

UK Research and Development Roadmap

ForrestBrown response

How can we best increase knowledge and understanding through research, including by achieving bigger breakthroughs?

As an R&D tax adviser, our subject matter expertise relates to applied development and commercialisation of research by companies. We regularly advise businesses across all sectors and of various sizes, from start ups to established businesses, on R&D tax incentives, giving us insight into the challenges faced by these businesses and how they interact with government support for R&D. As such, we will limit our responses to our area of expertise. Overwhelmingly, our clients find the R&D tax incentive to be a vital form of funding for innovation, and we have seen first-hand the transformative effect the tax incentive can have for a business. However, there are opportunities to review the R&D tax incentive to clarify the support on offer and to ensure that it is meeting its policy intent. A further review could help ensure that the system is not open to misuse either through poor-quality advice or fraudulent activity.

In terms of achieving bigger breakthroughs in research, a review of the R&D tax incentive could consider ways to incentivise collaboration on R&D projects between the academic and the business communities. Research should consider how companies working on 'moonshot' projects interact with the tax incentives currently available and what more could be done to raise awareness and impact. In addition, enhanced R&D incentives could be offered for those with a focus on recruiting the top talent from a variety of diverse backgrounds.

We welcome the chance to begin a dialogue on the future of the UK R&D landscape. However, the R&D roadmap is lengthy and full of big promises with little in the way of actual commitments. Once responses to the online survey have been gathered and analysed, the next phase should set expectations for some more tangible outcomes.

How can we maximise the economic, environmental and societal impact of research through effective application of new knowledge?

If government wishes to support projects which contribute to the key economic, environmental and societal challenges we face, it could use the R&D incentive as a dynamic way of achieving this. Projects which seek to create or improve technologies to tackle these big issues could attract a higher rate of relief, while relying on an established mechanism within the tax system to deliver this relief. Such a boost could be enacted temporarily, as it would target a subset of projects which already attract tax relief.

A further way in which the government could support projects which deliver economic and environmental merit is to clarify the relationship between grant funding and the R&D tax incentive. Currently, this interaction is complex and the guidance available to companies can be conflicting. Many of the complexities arise from the SME tax incentive's status as a notified state aid. These rules could be reformulated to create a funding environment for businesses where direct and indirect support enhance rather than conflict with each other.

How can we encourage innovation and ensure it is used to greatest effect, not just in our cutting-edge industries, but right across the economy and throughout our public services?

An effective tax incentive for R&D is an essential pillar of an economic strategy which encourages business innovation. The R&D tax incentive encourages innovation right across the economy (whereas direct funding targets specific projects).

The time is right for the R&D tax incentive in the UK to be reviewed. It was introduced 20 years ago and has undergone a substantial number of individual amendments since that time. The result is a complex set of rules and a number of challenges to its effectiveness. These challenges include a lack of awareness among business, a vulnerability to abuse and a market which attracts poor quality advisers, a hardening of compliance efforts from HMRC and increasing costs. As the UK moves into a potentially prolonged recession, an effective tax system which protect innovation becomes absolutely key to recovery.

There are currently consultations running covering the re-introduction of the PAYE/NIC cap and changes to qualifying expenditure categories. These changes will create further complexity and uncertainty, and because of the lack of research into the effectiveness of the incentive, their impact is far from clear.

The PAYE/NIC cap will introduce new restrictions on relief and is designed to address abuse of the incentive. It is being introduced in response to fraudulent activity. A well-funded and well-trained HMRC team would be a more effective way to combat fraudulent activity, instead of new legislative protections, which will increase the administrative burden on law-abiding companies while fraudsters will no-doubt take little notice (fraud operates outside the law).

With respect to the qualifying expenditure categories, the consultation suggests that any additional qualifying expenditure needs to come at the expense of reducing the scope of qualifying expenditure by some other means in order to make the change cost-neutral. A cost-neutral aim is made much more challenging when only peripheral aspects of the incentive are being reviewed and such incremental changes risk damaging the effectiveness overall as the wider context of the incentive is not being considered.

In this instance, a consultation on the inclusion of cloud hosting and data costs, reflecting a welcome modernisation of the computer software category, has been broadened to consider abolishing relief on qualifying indirect activities. This 'quid pro quo' approach to the consultation adds to the problem of incidental amendments creating complexity and potentially harming the overall effectiveness of the incentive.

How can we attract, retain and develop talented and diverse people to R&D roles? How can we make R&D for everyone?

A thriving community of innovative technology businesses will create a healthy and diverse market for STEM roles in the UK. Currently the R&D tax incentive does not place any restrictions on where R&D is carried out. A review of the incentive could look at whether it could be used to encourage employment of highly-skilled workers in the UK. There is already a differential between the relief awarded for employees and that available for contractors, with employee costs attracting the more generous treatment. It would, however, be beneficial for this to be a reward rather than a restriction. The proposed PAYE/NIC cap will restrict the relief for some genuine claimants who rely on a contract workforce or overseas expertise.

To remain globally competitive, the tax incentive needs to allow companies to access the expertise they need for

their R&D, and not punish those businesses if that expertise sits outside the UK. A balanced approach should be adopted which recognises that while we seek to attract talent to the UK, UK businesses may need to look outside of our borders to remain globally competitive in their fields.

As well as considering the cost base, there is currently no reward for businesses who choose to use their R&D tax credit funding to create new STEM roles within their businesses. Many of our clients tell us that they do, as the funding helps them to change their risk appetite for innovation and, as a result, increases their need for skilled staff to support increased R&D activity.

It is widely accepted that businesses who invest in R&D grow more quickly and are more successful. The economy benefits because these businesses then employ more people and spend more. The incentive could work harder to encourage these desirable behaviours.

How should we ensure that R&D plays its fullest role in levelling up all over the UK?

Capital investment tax incentives could be used effectively to support companies who choose to locate their businesses in areas which will benefit from that decision. Enterprise zone allowances are a tax mechanism which have previously been used to this effect. A combined enterprise zone and R&D capital allowance could give an additional boost to companies locating R&D centres in certain areas.

How should we strengthen our research infrastructure and institutions in support of our vision?

The value of R&D capital allowances has been eroded in recent years by a generous annual investment allowance, and the recent introduction of structures and buildings allowances. This underused tax incentive for capital investments in R&D and providing facilities for R&D should be reviewed and improved to incentivise business decisions about capital R&D investments. As mentioned, this could be linked to geographical location in order to promote Enterprise Zones and investment in technology infrastructure outside of the Golden Triangle. This could encourage stimulus to the economy and provide long lasting stability for UK R&D firms.

Furthermore, considering how and when businesses access the available research infrastructure could encourage additional collaboration between companies and research facilities/ higher education institutions. Where companies co-locate with academic or research organisations, tax relief could be awarded for premises costs to incentivise both tenants and developers of facilities. Currently larger companies can obtain a tax credit for contributions they make to independent R&D. A review of the tax incentive should consider whether the inclusion of this expenditure type informs business decisions or fosters greater corporate/academic collaboration. There is equivalent relief for SME businesses.

How should we most effectively and safely collaborate with partners and networks around the globe?

It is important that the UK's tax incentives for R&D are both competitive globally, and also reflective of the positive impact of global collaboration on research.

A balance is required between the desire to draw R&D activities and research talent to the UK, and recognising that R&D is inherently global. Restrictions such as the PAYE/NIC cap risk setting a nationalist perception; penalising companies who need to access overseas talent pools to carry out R&D.

How can we harness excitement about this vision, listen to a wider range of voices to ensure R&D is delivering for society, and inspire a whole new generation of scientists, researchers, technicians, engineers, and innovators?

In summary, the R&D incentive should be reviewed as a whole, including consideration of the definition of R&D, the different reliefs for different sizes of business, eligibility criteria (in particular interaction with direct funding), qualifying expenditures and the mechanism for the relief. Capital tax incentives should be included within this review. A clear definition of R&D or innovation (or both) is really important. The definition of R&D for tax purposes is not accessible for businesses or society. This has impacted awareness and effectiveness of the incentive. Too many businesses still do not access the incentive when they carry out R&D, many who do spend too much time preparing inaccurate claims as a result of the complexity, and still others find themselves in lengthy debates with HMRC over the merits of their R&D efforts.

Similar to the Innovate UK grants process the R&D incentive could benefit from an automatic processing for simple claims in order to further encourage use of this valuable funding. To protect against abuse and errors, a simplified relief and more prescriptive claim process would benefit these claims. In the national R&D tax credit statistics (2019), it was reported that three quarters of SME claims were for relief of £50,000 or less and 18% less than £5,000. Currently, the same process applies to a start up with 5 staff members, as for an established business with hundreds of employees.

There is a great opportunity here to optimise the R&D incentive for those that are using this credit to create more STEM jobs or using this funding to deliver 'moonshot' projects with other institutions. A review of how best R&D tax incentives can be used to encourage these practices would be welcomed.

Summary of our key recommendations:

- Initiate a more comprehensive review of the R&D tax incentive. Refrain from incremental changes which add complexity without addressing the root causes of the challenges faced.
- Update the definition of R&D so that it is accessible for businesses and society.
- Provide better, more comprehensive guidance on R&D tax incentives generally, and specifically on their interaction with other funding for innovation.
- Consider a different, simpler, faster mechanism for very small R&D tax credit claims.
- Consider temporary enhanced generosity for projects which address key economic, environmental and social problems.
- Consider tax incentives for collaboration between business and academia.
- Review incentives for capital investment in R&D, including enterprise-zone style incentives to encourage businesses to locate R&D outside of London and the Golden Triangle.

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