



IMPROVING ACCESS TO RESEARCH AND DEVELOPMENT TAX CREDITS FOR SMALL BUSINESS

ICAEW welcomes the opportunity to comment on the discussion document [Improving access to research and development tax credits for small business](#) published by HMRC on 16 January 2015.

This response of 27 February 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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Introduction

1. We welcome the opportunity to comment on the proposals in HMRC's consultation document of 16 January 2015.
<https://www.gov.uk/government/consultations/improving-access-to-research-and-development-tax-credits-for-small-business>
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

Key point summary

3. We welcome the changes announced in the Autumn Statement, namely the new advance assurance service for small companies making their first claim, planned for Autumn 2015, and new guidance.
4. While we welcome early stage consultation, 6 weeks is not long enough for a thorough response.
5. Our members' feedback on interacting with HMRC on using the R&D tax credits scheme has been generally positive.
6. Particular problems remain when identifying the expenditure which qualifies. Improved guidance, together with examples and case studies will help.
7. R&D tax credit information should be included automatically with any government grant in the technology area.
8. GOV.UK should provide a single list of which grants constitute notifiable state aid.
9. Better guidance is needed for sub contracted work.
10. The system could be amended to allow earlier access to the credit, for example by allowing in-year set off against PAYE as part of the new advance assurance scheme for smaller companies.

General points

11. We welcome the changes announced in the Autumn Statement, namely the new advance assurance service for small companies making their first claim, planned for autumn 2015, and new guidance.
12. The pilot scheme was very popular by all parties and its reintroduction would also provide SMEs with a first point of contact on R&D claims. Unlike large companies, SMEs do not have a customer relationship manager at HMRC.
13. Early stage consultation and early engagement will usually result in better engagement with those affected. In this case, allowing only six weeks for this consultation, has made gathering views from the population affected is problematic for a large organisation such as ICAEW.
14. Our members represent a large number of those businesses which benefit from research and development tax credits (R&D), but many will have been involved in personal tax work for other tax clients in the lead up to 31 January. This has made it difficult to respond in the time allowed.
15. Feedback received from members about their interaction with HMRC on the availability of R&D tax credits has been generally positive.

Answers to specific questions

Q1. Do you agree that awareness, design, understanding and administration are the most relevant factors in ensuring that small businesses can access R&D tax credits?

16. We agree these are the most relevant factors.

Q2. How can HMRC better engage businesses to help increase take-up of R&D tax credits?

- How could businesses best obtain information on tax reliefs (social or traditional media, trade bodies, agents, other sources of information)?
- Who, within a company, should we target with information? (finance, R&D managers, the business owner, agents, others).
- What is the right time for a business to receive information?
- What other promotional activities could be introduced to ensure maximum take up of the reliefs?
- Do you consider that HMRC works sufficiently well in partnership with other government agencies? If not why?
- Are there any models of good practice we might follow (eg in other countries)?

17. The key target for information about R&D tax credits should be the business owner. Larger SME's are already very aware of R&D, but smaller businesses are not necessarily as aware and also have little time to read or think about matters not directly related to their products and processes.

18. R&D information should automatically be included with any government grant in the technology area.

19. A major issue continues to be the administrative burden. Writing a report, even a formulaic one, is generally necessary to support an application, and draws in particular on the time of the technical staff involved. These people have little experience of tax and are generally wary of dealing with HMRC. Our members have told us that HMRC has been much more approachable in the last few years, but lack of detailed guidance on what projects qualify is a key deterrent.

20. There is a problem with notifiable state aid. There is no single list of which grants are notifiable state aid, and often different sources give a different answer, for example the EU's Seventh Research Framework Programme (FP7 grants).

Q3. Are you confident that you can contact the right R&D Unit if you need to do so?

Yes.

Q4 Is the current definition of R&D a barrier to small companies claiming R&D tax credits?

- Would a change in definition to align it to accounting practice simplify the rules? If so why? What alternatives might be better?
- If introduced, how far should this treatment be optional (say, for companies below a certain size) or should it be compulsory?
- What can we learn from other countries?

21. Currently many small businesses are keen to boost their balance sheets, so many will be keen to capitalise R&D costs if possible. In spite of this, as long as the work is actually revenue, a

corporation tax deduction can be claimed using s 1308, Corporation Tax Act 2009. If aligning the definitions changed this, many businesses would be reluctant to this proposal.

22. Any such change should therefore be optional.

Q5. Are the rules over which costs qualify for relief a barrier to small companies claiming R&D tax credits?

23. Software development costs are a common problem area. In particular, the development of apps, is almost certainly innovative, but this often is a process fraught with significant difficulty. For example, making an app cross-applicable across systems. Here HMRC guidance is currently very basic: mapping a paper system does not qualify, but writing a new operating system does, but there is usually an overlap.

24. Some businesses decide not to make a claim because they aren't sure that they qualify and there are no official examples to encourage them. The uncertainty about whether or not a project qualifies, deters risk-taking.

25. Another area of uncertainty surrounds 'soft' science topics such as how we learn and process data. For example, psychology based projects. We understand the need to ensure that only credible projects qualify, and suspect that in practice, it may be a few more years before such projects can qualify in any large number, but it seems possible that productivity gains in this area are potentially very large and R&D should be encouraged.

26. Government grants can cause problems where the department has not adequately advertised whether the grant constitutes notifiable State aid. We suggest that GOV.UK should have a section where every relevant body is required to list its grants and whether these do/do not constitute state aid (split by amounts in some cases).

27. HMRC will often focus on the descriptions used by business and disallow things which would be allowed if described differently. Better guidance would be helpful here. For example, further clarification on the distinction between consultancy costs and subcontractor costs would be useful as in our members' experience, HMRC focus is on the wording in the service agreement. Where individuals are referred to as consultants, then despite the individuals being actively engaged in the R&D, the claim is often rejected.

Q6. Are there other specific design features which could be simplified to help small companies?

28. It is usual for a large proportion of an R&D tax credit claim to relate to staff costs. A common problem occurs where the staff being paid by "the wrong company" and costs are recharged through management charges. Provided no profit margin is added, we would welcome a relaxation to permit the underlying staff costs to qualify, wherever in the group they were incurred.

Q7. If overall changes or improvements can be identified, would they be better as options or changes to the general rules, or as a particular scheme aimed at the smallest companies?

29. The rules applying where a SME subcontracts from a large company are particularly difficult for a small company to understand. Given the variety of size and nature of businesses eligible for these tax credits, any changes should be optional

Q8. Recognising that the R&D manual is used by different groups, what works well/ less well and for whom with the current format?

30. The manuals are very good for R&D, and currently are very accessible. One problem is that once they fully migrate to GOV.UK, the back arrow doesn't work, which makes accessing data very difficult particularly when doing technical searches.

Q9. Is dedicated external customer (rather than intermediary) guidance needed? If so, does the commercial market already provide what is needed?

31. No comment.

Q10. Should HMRC design its guidance by task or event rather than around the detail of the legislation?

32. A preferred method for using guidance seems to be a stage-by-stage description.

- Deciding whether a project qualifies
- Considering what costs will qualify
- Making sure the right records/etc are kept
- Calculating the claim
- Drafting the report
- Submission / pre-clearance.

Q11. What are the top issues for small companies and intermediaries both in terms of the legislation/rules and procedures?

33. Risk. HMRC is seen as a department focussed on bringing in as much tax as possible rather than giving reliefs; even if those reliefs are intended by parliament.

34. Micro and small businesses are wary of opening themselves up to a costly enquiry that will drain the time of the owner/manager. The more precise the guidance can be, the safer the claim is seen to be, so the more likely it is that the claim will be made.

35. More guidance would be helpful, particularly giving examples of qualifying projects with annotated comments explaining key factors, and perhaps more examples of consumable stores (an area of some confusion).

36. It would be helpful if the business did not have to worry as much about timing, such as when R&D starts; it must be a project that is seeking to resolve 'uncertainty' which ends when the 'uncertainty' has been resolved. However, we accept that this may be difficult to change without moving to a very rule based regime, which may not be popular.

37. Cash flow to SMEs is vital. A system whereby companies undertaking R&D could receive cash tax credits throughout the year (for example by offsetting the R&D claim against their PAYE due in the year) would make a significant difference to these companies' cashflow. If this were combined with the advanced assurance system this would remove the risk that cash tax credits were given that would subsequently have to be repaid.

Q12. Who uses the current guidance: companies, intermediaries or both? In particular, who uses the

- material currently on Gov.uk's site <https://www.gov.uk/corporation-tax-research-and-development-rd-relief>
- HMRC manual <http://www.hmrc.gov.uk/manuals/cirdmanual/index.htm>

38. Both.

Q13. How would companies and intermediaries prefer guidance to be set out Alternatives could include

- in the current format as a manual;

- **additional illustrations/ case study, Q&A, decision tree etc**
- **via online forums: webinars/ YouTube etc**
- **embedded in rules based applications (accounting software)?**

39. Webinars are very accessible to those working in technology. This area increasingly generates claims.

40. Some walk-through examples for software companies in particular would be helpful, as would an example of a project where the overall project didn't qualify, but elements did.

41. We suggest HMRC stresses that a reasonable claim made in good faith will not result in penalties if it is later rejected.

42. A "sense-check" type of checklist, including questions such as, can your competitors already do it, is the project viable without the claim repayment, will the project be a significant improvement over products offered by your competitors, can the intended result be achieved commercially using alternative means, would be useful?

Q14. Would the approach set out above improve take-up of R&D tax credits amongst firms who have never made a claim?

43. Yes.

Q15. We would welcome views on the design of the advance assurance service including

- **The companies that would benefit most (ie in encouraging them to carry out more R&D and grow faster)**
- **What specific issues do companies encounter in making their first claim?**
- **For how long an advance assurance should be valid?**
- **Whether your company (or a company you advise) would be likely to use advance assurances (and if not, why not)?**
- **Any issues for particular sectors/ types of company in administering and designing advanced assurance?**
- **How the service should be advertised?**

44. We suggest a focus group(s) of intermediaries with recent experience of making claims would be the most efficient way to gather this information. We would be happy to help organise such a group.

Q16. Another way to improve administration might be to link the advanced assurance service with access to finance. When attracting finance for an R&D project, how is this ability influenced by R&D tax credits? How could an advanced assurances service be structured to support access to funding?

45. Advance assurance would be helpful to those seeking access to finance. The level of detail needed would depend on the financier, but in many cases, the fact of such assurance and the knowledge of when cash flow would benefit, would be sufficient for this purpose.

Q17. Are there any specific aspects of the way which a claim is made or processed which could be simplified or improved?

46. Companies are required to file their corporate tax returns online using Inline Extensible Business Reporting Language (iXBRL). HMRC's free software cannot be used by a company which is making a claim for R&D tax credits and a work around has to be used by those companies filing returns without third party software. For some, this means filing the return without the claim and then sending in a revised return in PDF format.
47. For start-ups and other small simple companies, it would be helpful to have a publicised process where the tax return can be submitted using the free HMRC software, together with the R&D claim, in one single filing, but without having to buy special software.
48. Members have told us that there isn't really an application process – at the moment, it is self assessed so forms part of the tax computation.

Q18. Do you agree with the impact assessment? In particular do you think that changes to the R&D tax credits could have any equalities impacts?

49. No comment.

APPENDIX 1

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 via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).