



TAXREP 23/12

(ICAEW REP 87/12)

## ICAEW TAX REPRESENTATION

### CONSULTATION ON AN 'ABOVE THE LINE' CREDIT FOR RESEARCH AND DEVELOPMENT

Comments submitted on 28 June 2012 by ICAEW Tax Faculty in response to HM Treasury consultation on '*Above the Line*' credit for Research and Development published on 27 March 2012

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the Consultation *paper 'Above the Line' credit for Research and Development* [http://www.hm-treasury.gov.uk/d/condoc\\_above\\_line\\_credit\\_rd.pdf](http://www.hm-treasury.gov.uk/d/condoc_above_line_credit_rd.pdf) published by HM Treasury on 27 March 2012..
2. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

## WHO WE ARE

3. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
4. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
5. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

## OUR GENERAL COMMENTS

6. In our response, TAXREP 46/11, to the earlier Consultation we noted that:

'We do not have any evidence as to the likely effect on levels of R&D investment if the relief were to be given 'above the line' but we believe that it could have an impact for larger companies where the people involved in the R&D are likely to be more 'disconnected' from the accounting for the tax credits. We have always believed that if the R&D tax credit could be given in a way that directly impacts the budgets of those responsible for the R&D spend, then this should lead to an increase in the overall R&D spend.'

7. We are aware that there are concerns for those companies which do subcontract work who may be disadvantaged by the proposals as set out in the consultation document. This is because by moving the credit above the line it will be treated as any other grant/subsidy. As things currently stand, the credits will therefore have to be deducted when calculating prices for government non-competitive contracts as all grants have to be deducted, we believe, for government pricing purposes. This is not an issue under the current R&D tax credit regime where the benefit goes through the tax charge as all taxes are specifically excluded from government contract prices.
8. One solution put forward would be for the existing scheme to be maintained with the option for an 'Above the Line' credit as an alternative. If that was done there could be State Aid issues around the availability of the option/choice. If there was an option then we understand that could also cause problems in the US with credit relief under the Treaty.

## The accounting issues

9. One of the stated objectives of the scheme is that it meets international financial reporting standard (IFRS) requirements to allow the credit to be included in profit or loss before tax. We note that UK financial reporting standards (UK GAAP) will also be relevant here as many UK entities follow those standards rather than IFRS.
10. The financial statements, and the accounting standards that govern them, are designed to reflect the substance of the transactions an entity has entered into. It is undesirable for business decisions to be taken on the basis of, or even to be influenced by, the accounting treatment that will result and therefore in our view Treasury's design of the tax credit scheme should not be predicated on the accounting that will apply to it. We acknowledge the government's desire to encourage investment in R&D and accept that making the benefits to business more visible might encourage greater use of the scheme. We note, however, that for above the line presentation to have this result, it must be assumed that economic decisions are more likely to be made on the basis of pre-tax profit metrics rather than post-tax profits or cashflows. Further research would be necessary to conclude whether this was the case.
11. The terms of the tax credit scheme will be relevant for the accounting treatment. Were it to be structured simply as a reduction in the applicable tax rate then it is likely it would be included together with other tax items 'below the line'. However, if the scheme requires investment in a defined area or on particular assets then it might be regarded as an 'investment tax credit', in which case neither IAS 12 Income Taxes nor IAS 20 Accounting for government grants specify the treatment to be applied (neither does the new UK GAAP). In the absence of a specific requirement entities would look to the substance of the R&D incentive and use this to analogise to one of the two standards. For example, if conditions are attached to the credit then an analogy might be drawn between the tax credit and a government grant with the treatment under IAS 20 then applied. In this case the credit would be presented as 'other income' and would indeed be shown above the line. Otherwise, and particularly if receipt of the credit is linked to the entity's tax position, an analogy may be drawn to general tax credits or to a change in tax base, in which case the credit would be included within income tax income or expense as an increase to post-tax profit.

E [ian.young@icaew.com](mailto:ian.young@icaew.com)

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**ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM**

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see [icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx](http://icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx) )