

HM Revenue & Customs
100 Parliament Street,
London SW1A 2BQ

Emailed to: rntaxreliefdraftguidance2022@hmrc.gov.uk

12 September 2023

Dear Sir/Madam,

Research and Development (R&D) tax relief – consultation on a single merged scheme

The 100 Group of Finance Directors ('The 100 Group') represents the views of the finance directors of FTSE 100 and several large UK private companies. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses.

This letter is written by The 100 Group Tax Sub-Committee and sets out our response to the draft legislation for a single merged R&D tax relief scheme contained in Finance Bill 2023-24.

The impact of these proposals will not be uniform across The 100 Group membership. Some members may see an uplift in their existing R&D tax claim, others will be negatively impacted and for some the impact of the proposals should be neutral overall. This letter is intended to speak on behalf of the Group as a whole and sets out the common view of our members, regardless of the impact for each individual business.

1. Introduction

We appreciate the government's continued focus on ensuring that the UK R&D tax regime is as attractive as possible. This will help cement the UK's position as a world leader in science, research and innovation and contribute to the governments ambition to make the UK a global hub for innovation by 2035.

There have been a number of positive developments in the R&D tax regime in recent years, most notably the increase of the RDEC rate and the expansion of scope to include data and cloud computing costs. These have been set against a backdrop of constructive and positive stakeholder engagement, with consultation feedback being acted upon (the PAYE cap being the most recent example).

We welcome the government's latest efforts in this consultation to promote tax simplification, provide more clarity and certainty to businesses, and help to drive innovation in the UK. We also support the policy objective to tackle abuse and 'boundary-pushing' in the regime as described by HMRC in its 'Approach to Research and Development tax reliefs' publication of 17 July 2023. We believe HMRC is correct to conclude that 'any scheme that provides financial support to large numbers of claimants contains an inherent risk' and we note that the draft legislation in Finance Bill 2023-24 seeks to address this issue.

The purpose of this letter is to comment at a high level on the proposals, mainly to emphasise elements which, as currently drafted, do not appear to achieve the stated policy objectives.

2. General comments

2.1 Timing

The proposed introduction of the legislation from April 2024 gives businesses little time to prepare for these fundamental changes. The compliance burden for businesses is exacerbated by the number of significant changes in the R&D tax regime recently.

If the government goes ahead with these changes, we urge it to delay the proposed start date by at least 12 months to April 2025. This will allow sufficient time for other changes the R&D tax regime to properly embed and provide businesses adequate time to prepare for these additional rules. We would, however, encourage the government to go ahead as soon as

possible with raising the PAYE cap in the RDEC scheme: with the rate rise to 20% already in force, this cap could be inadvertently restricting claims in a move not aligned with the policy intent.

2.2 Certainty

As mentioned above, this proposal is the latest in a series of significant changes to the UK R&D tax regime recently. Whilst we do support efforts to improve the current regime - and in particular we welcome a final decision being made on whether or not the existing schemes should be merged - piecemeal changes create uncertainty and can negatively impact UK investment decisions.

We would therefore encourage the government produce a comprehensive R&D tax 'roadmap' for consultation with business. This holistic approach would promote certainty and make the UK more attractive as an investment location.

Such a roadmap should be based on three key pillars:

- **Predictability** – up-front certainty on the R&D tax relief available on an investment that can be factored into the investment business case (e.g. via early discussions with HMRC and expanded access to clearances)
- **Stability** – confidence that the R&D tax regime is stable over the long term and there will be no major changes to the original cost estimate of an investment
- **Simplicity** – including certainty on how the tax rules will apply and the administrative ease of claiming reliefs (e.g. a joined up approach between different government departments)

3. Specific comments on the draft legislation

3.1 Definition of 'sub-contracted'

Whilst we support in principle the policy objective to reduce the number of claimants, and in turn, the risk of fraud in the regime, the sub-contracting rules as drafted present practical challenges that need to be addressed.

The consultation proposes that sub-contractors will no longer be able to claim for R&D they undertake under a commercial contract – that right would now go to the customer paying for the R&D. However, the draft legislation does not adequately distinguish between the different types of sub-contracting that take place in practice.

For example, in a situation where a customer specifically commissions a contractor to undertake R&D on its behalf (e.g. testing services) we support the ability of the customer to claim R&D tax relief. However, there is another category of sub-contracting where the customer will commission the contractor purely to deliver a specific product or output, with no expectation or knowledge that R&D will be required in order to deliver the final product. In the course of its work the contractor may have to undertake R&D to deliver the solution to the customer. The contractor will bear the economic risks of the activity, has full autonomy on how the R&D is undertaken and will own the final IP. This is a typical scenario in the construction industry.

In this second type of contract we believe that the sub-contractor should be the entity entitled to claim the R&D, and the draft legislation should make this clear.

3.2 Establishing the right to claim

To promote certainty and simplicity for business, the preference would be for the draft legislation to be clear on which party is eligible to claim R&D tax relief (in line with our comments set out above). We consider this would be a better outcome than pursuing an approach that looked at the hallmarks of a contract to determine eligibility to claim relief, or an elective regime (e.g. like the Irish regime) which would bring with it a host of administrative and potentially commercial challenges.

3.3 Treatment of subsidies (s1042C (4) Condition B)

We ask the government to reconsider the exclusion for subsidies in the draft legislation - i.e. we believe there should be no exclusion for subsidies of any form. Rather than simplifying the rules this provision creates more complexity and uncertainty for businesses. One option to address this would be to retain the existing RDEC and SME rules in relation to subsidies within a new combined regime. This would promote predictability and stability for both large companies and SMEs.

If the government is intent on maintaining an exclusion for subsidies, we urge it to ensure that the term 'subsidised' expenditure is clearly defined. For example, it should be made clear the definition specifically excludes R&D where there is a customer involved and also intra-group funding arrangements e.g. loans, cash funding, share capital etc. Also excluded from the definition should be payment of R&D by affiliates who may have partial or full ownership of the intellectual property (IP): if the purpose of the regime is to encourage R&D activity in the UK, then the ownership of the IP should not be a factor, especially as the taxation of the profits of that IP will be dealt with by the Transfer Pricing rules.

4. Scope of UK R&D tax regime

Members of the I00 Group have previously met with HMT to discuss the concerns of some of its members that traditional definitions of R&D in the existing regime may not be well suited to modern innovation in certain industries that the UK wishes to excel in going forward. The current proposals do not address this fundamental issue.

In order to cement the UK's position as an innovation nation it is vitally important that the UK's tax relief system incentivises not only the industries where we are already strong, but also the sorts of activities that the UK wants to attract, including technologies of the future, e.g. Green and Net Zero and data-intensive technologies with the use of Artificial Intelligence (AI) and Machine Learning (ML). This will be crucial to achieving economic growth and productivity goals.

Corporates in the data-intensive technology sector face a particular challenge at present. We believe there is a knowledge gap around; how R&D works in the technology sector, how activity is organised, how it is paid for within the enterprise, and how technology R&D may contrast with R&D activities in traditional R&D-intensive sectors.

In the technology sector, new inventions tend not to be discovered from scratch as a self-contained innovation. Instead, advances in technology, particularly data analytics and AI/ML, often involve either applying existing algorithms to new scenarios or writing software by means of machine learning and open-source AI engines. Here, the innovation results from people defining the problem and setting the parameters for the machine rather than writing new code. This iterative approach is not currently well catered for within the UK's guidance and examples on R&D but delivers significant benefits.

For example, GenAI technology already exists and is open access through the likes of 'ChatGPT', but there is still innovation around how the technology is applied to new use cases. Based on existing guidance and definitions in the R&D tax regime, it is not immediately obvious how it would qualify for R&D even though it is surely the kind of innovation that the Government wants to incentivise.

There is a risk that the UK loses R&D investment as its tax regime is less attractive than others such as the US, Switzerland, Sweden, The Netherlands and Israel, who better acknowledge the benefits of R&D for data-related technologies.

We would therefore welcome a review by government into broadening the scope of the existing R&D tax regime, to ensure that the UK can attract and retain investment in the industries of the future.

We trust that you will find this letter useful but if you require any further information or assistance, please do not hesitate to contact secretariat@theI00group.co.uk.

Yours faithfully,



Andy Agg,

Chairman of the I00 Group Tax Committee