

## ***R&D Tax Reliefs Review Consultation on a single scheme***

A public consultation issued jointly by HM Treasury and HMRC in January 2023

Comments from ACCA to HM Treasury (HMT) & HMRC  
Ref: TECH-CDR-2034

13 March 2023

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## EXECUTIVE SUMMARY

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*“The UK’s R&D tax incentives for SMEs and large companies are designed to encourage greater R&D spending in order to promote investment in innovation. The strong message from business is that simplicity, consistency and certainty are key in achieving the aims of the relief.”<sup>1</sup>*

We agree with HMRC’s sentiment fully as set out in their Corporate Intangibles Research and Development manual (CIRD).

In our recent letter to the Chancellor regarding the Spring Statement we asked:

*We would like to understand how SMEs will be provided for if the proposal to merge the two existing schemes into one RDEC version. This method of ‘finance’ for innovation is relied upon by SMEs and decisions around innovation and R&D activity are taken with a long-term view and for this reason we recommend that any changes are phased in to give the businesses the time to make other arrangements as their access to finance is already limited as outlined above. Linked to this is the approach that HMRC is currently taking in processing the claims. We would ask that further resources are provided to HMRC or better procedures (such as those used by the Venture Capital Schemes team) are implemented to engage more with the businesses and their accountants, our members, to achieve mutually beneficial outcomes.*

Many of our members support SME businesses and research and development (R&D) for SMEs may also be in the form of productivity advances rather than large scale innovation. Alongside the advances in productivity there are other benefits both regionally in hubs, and across sectors that ‘spillover’. Spillover effects include knowledge dissemination through physical proximity and social ties, exchange of tacit knowledge, and exchange of ideas between neighbouring businesses on regional and sectoral lines.

*“In broad terms, however, the SME scheme is generally unaltered in terms of how it operates. Nonetheless, the rate at which relief is given has varied over the years. The current rate of 230 per cent (with a payable credit at 33.5 per cent) has applied since 2015.”<sup>2</sup>*

*“Like the SME scheme, although there have been various changes since the introduction of RDEC in 2013—including changes in the rate of relief—the form of the relief as it operates today is broadly unchanged. The current rate of relief of 13 per cent has applied since April 2020.”<sup>3</sup>*

And we echo the sentiments of the House of Lords and ask HMRC and HMT the question why is reform of this nature needed at this particular time? Should we pause, take time to assess the responses before proceeding with further changes when the calls are to maintain stability through existing schemes and certainty in HMRC’s action, interpretation, and knowledge?

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<sup>1</sup> CIRD80525: <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird80525>

<sup>2</sup> HOUSE OF LORDS Economic Affairs Committee 3rd Report of Session 2022–23 HL Paper 137 Research and development tax relief and expenditure credit: <https://publications.parliament.uk/pa/ld5803/ldselect/ldconaf/137/137.pdf>

<sup>3</sup> HOUSE OF LORDS Economic Affairs Committee 3rd Report of Session 2022–23 HL Paper 137 Research and development tax relief and expenditure credit: <https://publications.parliament.uk/pa/ld5803/ldselect/ldconaf/137/137.pdf>

## GENERAL COMMENTS

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ACCA welcomes the opportunity to provide views on the design of a single R&D tax relief scheme in response to a consultation issued jointly by HMT and HMRC. We would like to see both small to medium sized enterprises (SMEs) and large businesses fairly represented in the final scheme and echo HMRC's own words:

*“The UK’s R&D tax incentives for SMEs and large companies are designed to encourage greater R&D spending in order to promote investment in innovation. The strong message from business is that simplicity, consistency and certainty are key in achieving the aims of the relief.”<sup>4</sup>*

We have consulted through surveys, emails and expert interviews with our members including those working in practice and the corporate sector. In addition, we also wish to reference our response reference TECH-CDR-2031 to the recent HMRC consultation on *“Draft guidance: Research and Development (R&D) tax reliefs”* which we believe is linked to the discussion here and to which our members have also contributed.

There is also a public perception that the scheme is widely abused and that HMRC are cracking down, with stories in the press of R&D fraud letters. This promotes fear over the scheme.

Comments from our members suggest that through their networks they believe that some of the disreputable firms are exiting the market following further scrutiny from HMRC pointing to the fact that action by HMRC holds the most value to create impact. Albeit it should be imposed evenly.

We believe that HMRC needs to release more comprehensive guidance for business on how they could be eligible for R&D allowing HMRC to set out the legislative framework and parliamentary intent rather than some R&D agents controlling the narrative. Webinars with live Q&As could be held online or at events for SMEs, or specific targeted sectors (such as life sciences or technology etc.). Sharing examples of eligible R&D projects for the most common industries would be helpful and would raise public support for and confidence in R&D tax reliefs. As part of this engagement programme, HMRC should issue guidance to businesses on what to look for in an R&D agent, such as qualified tax professionals, accredited firms and regulated professional bodies.

Concern exists about the administration of the claims by HMRC as witnessed by our members. In our letter to the Chancellor regarding the Spring Statement, we asked the Government if they are concerned with the abuse rather than aiming to restrict the incentives, we call on them to confine R&D claims to certain avenues - through reputable companies and tax agents authorised by professional bodies who are signed up to Professional Conduct in Relation to Tax (PCRT). PCRT includes specific guidance to its members on how to provide R&D tax credit services. Leveraging the existing working relationships with tax agents and gaining reassurance through the professional body's investigation and disciplinary procedures.

We are glad to see the objective is to support R&D.

*“Overall, the Government would like a system for supporting R&D which drives innovation and growth, is simple to use and administer and underpinned by the effective application of taxpayers’ money.”<sup>5</sup>*

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<sup>4</sup> CIR80525: <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird80525>

<sup>5</sup> Foreword HMRC/HMT Consultation document: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1128970/20230113\\_R\\_D\\_Consultation.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1128970/20230113_R_D_Consultation.pdf)

This appears to be backed up by a new dedicated Department for Science, Innovation and Technology (DSIT) with a seat in the Cabinet, another key steppingstone on the path to a more knowledge-based innovation focussed economy. Another example, the investment of £20 billion in the Rosalind Franklin Institute developing the 5 technologies of tomorrow.

The fundamental problem is whether a one-size-fits-all scheme and single policy approach offers incentives for innovation to the entire business community in wider focus. A RDEC approach suits a larger company in, say, the pharmaceutical sector rather than attracting the UK or overseas based international investor. We are concerned that the current measures give the impression that the UK is not focusing on innovation through **all** business in the economy and the knock-on effect is that investors will look elsewhere. A concern shared by our members.

There's a suggestion also from our membership to expand relevant topics beyond pure maths –

*"In a modern society the study of anthropology, economics, political science, psychology, and sociology, could be extremely influential."*

There's a question about whether the existing or proposed schemes are agile enough for the changing landscape? Flexibility and agility should be built into the system and schemes and highlighting the attractiveness of the UK for innovation and business.

Finally, we would like to see bolder objectives, taking into account, some of the recommendations from the Skidmore Review on matters such as the green agenda, net zero commitments - specifically to "UN Sustainable Development Goal (SDG) number 9 - Build resilient infrastructure, promote inclusive and sustainable industrialization and foster **innovation**" and is one which ACCA is committed: "*We will empower our community so they can support organisations to be ethical, sustainable, successful and able to participate in the global economy.*"<sup>6</sup>

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<sup>6</sup> ACCA: Our commitment to the United Nation's Sustainable Development Goals: <https://www.accaglobal.com/my/en/about-us/sustainable.html>

## SPECIFIC QUESTIONS & COMMENTS

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1. Do you agree a new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?

Our members are generally positive towards above the line (ATL) schemes.

Nevertheless, we understand that HMT has already looked at this regarding small to medium enterprises (SMEs) specifically and decided not to proceed.

*“Following responses to the previous consultation, we are not proposing to change the existing SME scheme to an ATL credit. In addition, the level of SME R&D tax relief will not be reduced as a result of a change to ATL. We would still welcome your views on retaining the existing SME scheme and the impact on SMEs of introducing an ATL credit for large business.”<sup>7</sup>*

*“The econometric analysis suggests that the scheme does in fact stimulate additional expenditure by businesses that do conduct R&D (in other words, affects the intensive margin of R&D expenditure) in addition to attracting new claimants.”<sup>8</sup>*

The data shows that SMEs make up the largest proportion of R&D claims and are more open to persuasion by incentives. Good examples of successful innovation are start-up fintech companies.

*“This is consistent with findings suggesting that, for a given scheme, SMEs are more responsive to R&D tax incentives than larger companies, as they are more likely to be financially constrained (Dechezleprêtre and others, 2019).”<sup>9</sup>*

*“Innovative behaviour is measured by examining the number of UK patent applications filed by claimants in the years prior to and after their first claim, as well as comparing the types of intellectual property (IP) protections used by claimants to those by non-claimants. In total, the number of UK patent applications filed peaked in the year in which the business first claimed under the scheme (Figure 10). In comparison to years before claiming, the average number of applications filed per business per year increases after their first claim, suggesting that businesses are more innovative after having claimed under the scheme. Following businesses’ first claim, the decreasing total number of patents filed, and the increasing average number of patents filed per business, suggests that there is a select group of claimants that are more innovative than others. However, results are likely to underestimate the number of UK patent applications among claiming businesses as only exact matches based on the company name and region are used.”<sup>10</sup>*

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<sup>7</sup> HM Treasury: Consultation on an ‘Above the Line’ credit for Research and Development:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/81255/condoc\\_above\\_line\\_credit\\_rd.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/81255/condoc_above_line_credit_rd.pdf)

<sup>8</sup> Section 2.3.2, page 26 Evaluation of the research and development tax relief for small and medium-sized enterprises published by HMRC on 17 November 2020: <https://www.gov.uk/government/publications/evaluation-of-the-research-and-development-tax-relief-for-small-and-medium-sized-enterprises>

<sup>9</sup> Section 2.3.3, page 26 Evaluation of the research and development tax relief for small and medium-sized enterprises published by HMRC on 17 November 2020: <https://www.gov.uk/government/publications/evaluation-of-the-research-and-development-tax-relief-for-small-and-medium-sized-enterprises>

<sup>10</sup> Section 3.2.1, page 28 Evaluation of the research and development tax relief for small and medium-sized enterprises published by HMRC on 17 November 2020: <https://www.gov.uk/government/publications/evaluation-of-the-research-and-development-tax-relief-for-small-and-medium-sized-enterprises>

There is a feeling that merging the schemes will disproportionately affect SMEs at a time when they are grappling with the current prevailing economic headwinds. Members felt the key to economic stability and growth at present was **certainty**.

2. Does the taxability and subsequent different post tax net benefits impact your decision making when allocating R&D budgets?

There were mixed feelings from our members on this question. Although, the decision over whether to carry out R&D was not felt to be solely motivated by tax reliefs and rather those were helpful in financing the endeavour.

3. If you use RDEC now, is there anything in your view that should be changed?

Our members preferred the 'status quo' with R&D schemes providing the much-needed certainty to their companies and clients. Some comments our members shared with us:

*"I suggest the new proposals for SMEs is what needs to be adjusted to maintain the 130% and 14.5% instead of introducing the 86% and 10%, as proposed for 01 April 2023."*

4. Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?

Our members did not agree.

*"The subcontracting rules mean that the company commissioning the R&D isn't incentivised to do so where a subcontractor is involved / needed. This is perhaps less relevant for large companies but highly relevant for smaller companies that have a competent professional in-house but can't afford to staff a team."*

5. If so, where R&D activity is subcontracted, do you think that the customer should claim the tax relief, as in the SME scheme, or the subcontractor, the person carrying on the R&D, as in the RDEC?

Our members did not express a definitive view on this question. The following comments are from one of our members:

*"I think my main feedback/concern was around subcontracting and how disadvantaged SMEs will be if the RDEC approach was adopted. The smallest businesses can't afford to run everything in-house in the fledgeling days and has to subcontract. Those businesses should be nurtured, supported and incentivised. Also that the rules should be seeking to incentivise R&D to be undertaken rather than reward R&D that would have been done anyway. So if a subcontracting business is the one that's able to claim, it's more of a reward for being clever than an incentive to take a chance."*

*"Also though, that simplification needs to be an overriding principle - which sadly runs counter to my concern re subcontracting as it's one of the sticky areas. If there isn't a big push to simplification, then it will be a missed opportunity,"*

It would seem reasonable that the claimant is the company which undertakes the activity and can substantiate the claim in full. However, if there were requirements for a subcontractor to provide a report in an approved format using an agreed template to the principal contractor in order for the principal company in the chain of subcontractors to make the claim. We note that other bodies are suggesting a joint election facility which would provide the necessary flexibility for SMEs.

Alternatively, there could be claims made based on the 'value-added' at each level in a similar way to VAT. It would seem to add another layer of complexity that would further complicate and potentially delay the process of making a claim and for this reason the joint election is preferable.

6. Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?

Consideration of the impact on start-up businesses to any changes to the subcontractors' rules should be borne in mind and more broadly the likelihood of those businesses registering their intellectual property in the UK. Please see a quote from our member in answer to question 5.

7. Do you have an alternative model you think could apply all claimants in the new scheme? Please provide qualitative and quantitative evidence with your proposal.

Our members did not provide any suggestions for an alternative scheme and instead preferred the stability and certainty offered by retaining the existing schemes.

8. What are your experiences of the PAYE / NICs cap?

We understand the reasons for using a cap and for that to be based/backed on PAYE/NIC in incentivising companies to harness labour intensive R&D activity and limit the investment by HMRC (tax incentive franked by other corporate taxes already paid).

*"It's never been close to the cap, and this will be even more the case given the exclusion of overseas expenditure."*

As referenced by the above comment, members did not seem to be overly concerned about the impact of the cap. Although, other comments included:

*"It makes little sense to me that personal income tax of non R&D related personnel should be a factor in the calculation."*

9. Are there any ways the Government could simplify the PAYE / NICs cap whilst ensuring there is protection against abuse?

As mentioned in answer to question 8, our members did not feel the cap impacted the claims they worked on. It would seem reasonable to assume there was no abuse. Members did feel the approach taken by HMRC in practice could be more collaborative working with tax advisers and particularly those signed up to the Professional Conduct in relation to Tax (PCRT).<sup>11</sup>

Our members felt that media allegations about abuse of the R&D schemes have led to a change in HMRC's approach to be more adversarial across the board. This is leading to a lack of confidence in the administration of the system by the claimants.

A better option may be for HMRC to adopt a similar approach to that used by the Venture Capital Schemes (VCS) team? This was a suggestion made by a couple of our members due to their experience of good quality customer service levels with reasonable more certain turnaround times. In saying that we understand the approach set out in CIRD80525 but would recommend those points are used to benchmark actual experience by HMRC's customers. This could be included in the performance plan.

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<sup>11</sup> *Professional Conduct in relation to Tax (PCRT)*: [https://www.accaglobal.com/sg/en/technical-activities/technical-resources-search/2019/february/professional-conduct-in-relation-to-taxation-pcr.html#:~:text=Professional%20Conduct%20in%20Relation%20to%20Taxation%20\(PCRT\)%20sets%20out%20the,members%20who%20undertake%20R%26D%20work.](https://www.accaglobal.com/sg/en/technical-activities/technical-resources-search/2019/february/professional-conduct-in-relation-to-taxation-pcr.html#:~:text=Professional%20Conduct%20in%20Relation%20to%20Taxation%20(PCRT)%20sets%20out%20the,members%20who%20undertake%20R%26D%20work.)

One member made the suggestion for using Employer NICs as a cap given the investment by employers in labour.

*“A cap based on Employer NICs makes more sense to me.”*

10. Which of the SME and RDEC PAYE & NICs cap should the Government implement in the new scheme?

There was little to provide detail on which cap was preferred, possibly a softening towards RDEC system but not to cast a shadow on maintaining **certainty**.

11. Should the Government change the way either cap is calculated if it is taken forwards? And if so, how?

Our members support stability at this time of such uncertainty in the economy.

The cap is useful in incentivising companies to engage more labour in their R&D activity. There was a call for stability in the existing schemes and to not make changes to the way either cap is calculated.

12. Do you consider the Government should provide more generous support for different types of R&D or more R&D intensive companies relative to less R&D intensive companies?

Our members have expressed interest in learning more about provisions of more generous support for different types of R&D but care to be taken not to distort the market.

*“No, the aim should surely be simplification, and this just introduces more subjectivity/complexity.”*

We are interested in learning more about how and why the Government may provide more generous support for different types of R&D, although we are cognisant of the challenge of managing market distortions. We believe HMRC could manage relationships across the R&D sector with regular feedback in both directions in taking a collaborative approach in this area.

The challenges of reaching net zero will mean that new approaches and ways and transformation is necessary to prevent catastrophic climate change and which must be incentivised above all other. We call on the Government to consider how more generous support could be provided to meeting those challenges.

13. In the event this were to be done, how might this best be achieved within an overall cost envelope?

ACCA believes there are three foundations for a sound tax system: simplicity, certainty, stability and any changes should flow through those three gates. We are unable to comment on the overall cost envelope without further details on what and how that works.

Our members thoughts:

*“Keeping it simple is better otherwise it may be susceptible to abuse.”*

14. If the schemes are merged do you agree the Government should implement the merged scheme on 'accounting periods starting on or after 1 April 2024'?

Timing is incredibly important particularly in maintaining stability in an already uncertain environment. Our members agreed with this sentiment.

A member provided some strongly worded feedback to this question below:



*“We need clarity and certainty for decision making, it seems implausible that an April 2024 timeline can provide that unless this consultation is a sham and the new scheme is ready to go.”*

We would ask - is the timing too ambitious?

Our membership seems to understand how to use the existing schemes and feels they meet the needs of those diverse groups: SMEs and large companies. The action our members felt would bring the most impact was the administration of the schemes (i.e. how the claims were dealt with) – simply, in a stable system leading to greater **certainty** (i.e. processing times, interaction with HMRC officers etc.)

We recommend taking more time to review the responses to the consultation along with preparing an economic impact assessment and announcing the rates that will be used, before implementing the changes. Providing not less than a 12 to 24 months transitional period to enable companies absorb, process and to plan for the changes. Especially for SMEs (where our members believe the largest impact will be felt). We did not find any support for the measures being implemented for accounting periods starting on or after 1 April 2024.

15. How can Government ensure SMEs are supported in the transfer into a new scheme?

*“Clarity, simplicity, advance warning.”*

As outlined in our answer to question 14 we believe that careful planning of the timing for the roll-out, should the Government wish to proceed with the merged scheme after the consultation period, should be made.

*“SMEs should not be penalised by lower incentives because the point is to encourage innovation. If cash flow is impacted by low R&D claims, this can hinder the future of innovation across businesses in the country as a whole.”*

16. Does claiming for expenditure on qualifying indirect activities influence your decision to undertake R&D?

Our survey results did not show a link between the decision to undertake R&D and claiming for expenditure on qualifying indirect activities, although we feel that this may impact how globally competitive the scheme is.

17. Do you think a threshold should be implemented? If one was implemented at what level should it be introduced?

A threshold seems reasonable to manage the stretched resources at HMRC. Yet, we note the original threshold of £10,000 was removed in April 2012.<sup>12</sup> In a discussion with one of our members it was mentioned that, based on their cost benefit analysis, they’ll be forced to apply a threshold to the claims they can work on profitably should the proposed changes come into force. This trusted adviser will effectively leave the market for smaller SME claims and this will lead to a further lack of support for SMEs.

18. What is the average amount of R&D expenditure per year per firm in your business or sector?

Our member survey indicated a spend of between £100,000 and £3 million.

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<sup>12</sup> Section 2.2.1, page 17 *Evaluation of the research and development tax relief for small and medium-sized enterprises* published by HMRC on 17 November 2020: <https://www.gov.uk/government/publications/evaluation-of-the-research-and-development-tax-relief-for-small-and-medium-sized-enterprises>

## CONCLUSIONS

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In keeping with HMRC's own guidance and as included in our second paragraph in the general comments section, we would ask for simplicity, consistency (stability) and **certainty** especially given the current economic situation.

Our members support SMEs, by and large, and we would like to remind HMRC and HMT of the direct and indirect impacts, and 'spillover' effects of companies carrying out R&D activities in the UK and to not preclude the SME sector including start-up businesses from such benefits.

We recommend aligning the definitions (such as qualifying indirect activities) and measurement of innovation and R&D (to those in the Frascati manual) to provide transparency and enable international comparisons to be drawn.

ACCA remain steadfast in their role and on behalf of our members to guide the process, and work with HMRC and HMT on finding the optimal solution that supports the public interest and value for taxpayers money. Our members who are trusted advisers are interested in working with HMRC to reduce fraud and error.

In the voice of one of our members, the success of any new scheme:

*"It depends how simple and clear the new scheme is."*