

THE FUTURE OF R&D

BDO REPORT OF SURVEY FINDINGS

MAY 2021

IDEAS | PEOPLE | TRUST



In the wake of Brexit, the UK government is carrying out many reviews of the way UK business subsidies work to make sure they are fit for the 21st century.

A major review of R&D tax reliefs is part of this process and, on Budget day 2021, the government launched a wide-ranging consultation into the future of R&D tax incentives in the UK. In responding to the consultation document, BDO wanted to take into account the views of our clients and contacts, so we conducted a short survey online and during a webinar to gather opinion on what we believe are the most important areas for reform.

This report summarises responses to our survey from over 80 businesses, and highlights some widely held views on how R&D tax reliefs should be reformed and improved for UK companies. We would like to thank all those who took part in the survey.

EXECUTIVE SUMMARY

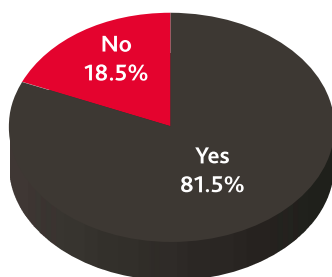
While many respondents see the UK's R&D tax reliefs as 'globally competitive', and some regard them as generous, there are both financial and operational ways in which the government could (and should in our view) improve the UK regime. Although the reliefs are currently competitive, the government should not assume that they will remain so or will always be the most attractive for any given group/project – enhancing their benefits will be essential to guarantee growth towards its target for UK R&D spending to reach 2.4% of gross domestic product by 2027.

Although there is widespread support for extending qualifying costs and simplifying qualification rules, the current differential rate of relief between the SME and RDEC schemes is important to many companies. Therefore, if there is reform to align the two schemes, the government should continue to differentiate, based on the size of the claimant firm but not based on its specific location within the UK. Developing this theme, there is strong support for using R&D incentives to achieve specific social goals and, for example, we suspect that higher rates of R&D relief for work on carbon reduction technology would be widely supported.

Responses clearly indicate a need for procedural changes to the way claims are made in the future, and decoupling claims from the annual corporation tax return process is clearly attractive. The same cannot be said for the current advance clearance procedure: we believe that if it cannot be improved substantially, it should be removed.

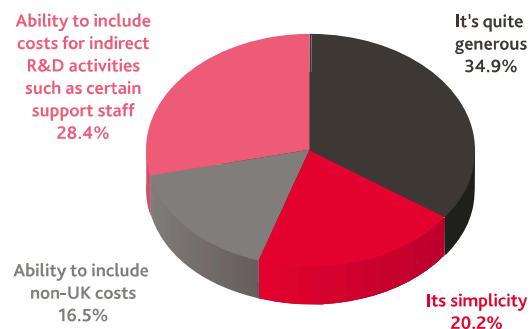
SURVEY FINDINGS

1. DO YOU FEEL THAT THE UK R&D SCHEMES ARE GLOBALLY COMPETITIVE IN ATTRACTING AND RETAINING INNOVATIVE BUSINESSES?



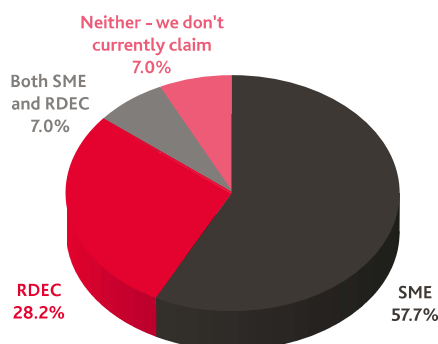
There is clear support for the current attractiveness of the UK R&D tax reliefs, with over 80% of respondents agreeing that they are already 'globally competitive'. This does not mean that the government should leave reliefs as they are: if it is to meet its own R&D investment targets for the future, the reliefs will probably have to be enhanced still further, and there is certainly no scope for any overall reduction in relief for companies.

2. WHICH OF THESE IS THE MOST ATTRACTIVE FEATURE OF THE CURRENT UK R&D TAX CREDIT?



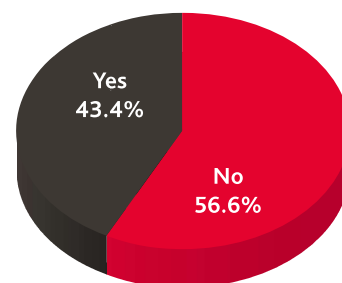
With this question we wanted to tease out perceptions of the schemes for different companies, and it is perhaps no surprise that there is quite an even spread of opinion. Even so, there is a clear feeling that the scheme is generous - although it should be noted that the majority of respondents will have been claiming under the SME scheme (see Q3). This illustrates that while an increase in the rate of R&D relief available to companies will be welcome, this need not be the sole focus of any reforms introduced as part of the government's review.

3. WHICH R&D TAX CREDIT SCHEME DO YOU CURRENTLY CLAIM UNDER?



Although government statistics show that far more relief is claimed under the RDEC scheme, the highest number of individual claims is made under the SME scheme; indeed our own statistics for claims made by BDO clients since RDEC commenced show that 80% of claims were made under the SME scheme. Relatively few companies claim under both schemes, and we suspect that this is a reflection of the fact that there are limited circumstances where an SME can claim under the RDEC scheme (and even fewer cases where they would wish to, given the lower rate of relief).

4. DO YOU THINK THE SME AND LARGE COMPANY (RDEC) R&D SCHEMES SHOULD BE CONSOLIDATED INTO ONE 'ABOVE THE LINE' SCHEME FOR ALL CLAIMANT COMPANIES?

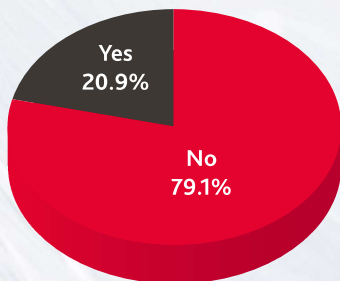


Combining the current two R&D relief schemes into one set of rules should increase simplicity for users, and this option attracted significant support. However, a greater number of respondents were against the idea, and we believe that this may be because they fear it would lead to a reduction in the rate of relief available under the SME scheme (which many see as 'generous').

We believe that it would be possible to both combine the basic qualification rules for both schemes but maintain a differential in rates of relief to ensure that the SME scheme remains attractive and globally competitive.

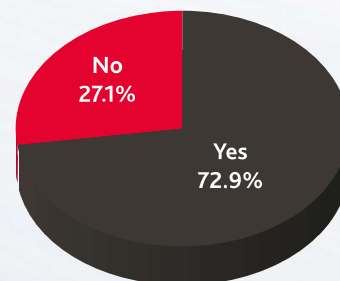
SURVEY FINDINGS

5. DO YOU THINK THE RATE OF R&D RELIEF SHOULD DIFFER BASED ON THE UK REGIONAL LOCATION OF THE R&D FUNCTION? (E.G. TO SUPPORT THE GOVERNMENT'S 'LEVELLING UP' AGENDA)



We have not tracked the location of the respondents, but it may perhaps be assumed that the strong response to this question indicates that the majority are based in areas that are 'traditionally' strong in R&D, and so would not expect to gain as part of the government's leveling up agenda. If anything, this demonstrates how valuable the current R&D tax reliefs are to companies that already claim them.

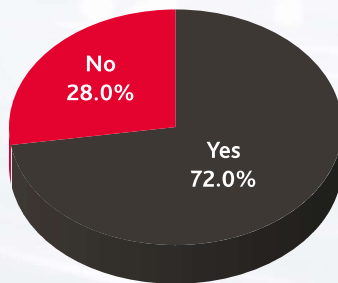
6. DO YOU THINK R&D TAX RELIEFS SHOULD BE USED TO INCENTIVISE R&D WITH SPECIFIC SOCIAL VALUE, E.G. DEVELOPING GREEN TECHNOLOGY, AND DISCOURAGE R&D IN CERTAIN OTHER FIELDS, E.G. TOBACCO RELATED PRODUCTS, ALCOHOL AND HIGH SUGAR CONFECTIONERY?



73% agreement to the idea of using R&D to achieve positive social outcomes illustrates that respondents believe that the financial incentives that the current R&D reliefs offer are sufficient to drive positive technological developments and would be a useful tool in the government's policy armoury.

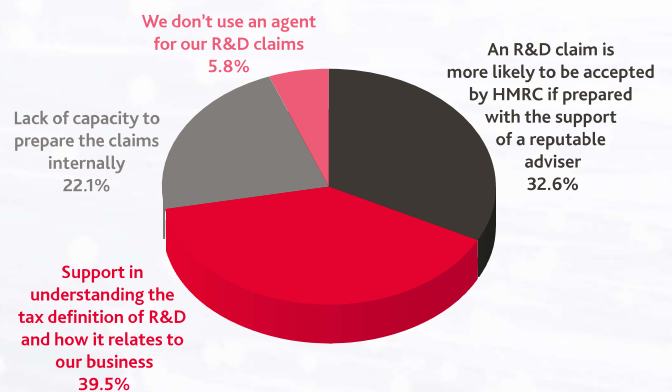
However, in a direct comment, one respondent pointed out that this should not be used bluntly against developments in established areas that might now be considered out of favour (such as petrochemicals). The respondent said that "Repurposing has excellent value for UK plc internationally and allows industries and jobs outside the UK to evolve into more useful contributors to society rather than killing them off and damaging more fragile economies."

7. DO YOU THINK THE CURRENT DEFINITION OF R&D (AS PER THE BEIS GUIDELINES) ACCURATELY REFLECTS THE INNOVATIVE ACTIVITIES YOU UNDERTAKE?



We are a little surprised that 72% of respondents feel that the current definition of R&D matches their own project work. Clearly, respondents who are familiar with the current R&D rules are perhaps confident in its application, and it is possible that projects are designed specifically to fall within the rules. We continue to believe that there is scope to broaden the definition of qualifying R&D to increase its attractiveness in the international context.

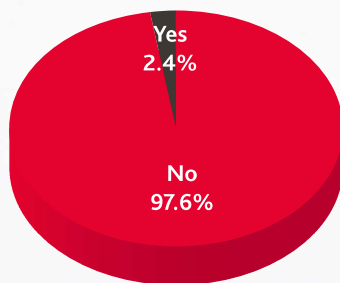
8. HMRC IS INTERESTED IN THE ROLES AGENTS PLAY IN THE R&D CLAIMS PROCESS: WHY DID YOU CHOOSE TO USE AN AGENT TO HELP WITH YOUR CLAIMS?



Given the strong answer to Q7, it perhaps a little surprising that 40% of respondents said they engage an agent to help with their R&D claim for "Support in understanding the tax definition of R&D and how it relates to our business". While it is gratifying that a third of respondents feel that an R&D claim is more likely to be successful if a reputable agent (such as BDO) prepares it, it is likely that simplifying the current rules and HMRC's procedures may open up access to more businesses.

SURVEY FINDINGS

9. HAVE YOU EVER BEEN GRANTED ADVANCED ASSURANCE FOR AN R&D CLAIM UNDER EITHER OF THE HMRC R&D ADVANCED ASSURANCE FACILITIES?



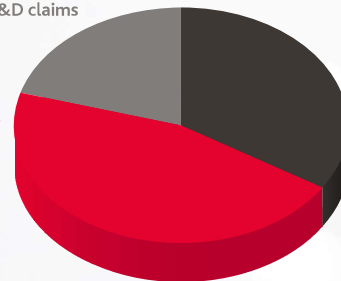
As we have stated in our formal response to HMRC's consultation, we believe that HMRC's current 'advanced assurance facilities' are not fit for purpose and offer very little benefit to companies, and the fact that 98% of respondents have not used them appears to bear this out.

10. WHICH OF THE FOLLOWING PROCEDURAL CHANGES FOR R&D CLAIMS WOULD YOU MOST LIKE TO SEE IMPLEMENTED BY HMRC?

HMRC to commit to processing RDEC claims as quickly as SME R&D claims
20.2%

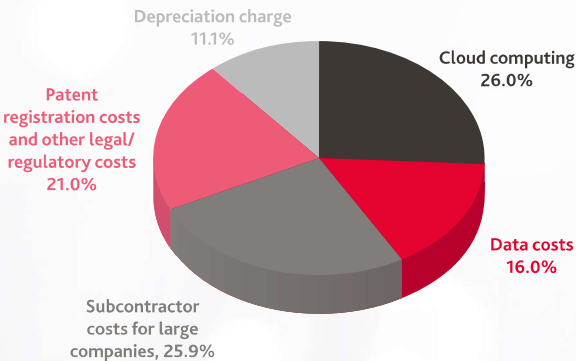
An on-line portal for submitting R&D claims outside the corporation tax return and tracking claims progress in real time
45.6%

The ability to make 'live R&D' claims on a quarterly basis throughout the relevant accounting period
34.2%



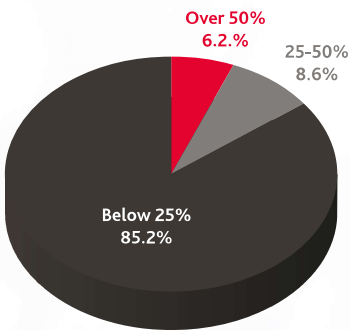
A combination of 80% of respondents want to be able to make R&D claims outside of the normal corporation tax return process, and the preference for using an online portal to make and track R&D claims illustrates that companies feel the current claims process needs to be simpler and more transparent.

11. WHICH OF THE FOLLOWING COST CATEGORIES WOULD YOU MOST LIKE TO SEE ADDED TO THE QUALIFYING COST CATEGORIES FOR R&D CLAIMS?



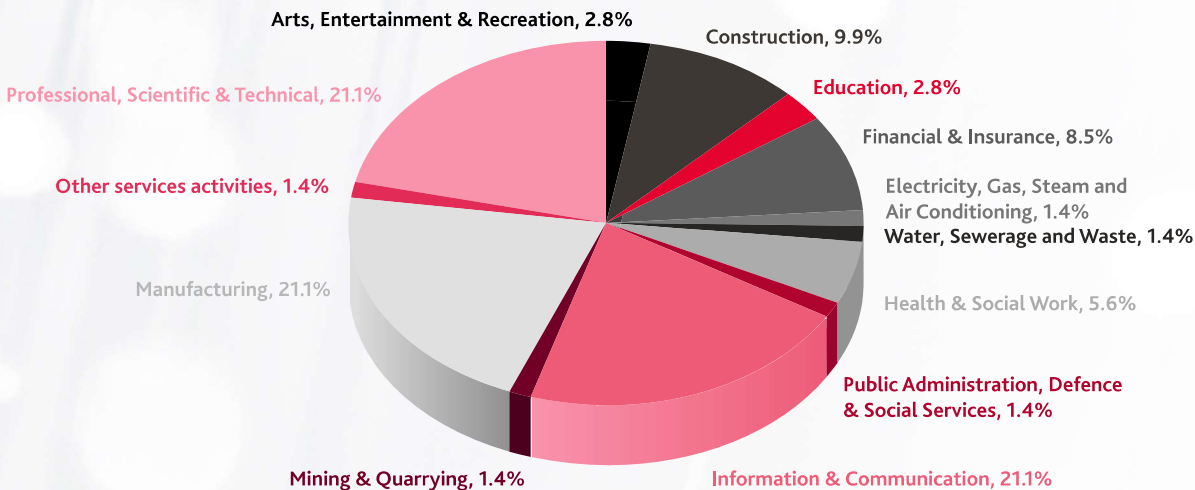
We can see the benefit of expanding qualifying costs to cover all these categories, but the fact that including cloud computing and data costs would benefit 42% of survey respondents just illustrates how business models have changed since R&D was first introduced.

12. WHAT PROPORTION OF YOUR QUALIFYING EXPENDITURE FOR YOUR MOST RECENT UK R&D CLAIM WAS COMPRISED OF OVERSEAS COSTS?



Although the government has expressed concern that the UK's R&D reliefs should not be used to support overseas research jobs, respondents have clearly shown that for the vast majority of companies, overseas R&D costs are relatively small. We believe this demonstrates that the current restrictions are adequate and no further limitations are required to protect the Exchequer.

13. WHICH IS THE MAIN BUSINESS SECTOR IN WHICH YOU CLAIM R&D RELIEF?



SURVEY FINDINGS

14. ARE THERE ANY OTHER CHANGES YOU WOULD LIKE TO SEE MADE TO UK R&D TAX CREDITS? IF SO, WHAT ARE THEY, AND WHY?

Please note that the feedback we received has been edited and abridged, but we have aimed to summarise the key thrust of each comment.

RATES OF RELIEF

Several respondents suggested rates of R&D relief should be increased to give more support to SMEs and to improve the UK's competitiveness with other countries – notably France. It was also suggested that the cost restriction to 65% for third party providers is removed to give 100% relief as these are still relevant costs to the claimant business. One respondent went so as far as saying *"The current system is not fit for purpose or generous in any way, shape or form compared to some EU countries and the EU Horizon and other schemes."*



SCOPE OF THE RELIEFS/QUALIFYING EXPENDITURE

There were a number of comments about expanding the current scope of the R&D reliefs, with a number of respondents pointing out that the current definitions are not suitable for technology and software businesses and that *"The current regime is too focused on the 'old economy' (e.g. pharma, engineering)"*. It was pointed out that R&D in the tech sector looks quite different to that in pharma or engineering – the "innovation" is not really about creating new discoveries or even new algorithms; rather it is about applying existing tech to new use cases: *"...the R&D definition doesn't encompass this, so how are we going to incentivise UK companies to step up in this space?"*. One respondent pointed out that *"The US, Netherlands, France etc. all reward this [type of activity] through R&D tax credits but the UK regime doesn't"*.

Although the government has been consulting on including data and cloud computing costs as qualifying expenses, one respondent commented that this *"...doesn't remotely address this issue: it still considers these things as 'inputs' for old-economy businesses rather than things that require innovation in order to turn them into outputs"*.

There were comments about the inclusion of regulatory-related costs in R&D qualifying expenditure, for example related to Medical Device Regulation, as well as expanding the scope to *"...include higher manufacturing readiness level (MRL) innovation activity"*. A respondent from a Pharma research business suggested that costs of 'Phase IV' testing activities be included as eligible within an R&D claim: the point being that although the activities are 'post market', *"...there is still significant scientific input, technical uncertainty to resolve"*. We understand that the ABPI phases were originally developed with a view to carrying out clinical trials within the R&D rules so excluding Phase four seems inappropriate – particularly following the pandemic.

A post-Brexit issue was identified by a respondent concerning Pre-Clinical and Phase I-IV Clinical trials. Where this work is subcontracted to a UK business by an EU business, the EU business can now only claim for costs of subcontracted/outsourced R&D performed in the EU/EEA in their local R&D claims. Although this does not yet apply to all EU countries, it is expected to in time, which puts UK-based researchers at a commercial disadvantage. The respondent suggested that this might be offset by *"the government unilaterally providing some kind of incentives to clients from the countries impacted to continue placing work in the UK (e.g. so they are at least partially compensated for the 30% tax credit they can obtain in France, 25% in Spain etc.)"*.



One respondent pointed out that including capital expenditure within the scope of RDEC would *"simplify the claim process, remove another area of subjectivity (in having to distinguish between capital and revenue) and provide a greater stimulus for investment in large scale, transformative R&D projects"*.

Another added that it would be better to have some kind of inclusion of depreciation / capital spend within the RDEC rather than the current RDAs so that there is an incremental benefit of making significant R&D capital investments in the UK (rather than just a 100% year one deduction). The respondent pointed out that *"Adding to the RDEC would allow us to forecast the incremental benefit when planning / forecasting return on capital investments UK vs EU vs APAC vs Americas etc."*

ADMINISTRATIVE PROCESSES

Although the issue was partially covered in question 10, several respondents also specifically mentioned that the ability to make R&D claims on a quarterly basis would make a dramatic improvement to the reliefs and would bolster cash flow for smaller businesses. Another also pointed out that improving the *"visibility of the claim"*, i.e. a system to let the claimant know what stage it had reached within HMRC's process, would be very helpful.



It was also suggested that the deadline for claims be extended from two years after the relevant year to six years, to allow companies to revisit past claims.

One respondent also suggested that HMRC publish a wider range of case studies *"...to help SMEs understand what to claim"* as well as simplifying the expenses rules.

POLICY ISSUES

Although respondents were split on the attractiveness of combining RDEC and the SME scheme, one respondent did set out some of the simplification benefits around contractors/subcontractors as follows:



"If the SME and RDEC scheme were consolidated into one, then entitlement to claim for subcontracted R&D could be given to either the contractor or the subcontractor without reference to the SME status of each party (as is currently necessary). If entitlement to the claim was given to the contractor rather than the subcontractor, then there is a greater incentive to the person making the investment decision. Alternatively, entitlement could be given to the subcontractor by election as part of negotiations between both parties. An added consequential benefit would be the removal of any need to distinguish between subcontracted R&D and externally provided workers, as both could be qualifying expenditure for the contractor (or to the subcontractor, by election)."

As an alternative to merging the schemes, one respondent suggest that UK accounting standards are adjusted so that credits are recorded above the EBITDA line to better reflect the commercial substance of subsidy; the aim would be to support SME's access to external finance.

A further suggestion that we wholeheartedly support was that the government should provide long term assurance that R&D tax reliefs will not be withdrawn, so business can budget investment decisions more confidently.

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