



Faculty of Taxation

TAXREP 7/03

Research and Development (R&D) Comments on the Inland Revenue Guidance on the meaning of R&D for Tax Purposes

Memorandum submitted in March 2003 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Inland Revenue in response to the draft Guidance to be issued as part of the new CIRD (Corporate Intangibles and R&D) Manual

CONTENTS

	Paragraph
INTRODUCTION	1-3
WHO WE ARE	4-6
GUIDANCE ON R&D TAX CREDITS	7-8
GENERAL COMMENTS	9-11
SPECIFIC COMMENTS	12-21

Tax Representation

Research and Development (R&D) Comments on the Inland Revenue Guidance on the meaning of R&D for Tax Purposes

INTRODUCTION

1. We welcome the opportunity to respond to the request from Inland Revenue Policy (Business Tax) to comment on the Revenue Guidance on the meaning of R&D for Tax Purposes.
2. Inland Revenue Policy (Business Tax) wrote in February 2003 to the ICAEW and other representative bodies seeking their views on the draft Guidance on the meaning of R&D for tax purposes which the Revenue proposes to include as part of the new manual, 'Corporate Intangibles and R&D'.
3. R&D is defined by a set of guidelines issued on 28 July 2000 by the DTI (the DTI Guidelines). These Guidelines provide a statutory definition of R&D for the purposes of ICTA 1988 section 837A (Statutory Instrument SI 2000 No 2081, Research and Development (Prescribed Activities) Regulations 2000). The Inland Revenue Guidance is intended to clarify the application of the Guidelines.

WHO WE ARE

4. The Institute is the largest accountancy body in Europe, with more than 123,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
5. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
6. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

Tax Representation

GUIDANCE ON R&D TAX CREDITS

7. In our earlier representation, TAXREP 1/03, submitted in January 2003, the Tax Faculty commented on earlier draft guidance on the new R&D system as well as suggesting possible improvements to the operation of the system.
8. To the extent that the general comments in our earlier representation remain of relevance these are repeated below. We also include a number of detailed comments on the latest draft Guidance.

GENERAL COMMENTS

9. The Business Tax Committee of the Tax Faculty has been involved working with the CBI in highlighting ambiguities in the existing DTI Guidelines. The CBI has also produced a number of detailed examples which we believe are extremely helpful in understanding the true nature of R&D expenditure.
10. We believe that agreeing what does, or does not, constitute qualifying expenditure is going to be one of the most difficult aspects of the R&D regime and anything which will make the Guidelines easier to interpret represents a very worthwhile improvement.
11. We strongly recommend that suitable examples should be published as part of the Inland Revenue Guidance.

SPECIFIC COMMENTS

12. Our comments follow the numbering in the draft Guidance, and not the paragraphs in the DTI Guidelines to which the Revenue Guidance itself refers.
13. In *paragraph 7*, we welcome the explicit statement in the Revenue Guidance, which echoes a similar statement in the DTI Guidelines, that R&D for tax purposes can take place in sectors such as engineering and software design. The legislation which the R&D regime superseded gave relief for expenditure on 'scientific research' and claims were concentrated in the area of pure science.
14. *Paragraph 9* deals with 'staff costs' eligible for the R&D tax credit and states that "the indirect activities listed at paragraph 29 of the Guidelines do not qualify for the R&D tax credits."

We believe that this is a misleading statement of the law.

Paragraph 29 of the DTI Guidelines, which has the force of law, is a positive statement of those indirect, or supporting, activities which do qualify as R&D if they are part of a larger R&D project.

There is a restriction on indirect activities, even if they qualify as R&D under paragraph 29, contained in FA 2000 Schedule 20 paragraph 5(4) and this is in respect of

Tax Representation

‘indirect supporting activities such as maintenance, security, administration and clerical activities, and finance and personnel activities, insofar as undertaken for R&D’

However this overriding prohibition in effect relates only to those activities which are listed in the second, and possibly the third, bullet point in paragraph 29 of the Guidelines.

So in our view all the other indirect activities listed in paragraph 29 should rank for relief provided they are part of a larger R&D project.

We recommend that the statement at *paragraph 9* of the Guidance is amended to reflect the above.

15. We are concerned by the use in *paragraph 14* of the phrase ‘obvious to a competent professional user’. Who is to judge what is ‘obvious’? Are there plans for experts in the relevant fields to be involved? In the absence of independent experts, we are concerned that this could be an area of significant disagreement between the taxpayer and the Revenue as to whether the improved version is different to the original.
16. In *paragraph 16* the use of the word ‘device’ suggests a narrow range of meaning and we would suggest the use of the word ‘product’.
17. In *paragraph 19* we are concerned that the Revenue is setting itself up as the arbiter of whether ‘a competent scientist or engineer, or R&D manager’ ought to have known that their company was covering the same potentially innovative ground that another business had already covered. This could lead to unproductive arguments about what a ‘competent’ person would have known, but the particular company’s staff did not. Also we note that in *paragraphs 25 and 49* the emphasis is on the aim of the work carried out, which suggests a subjective rather than an objective test. We believe there should be a similar emphasis in the Guidance at *paragraph 19*.
18. We do not understand the final sentence of *paragraph 27*: ‘Where such a person is able to anticipate how to achieve the advance, the activity would be routine and not R&D.’ Surely many great discoveries and inventions have been made because intelligent people have anticipated how an advance might be achieved.
19. We do not understand the final sentence of *paragraph 29*. Is it contemplating the case where the testing is carried out by a different company from the one carrying out the main research i.e. a subcontracting situation, in which case FA 2002 Schedule 12 paragraph 14 would seem to cover this situation? Otherwise, that sentence appears to conflict with the rest of *paragraph 29* and is in our view incorrect.
20. The first sentence of *paragraph 30* seems to be suggesting that the work done in planning an R&D project does not qualify for R&D credits. Planning is an integral part of any R&D project and in our view must qualify for R&D tax credits.

Tax Representation

21. *Paragraph 36* again uses the phrase ‘obvious to a competent professional user’.
As noted above, we are concerned that this test will lead to disagreements.

IKY

14 March 2003