lower than in other comparable countries, and the calculations are simpler and more transparent. At the same time, there was still room for improvement. Some respondents pointed out that in their experience, other countries may take a more expansive interpretation than the UK does of what constitutes “R&D”. Others noted that all R&D reliefs are complicated and require specialists to prepare claims.

## Qualifying expenditure and R&D definition

- A.29 Q9 - Is there evidence to suggest areas of activity other than those currently covered by the R&D definition drive positive externalities which should be recognised by the tax system?
- A.30 The majority of respondents who expressed views on this question were broadly in favour of expanding qualifying activities to cover areas that are not currently eligible, including pure mathematics, different disciplines of social science and parts of the creative industries. Some respondents pointed out that many European countries with R&D schemes include social sciences and humanities and that the UK should emulate this.
- A.31 However, there was a strong consensus amongst respondents, that the definition of “R&D” itself does not require amending given it is well understood, embedded and is consistent with the OECD Frascati standard; but there was appetite for guidance to be updated regularly on how the definition applies across sectors and the government’s assessment of what qualifies.
- A.32 Some respondents did not support any change to how the current definition of R&D operates for tax purposes. They said that companies value the breadth of the UK definition and how accessible it is to a wide variety of companies undertaking R&D across all sectors. Some raised concerns that a further widening of the definition could result in deadweight claims, uncertainty and complexity.
- A.33 Q10 - Do you think R&D tax reliefs could better incentivise R&D with specific social value, for example developing green technology? Could R&D tax reliefs be used to disincentivise R&D in certain fields?

- A.34** Many respondents expressed support for incentivising specific types of R&D through the R&D tax relief system, with green technology the most referenced example. Some made the case for reducing tax relief for R&D in the oil and gas sector to support Net Zero objectives. But 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.
- A.35** 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 be less effective than direct government spending.
- A.36** Question 11 - **What is your experience of conducting R&D in different regions across the UK? How do R&D tax reliefs benefit these activities, and how could the offer be improved to better support these activities?**
- A.37** Most respondents emphasised that R&D is taking place very broadly across the UK, with companies dispersed across the country. Many respondents stated that the current data on the location of R&D is likely to be misleading as businesses have many sites and the registered office (which is what HMRC data track) may not be where the R&D is taking place.
- A.38** There was no clear consensus on using R&D relief to support regional activities. Most respondents were opposed to targeting specific regions, for example by offering different rates of relief. It was noted that differentiated tax relief for specific regions would increase complexity and would not be a powerful enough incentive for businesses to move their R&D, and that other policies would be more effective in supporting R&D across the UK (such as freeports and enterprise zones).
- A.39** A few respondents stated that R&D tax reliefs could further support industrial areas outside London and South East by including capital expenditure as eligible for R&D tax relief.
- A.40** Q12 - **Are there any other areas of qualifying expenditure that should be included within the reliefs? How would this influence your investment decisions?**
- A.41** Respondents suggested numerous areas of qualifying expenditure they thought should be included in the reliefs. Areas mentioned more than once were; cloud computing, data, rental costs, capital expenditure, more generous subcontracting rules in RDEC, updated software categories, overheads, an inconsistency in the treatment of travel expenses, patent costs, and compliance testing.
- A.42** The most frequently suggested additions were cloud computing costs and data. The reasons for this were in line with those given to the 2020

consultation on scope of qualifying expenditure – because many modern R&D methods use large amounts of data.<sup>2</sup>

- A.43 It should be noted that many respondents understood that collecting and organising data is, by itself, of little value. As one respondent said, it is the processing and manipulating of the data into useable outputs that adds real value.
- A.44 Other respondents were content with current rules. They observed that the more separate categories of cost exist, the more definitions and boundaries are required.

## Capital Expenditure

- A.45 Q13 - **What proportion of your R&D expenditure is treated as capital for the purposes of corporation tax? What would be the impact on your R&D activities of increased relief for capital expenditure?**
- A.46 Many respondents suggested that more generous relief for capital assets for R&D purposes would incentivise them to conduct more R&D overall. One thought that increased incentives would lead to a sustained increase in UK R&D expenditure as fixed capital investment would provide an ‘anchor’ for future projects in the UK. There was a divergence of views, however, as to how best to increase the level of relief for R&D capital expenditure. Several respondents wanted capital expenditure to be brought into the scope of qualifying costs, or failing that, for tax relief to be available for depreciation costs (as they are in some other countries).
- A.47 Others preferred to keep capital expenditure in the capital allowance regime for simplicity, but to increase the generosity of the Research and Development Allowance (RDA) beyond a 100% first year allowance – they did not mention a specific amount of tax subsidy over and above full expensing.
- A.48 Several replies noted that the Annual Investment Allowance (AIA) and RDA offer only a timing benefit compared to normal Capital Allowances, and that this must lead to a lower impact on investment decisions than the subsidy available through R&D tax reliefs (especially the cash/cash flow benefit from payable credits to loss-making SMEs). A few respondents underlined that it is not possible for loss-makers to get a payable credit from any capital allowances, so in their view the RDA and AIA are of no benefit to companies which are lossmaking.
- A.49 On the other hand, other respondents were less convinced of a need to increase incentives for capital expenditure, often because they or their clients did not undertake much capital investment anyway. Several noted that whilst increased relief would be helpful, the level of capital spend a company can undertake is principally determined by its cash flow. The availability of

---

<sup>2</sup> [The scope of qualifying expenditures for R&D Tax Credits: consultation, HM Treasury, 2020](#)

tax relief might change some companies' behaviour at the margin, but only in limited cases, and where the companies had specialist equipment needs. Instead, the businesses those respondents worked with either already possessed the necessary capital equipment or subcontract out capital intensive elements of their R&D to third parties.

- A.50** Very few respondents gave a proportion for their R&D expenditure treated as capital for the purposes of corporation tax. One noted that the AIA is a much easier method than RDAs to obtain full expensing for their capital expenditure, and in claiming it, they wouldn't need to identify items of capital equipment that would be used for R&D. Other respondents also felt there was a lack of clarity in RDAs with respect to where facilities are shared, as there is no prescribed methodology where assets are not solely used for R&D purposes.
- A.51** Q14 - **Do you currently claim Research & Development Allowances (RDAs)? If not, why not? What do you like and/or dislike about RDAs?**
- A.52** There was an even split between those respondents that claimed RDAs and those that didn't. Those who did claim RDAs liked the simplicity of the process of claiming through their normal tax returns and thought the definition of RDAs was clear so there was little confusion for inexperienced claimants. However, many others felt that there were other, more attractive, avenues such as AIA or the super-deduction.
- A.53** Some respondents also suggested that tax relief should be available for the cost of renting capital assets from third parties. They suggested that this would be of particular benefit to SMEs, since SMEs may not have sufficient available funds to purchase specialist equipment outright, and so are more likely to rent.

## **Subcontracting, and overseas expenditure**

- A.54** Q15 - **How much of the activity in respect of which you claim R&D in the UK is undertaken outside of the company, and how much of that is not undertaken in the UK? What are the benefits and drawbacks of subcontracting, whether overseas or domestically? What are your commercial/other reasons for carrying out work overseas rather than in the UK?**
- A.55** Many respondents made clear that they consider that subcontracting and outsourcing are valuable commercial strategies that allow R&D work to progress even if the company does not possess in-house expertise due to its size or the technical nature of the subcontracted work (which may for example require specialist equipment).
- A.56** Some of the specific reasons given by respondents for pursuing subcontracting included:
- access to expertise not already available in the company.

- lower staff costs, by avoiding the need to retain in-house expertise that may not be needed all the time. This route would also avoid recruitment problems if there were skills shortages in the areas that the company wanted to research in. Some respondents also said the time required for the recruitment process made subcontracting/EPWs a better solution.
- productivity benefits, if conducting research in-house would prevent company staff from conducting other work.
- collaboration and flexibility were also offered as benefits.

**A.57** One respondent noted that their innovation licence from a regulatory body mandated that the majority of their innovation is subcontracted, typically to SMEs who are specialists in the field concerned.

**A.58** Fewer respondents discussed the limitations or drawbacks of subcontracting research activity to third parties, but the potential downsides mentioned included:

- reduced control by the commissioning company over how the research would be conducted, and reduced ability to ensure quality.
- lack of clarity of ownership over any intellectual property that was produced as a result of outsourced research.
- administrative problems in claiming for the R&D tax reliefs, such as the additional complications in establishing that expenditure by a third party is within a qualifying R&D cost category; and ensuring that claims for payable credits would not be capped by the requirement that companies cannot claim for more than 3 times their PAYE/NICs costs.
- many respondents discussed the benefits of engaging EPWs (Externally Provided Workers) as opposed to subcontracting explicitly.

**A.59** The majority of respondents did not report conducting any activity overseas, and where companies did outsource activity outside of the UK, they reported that the bulk of spending was still in the UK. The commercial drivers for subcontracting domestically or internationally were almost identical and few companies gave specific reasons for needing to outsource work specifically overseas rather than domestically, over and above the generic benefits of outsourcing set out above.

**A.60** Of those that did, the most common reasons given were that it was impossible to access required expertise within the UK or that there were regulatory requirements in other markets which dictated that research results reflected prevalent conditions in that territory. There were only a very limited number of circumstances where claimants considered that it would be strictly necessary to perform research overseas or for specifically overseas subcontracts.

**A.61** Q16 - **How could the government distinguish between work that needs to take place abroad and which benefits the UK, and that which doesn't?**

- A.62 Many respondents noted that work is outsourced for valid commercial reasons, and interfering with this would mean that costs would rise. Others thought the main reason for outsourcing was due to skills shortages inside the UK, which, they believed, would not be resolved simply by a rule change in the R&D tax reliefs. Therefore, one respondent thought limiting overseas activities could be punitive.
- A.63 Others made the point that they believed that even work subcontracted overseas still benefited the UK, since the commissioning company (usually) retained any IP that flowed from that research.
- A.64 A number of responses also pointed out that the non-territorial nature of our R&D regime is very attractive to global companies and encourages them to base global R&D efforts in the UK. In particular, the ability for companies to claim UK tax relief for overseas labour costs was seen as attractive. There was a view that restricting tax relief to UK activities only could weaken the incentives for companies to base the leadership of their global R&D efforts in the UK.
- A.65 A number of replies noted that the introduction of the cap on payable credits in Finance Act 2021 had already effectively limited relief for loss-making SMEs who outsourced R&D outside the UK, and did not support further restrictions.
- A.66 On the question of how to administer a restriction of the UK tax reliefs to activity that takes place in the UK, most respondents felt that any attempt to do so would bring a fair degree of complexity into the tax reliefs. There were mixed views on how it might be achieved. Some felt that clear overarching legislation would be best, but others felt that a case-by-case approach would be better.
- A.67 Solutions suggested included:
- requiring companies to justify why they required work to be carried out abroad.
  - allowing work to be carried out abroad if there is a shortage of the required skills in the UK.
  - implementing a cap on overseas activities within a claim.

## Qualifying Indirect Activities

Q17 - How can we identify the supporting activities which are most valuable for R&D, while providing a clear boundary to assist companies in claiming and the government in administering?

- A.68 There was a mixed response to this question with some arguing that the scope of Qualifying Indirect Activities (QIAs) is adequate and should not be changed whilst others believed there was a need to restrict or redesign them.



- A.69 However, there was a general consensus in both camps that the government guidance needs to be updated to ensure appropriate claims are being made. This was echoed by other respondents saying they felt QIAs were complex and remained unsure of what they can claim for. There were also calls for greater engagement by government to help assist companies claiming for QIAs.
- A.70 Some replies argued that QIAs should be removed and replaced with a standard uplift to qualifying cost.
- A.71 One respondent who carried out a survey of their members found that QIAs have a very minimal impact on R&D investment decisions for the majority of companies.

## HM Treasury contacts

This document can be downloaded from [www.gov.uk](http://www.gov.uk)

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

Email: [public.enquiries@hmtreasury.gov.uk](mailto:public.enquiries@hmtreasury.gov.uk)