R&D Tax Reliefs

techUK’s response to the HM Treasury consultation on the implementation of R&D Tax Reliefs reforms

February 2022

About techUK

techUK is a membership organisation launched in 2013 to champion the technology sector and prepare and empower the UK for what comes next, delivering a better future for people, society, the economy and the planet.

It is the UK’s leading technology membership organisation, with more than 850 members spread across the UK. We are a network that enables our members to learn from each other and grow in a way which contributes to the country both socially and economically.

By working collaboratively with government and others, we provide expert guidance and insight for our members and stakeholders about how to prepare for the future, anticipate change and realise the positive potential of technology in a fast-moving world.

**Introduction**

The Government’s Plan for Growth see’s innovation as one of the key pillars of growth for the post-COVID and post Brexit economy. To help steer this goal the Government has set a target of achieving 2.4% of GDP being invested in R&D by 2027. Increasing this from the 2018 level of 1.7% of GDP invested in R&D will mean achieving the fastest increase in R&D spending in over 20 years.[[1]](#footnote-2)

The share of private investment in R&D makes up a larger proportion of the UK’s total investment now than it did in 1985 and in 2018 accounted for 68% of all investment in R&D.[[2]](#footnote-3) While we have seen welcome increases in public sector commitments to invest in R&D, ensuring private sector investment continues to rise will be vital to achieving the 2027 target.

Enabling businesses to invest more in R&D fundamentally means businesses seeing clear returns on investment in innovation. While this does not solely come from tax reliefs the UK’s R&D Tax Credit system is an important part of this and is seen by many techUK members as a key part of the value case when locating R&D activity in the UK.

In the [Autumn Budget 2021](https://www.gov.uk/government/publications/autumn-budget-and-spending-review-2021-documents), the Chancellor acted on long standing ask from techUK and our members to expand the coverage of the R&D tax credit to include data and cloud computing costs.

techUK and our members welcomed this announcement since we have been advocating for expanding the scope of qualifying expenditures to cover key intangible assets, with a specific ask to include **data, data analytics and cloud computing since 2017**. This means that companies can finally use the UK’s R&D support system to cover data driven research, which is good for science, product development and productivity. This welcome announcement has helped align the UK’s R&D relief scheme with how research and development is done in the modern economy.

techUK welcomes this opportunity to respond to the HM Treasury consultation on the implementation of the proposed reforms to R&D tax credit reliefs. This is a critical component of the R&D system for techUK members, who account for a large proportion of business R&D investment in the UK, [[3]](#footnote-4) and it has enormous potential to generate benefits that extend beyond these companies, resonating throughout the UK economy.

1. **Data and cloud computing costs**

techUK members are supportive of the general direction of the proposals outlined in this section as we believe this expansion of the R&D tax system better aligns with the way companies use technology to transform their businesses in the modern world.

**Licence payments for datasets**

techUK members are supportive of including licence payments of datasets as a qualifying expenditure for R&D tax reliefs as we agree with the government that datasets are as vital an ingredient as any raw materials or labour inputs which are employed in the process of R&D.

Incentivising both data purchases as well as data manipulation for R&D would have the result of both encouraging organisations to use and invest in data for R&D purposes, and also to invest in the use and development of new advanced data analytics technologies which make the raw data more valuable.

techUK understands the government's concerns about making the best use of the tax system and we therefore recognise the measures to ensure that tax reliefs are claimed only for costs incurred solely for R&D. We generally support government’s measure that companies will not be able to claim relief for the cost of datasets that can be resold or have a lasting value to the business beyond the duration of the project.

However, members are concerned that some of the restrictions imposed are not aligned with current business models and how companies conduct R&D in the UK. For example, the proposals include a restriction that the owner of the data will not qualify for an R&D tax relief if the data grants “**the claimant any right to publish, share or otherwise communicate the raw data within the dataset to a third party”.**

Members have raised that, for example, in customer funded programs, companies usually need to share datasets to a third party (the client). This action is being taken as a transparency measure so customers can understand the provenance and diligence of the analytics that have been performed. However, this action would prevent companies from claiming relief under this provision.

Members have also expressed concerns on the restriction to claim the relief when the dataset has “**any ongoing rights of use, beyond the expected term of the R&D project being undertaken by the claimant”.** We understand that there is concern that data could be used for multiple projects or that some businesses could receive multiple claims for the same expense. However, it is generally important that businesses are able to reanalyse data sets and extract continued learnings from the data. We ask that HM Treasury takes account for this when designing the tax credit reforms.

We recommend the government to:

* Limit companies from claiming R&D tax reliefs for the cost of datasets that can be resold or have a lasting value to the business beyond the duration of the project.
* Not limiting companies' claims on the ability to communicate, share and publish the data for quality assurance and transparency reasons; as stated above, restrictions should be targeted to where the dataset would be sold to a third party for purely commercial reasons.
* Take into account when designing the tax credit reforms, that businesses need to reanalyse data sets and extract continued learnings from the data, which may go beyond the expected term of R&D projects

**Staffing costs for creation of datasets**

Members believe that allowing companies to claim R&D tax reliefs for costs for staff-related expenditure for the purpose of collecting, cleansing and analysing data struck the right balance and have no substantive comments at the moment. techUK and its members are happy to work with HMT and HMRC as they develop the revised guidance and will monitor the implementation of the tax credit when it goes live on the expected date in 2023.

**Cloud computing and software**

techUK members are supportive of the general direction of the proposals outlined in this section. We believe that there is an industry trend towards the use of cloud computing solutions that allow companies to work with large datasets and train new algorithms without the need for costly capital investment in traditional IT infrastructure. This allows development of technologies based on machine learning and artificial intelligence at a significantly larger scale and accessible to a wider range of firms.

Therefore, techUK supports including costs which can be attributed to **computation, data processing, analytics and software** on the cloudto be claimable for R&D tax reliefs. However, we recommend the government to include **storage** of data to the list of costs outlined above.

Members have raised that R&D projects are increasingly including more substantial data in order to do data driven R&D. The costs of getting the data in and out, make these projects financially unsustainable, therefore this data is stored on the cloud in order to do the secondary processing to extract the value from it. This process is however expensive, and some members have expressed that some projects have 80% of the costs attributable to the storage of data. Excluding storage costs may have unintended consequences, such as skewing activity towards particular types of R&D activity (e.g. those with less storage costs), which is contrary to the scheme's objectives.

We therefore recommend the government:

* To include storage of data as a qualifying cost for R&D tax relief, however we understand that limits will need to be placed on this. Our suggestion is that storage costs are covered for a time limited duration for example the period where active R&D activity is taking place rather than on the headline cost.
* To follow a flexible approach to address the dynamic nature of computer paradigms, this means to prioritise the review and update of HMRC’s guidance instead of setting key definitions in primary legislation. Current definitions of computation, for example, may change as non-traditional computing models become available in the coming years, as may other key definitions of the scheme, such as storage or processing.

1. **Refocusing the reliefs towards innovation in the UK**

techUK recognises the principle of these proposals which seek to refocusing support towards innovation in the UK. However, considering the predominant dynamics of the UK's internal markets, we consider that some of the recommendations stated in the consultation would be challenging to put into action.

**Shortages of skills and talent**: Members have indicated that the decision go offshore is usually not motivated by cost reduction measures (in fact some innovation hubs can be more expensive than UK, e.g. Singapore), but by an inability to find the right talent and skills to carry out the R&D project in the UK. Recruiting also becomes more complicated for companies outside of London and far from main urban centres.

A government report found that there is significant demand for data skills with UK companies recruiting for 178,000 to 234,000 roles requiring hard data skills. Almost half of businesses (48%) are recruiting for roles that require hard data skills but under half (46%) have struggled to recruit for these roles over the last 2 years.[[4]](#footnote-5) Similarly, techUK’s Digital Economy Monitor 2021 Q3 survey shows that while the majority of tech companies want to increase their headcount in the UK, they face major difficulties in accessing talent and skills as a direct result of COVID-19 (37%) and Brexit (16%).[[5]](#footnote-6)

Members have also expressed concern that the proposals are incompatible with the current global context emerging from Covid-19 pandemic. Employees can now work remotely and companies can hire the best talent available from all over the world. Businesses will sometimes hire entire teams for R&D projects that can work smoothly with remote work tools and are unlikely to relocate to the UK. In the current context, incentivising firms to hire internally through R&D tax reliefs, may affect the competitiveness of our innovation ecosystem, as firms will continue to struggle finding the right skills to conduct R&D.

Smaller companies have also expressed concerns that the removal of overseas costs from scope could in fact result in a net negative for tech starts up who have scaled rapidly international. SMEs believe that larger companies may easily increase their headcount in the UK, which in turn can make the competition for talent even more fierce, which can negatively affect UK smaller innovative companies to get the right talent to grow and scale up.

If the government wishes to pursue the proposed reforms, we advise to follow a just and reasonable approach:

* Allowing companies to claim tax relief if they were unable to find a qualified body to outsource R&D activity in the UK within a reasonable timeframe.
* Allowing companies to claim tax credits when they go offshore to find skills and talent when they were unable to find it in the UK within a reasonable timeframe.
* Allowing businesses to claim tax credits when a third party (e.g., a client) has a specific requirement for the project to be conducted offshore or for a regulatory requirement of the country where the R&D activity is taking place.
* Providing incentives for companies, particularly SMEs, to expand its businesses, build technical products and invest in new technology developed in the UK, as well as provide support to close the skills gaps; otherwise, the proposed reforms are unlikely to have the desired impact.

**Support SMEs transitioning from R&D schemes**: Another concern raised from members, particularly SMEs, is the significant difference between SME claims and large company claims, and the issues related to the transitioning from one scheme to another. Companies that have grown rapidly based on their R&D activities and which have a high balance sheet due to investment from TPG, are suddenly facing a significant tax credit cut due to their loss of SME status. This sudden change generates distortions in their business models and can lead to a decrease in the spending on R&D by these companies. **We recommend the government review this threshold in a way that excludes cash related to investment, or at the very least provides a tapered reduction to support fast growing innovative companies**.

1. **Abuse and compliance**

techUK welcomes HMRC’s announcement of allocating additional resources to R&D tax relief compliance and the creation of a new cross-cutting team focussed on abuse.

techUK members are however interested on how the measures proposed to “address the root of the problem” would work in practice without overburden companies making R&D claims, and how HMRC will engage with industry to ensure compliance. techUK and its members are happy to work with HMT and HMRC as they develop new measures to address abuse and compliance.

1. [Gross domestic expenditure on research and development, UK: 2018](https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/bulletins/ukgrossdomesticexpenditureonresearchanddevelopment/2018) [↑](#footnote-ref-2)
2. [Gross domestic expenditure on research and development, UK: 2018](https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/bulletins/ukgrossdomesticexpenditureonresearchanddevelopment/2018) [↑](#footnote-ref-3)
3. techUK’s members have significant R&D operations in computer programming, info services, research and development services, software development, aerospace and telecommunications sectors. These sectors make up half of the ten sectors which spent most on R&D in the UK in 2019. [ONS, Business enterprise research and development, UK, 2019.](https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/bulletins/businessenterpriseresearchanddevelopment/2019) [↑](#footnote-ref-4)
4. [Quantifying the UK Data Skills Gap - Full report – may 2021](https://www.gov.uk/government/publications/quantifying-the-uk-data-skills-gap/quantifying-the-uk-data-skills-gap-full-report#:~:text=The%20research%20found%20that%20there,roles%20requiring%20hard%20data%20skills.&text=In%20Autumn%202020%20DCMS%20and,in%20data%20science%20and%20AI.) [↑](#footnote-ref-5)
5. [techUK Digital Economy Monitor 2021 Q3](https://www.techuk.org/resource/digital-economy-monitor-q3-2021.html) [↑](#footnote-ref-6)