R&D Tax Reliefs Plan

Actions to boost innovation and maximise growth through stability and effective delivery of R&D tax reliefs

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How the Government can boost innovation, productivity and maximise growth through stability and effective delivery of R&D tax reliefs

Executive Summary

After a period of significant change, techUK call for the Government to restore confidence in the UK's flagship R&D tax relief scheme by prioritising longer-term policy stability, effective administration from HMRC and better support for SMEs.

Key insights:

- To maintain our competitiveness and pool investment into the UK, we need a long-term strategy for the flagship R&D tax relief scheme. This will help to (i) give business the confidence to invest in the UK and (ii) help to raise the amount of GDP invested in R&D.
- International competitors, such as Iceland, France and Portugal offered more generous R&D tax incentives for SMEs in 2023 regardless of whether they turn out a profit.[1]
- R&D is the cornerstone of international competitiveness, enhanced productivity, more efficient & effective public services, high-value jobs and fuels sustainable economic growth.
- A robust R&D tax relief offer to stimulate business R&D investment will also be central to any future industrial strategy.
- There is an effective ROI if we increased the amount of investment UK firms made into R&D. Every £1 of tax forgone through R&D tax relief results in up to £2.70 of additional investment in R&D by UK companies.[2]
- Firms that consistently invest in R&D are predicted to be 13% more productive than those that don't.[3]
- HMRC are failing to deliver on administering the credit effectively, part of the wider picture of HMRC services falling below expected service levels.[4] techUK members outline inconsistency in approach, a lack of experience and repeated errors in correspondence.

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[1] OECD (2023) 'OECD R&D tax incentives database: Highlights from the April 2024 Update' https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/r-d-tax-incentives/oecd-rd-tax-highlights.pdf

[2] HMRC (2020) 'Evaluation of the Research and Development Expenditure Credit (RDEC)' Evaluation of the Research and Development Expenditure Credit (RDEC) (publishing.service.gov.uk)

[3] The Royal Society (2022) 'Investing in UK R&D' https://royalsociety.org/-/media/policy/Publications/2022/Investing-in-UK-RD--2022-update.pdf

[4] NAO (2024) 'Taxpayers let down by poor HMRC customer service' https://www.nao.org.uk/press-releases/taxpayers-let-down-by-poor-hmrc-customer-service/

Within this policy paper, we provide three priority areas for the Government to deliver on this. These include:

- Prioritise improving HMRC's delivery of R&D tax reliefs
- Make changes to the R&D tax credit scheme to drive further investment into the UK
- Get started on a longer-term five-year plan for the delivery of R&D tax reliefs

Our recommendations have been developed with insight and expertise from our members, including SMEs and larger tech firms, and tax experts.

Section 1. State of play: context and background

The Government has outlined their central mission to drive economic growth.[5] This is vital to deliver on public services and tackle the UK's greatest challenges – whether achieving net zero, ensuring our national security or breaking down barriers to opportunity across all regions of the UK

With limited fiscal headroom, our members recognise that tough decisions will need to be made ahead of the next Budget and Spending Review. Despite this, we stand at a pivotal moment, where the UK has a chance to show that it is a leading nation for research and development (R&D) and continues to be a place for our most innovative businesses to thrive. To show our national commitment to innovation, the R&D tax credit must continue to be fit for purpose and taxpayers' money must be effectively spent.

Following a period of turbulent change, prioritising the stable and effective delivery of R&D tax reliefs is a step that the Government can take to yield substantial returns and deliver on economic growth.

Since its inception in 2000 for Small and Medium Enterprises (SMEs) and 2002 for larger companies,[6] the UK's R&D tax credit scheme has provided companies with tax relief to encourage more spending on R&D. It acts to incentivise innovation and reward companies who invest in it by offering a reduced corporation tax liability or a credit payment, both of which are tied to the company's qualifying R&D expenditure. Demonstrating delivery, every £1 of tax forgone through R&D tax relief results in up to £2.70 of additional investment in R&D by UK companies.[7][8]

Alongside this, the tax relief provides a useful tool to de-risk innovation, acting as a crucial source of cash flow for smaller businesses and ultimately fostering business growth. In 2021 to 2022, the estimated amount of total R&D tax relief support claimed for the tax year was £7.6 billion, an increase of 11% from the previous year and equating to £44.1 billion of R&D expenditure.[9]

But changes to the R&D tax relief in recent years have resulted in a seismic shift for technology businesses using it to fund innovation. First announced in 2021, the

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[5] Labour's Manifesto (2024) 'Kickstart economic growth' https://labour.org.uk/change/kickstart-economic-growth/
[6] GOV.UK (2023) 'Background information and quality report: Research and Development Tax Credits' https://www.gov.uk/government/statistics/background-information-and-quality-report-research-and-development-tax-credits/background-information-and-quality-report-research-and-development-tax-credits
[7] ForrestBrown (2022) 'Potential reforms to the UK's Capital Allowances Regime' https://forrestbrown.co.uk/wp-content/uploads/2023/12/Potential-reforms-to-UKs-capital-allowance-regime-ForrestBrown-response.pdf
[8] HMRC (2020) 'Evaluation of the Research and Development Expenditure Credit (RDEC)' Evaluation of the Research and Development Expenditure Credit (RDEC) (publishing.service.gov.uk)
[9] HMRC (2023) 'Research and Development Tax Credits Statistics: September 2023' https://www.gov.uk/government/statistics/corporate-tax-research-and-development-tax-credit/research-and-development-tax-credits-statistics-september-2023#:~:text=5.-,R%26D%20expenditure,claiming%20under%20the%20RDEC%20scheme.

previous Government reviewed and revised the R&D tax reliefs through a consultation process to simplify the scheme and help drive innovation in the UK.[10]

Recent changes, along with advocacy action from techUK, include:

- **In Spring 2022**, the Government concluded that all cloud computing costs, data licenses and mathematics would qualify for relief from 1 April 2023.
- **Throughout 2022**, techUK advocated for the reversal of damaging cuts to SME R&D tax credits.[11] This resulted in the Government revisiting the generosity of the scheme in Spring 2023. From 1 April 2023, loss-making SMEs with at least 40% R&D expenditure out of total were eligible for a higher payable credit rate of 14.5% for qualifying R&D expenditure.
- **In Spring 2023**, the Government concluded its public consultation on the design of a single scheme, weighing questions on the balance of SME and RDEC scheme mechanics, support for specific industries and a broader view on R&D tax credit support. The Government announced they would go forward with the merged scheme.
- **In August 2023,** HMRC introduced an Additional Information Form (AIF)[12] requirement for all R&D claims. For new claimants, they will need to pre-notify HMRC.[13] This measure aims to tackle non-compliance within R&D regimes and to support the administration of the credit.
- **From 1 April 2024,** the merged scheme took effect following the 2024 Finance Act and announcements in the 2023 Autumn Statement.[14] This brings together the UK's two R&D tax relief incentives into a single scheme.
    - All companies, including those who previously claimed under the small and medium-sized enterprises (SME) scheme, will benefit from the receipt of a 20% tax credit that can be recognised as taxable income, providing better visibility in their accounts.
    - For loss-making companies, the notional tax rate applied to the R&D expenditure will be reduced to 19%, improving the cash benefit.
    - However, the new merged scheme poses a disadvantage for SMEs overall.

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[10] Commons Library Research Briefing (2023) 'Research and Development funding policy' https://researchbriefings.files.parliament.uk/documents/CBP-7237/CBP-7237.pdf
[11] techUK (2023) 'R&D tax credits in the Spring Budget 2023: What has happened and what next?' https://www.techuk.org/resource/r-d-tax-credits-in-the-spring-budget-2023-what-s-happened-and-what-s-next.html
[12] Gately (2023) 'Additional information form (AIF) required for R&D claims' https://gateleyplc.com/insight/article/additional-information-form-aif-required-for-r-d-claims/
[13] Moore R&D (n.d.) 'HMRC introduces pre-notification requirement for R&D claims' https://moorerd.com/insights/hmrc-introduces-pre-notification-requirement-for-rd-claims-act-now-before-its-too-late/
[14] HM Treasury (2023) 'Technical note on changes to research and development tax reliefs at Autumn Statement 2023' https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform/technical-note-on-changes-to-research-and-development-tax-reliefs-at-autumn-statement-2023

    - For some companies in a contractual R&D supply chain, the rules have not created the simplification that was heralded and is needed (due to added complexity of determining which party in a subcontracted R&D programme can claim the benefit).
- **From 1 April 2024**, alongside the merged scheme, an additional tax relief for R&D intensive SMEs.
    - It offers enhanced rates of relief for certain loss-making SMEs, providing a cash benefit of up to 26.97% for every qualifying R&D £1 incurred.[15]

While the UK has developed a competitive R&D tax credit, and some recent changes have improved the relief, repeated and significant alterations to the scheme have impacted business confidence and driven some R&D investment abroad. Results following the introduction of the merged scheme will be determined over the coming years.

Ahead of the Budget and Spending Review, there is an opportunity for the Government to provide industry with the confidence to invest in R&D and work in close collaboration to develop a longer-term five-year plan.

[15] Grant Thornton (2023) 'Guide to R&D tax relief reform as UK moves to a merged regime' https://www.grantthornton.co.uk/insights/guide-to-rd-reform-as-uk-moves-to-a-merged-regime/

Section 2. Priority areas for the Government

Area of focus	Policy action	Growth benefit
Prioritise improving HMRC's delivery of R&D tax reliefs.	1. **Use the 'R&D tax reliefs: Expert Advisory Panel'** announced in Spring 2024 to inform recommendations around HMRC's administration, operation and delivery of R&D tax reliefs.	Currently, HMRC under-delivery is costing both the Government and business. According to the NAO's most recent customer service report,[16] customers spent the equivalent of 798 years (7 million hours) in 2022-23 waiting to speak to an adviser, up from 365 years (3.2 million hours) in 2019-20. Improving delays to delivery of the R&D tax credit would have significant positive impacts on the cashflow situation of businesses and individuals.
	2. **Re-introduce geography specific expert teams within HMRC.** This would create sector specific specialists due to the clustered nature of R&D investments.	Evaluating the impact of R&D tax relief on a sector-by-sector basis would better help the Government to understand, identify and support the UK's high-growth industries across all regions.
	3. **Commit to providing the human capital and data to deal with the volume of cases and meet cases where self-assessment comes into question.** This should be accompanied with clear guidance and reasoning for challenging and/or rejecting a claim.	Prioritising investing in new technology and building capacity within HMRC would support the vision for a trusted, modern tax and customs department. This would improve resilience, effectiveness and support for taxpayers.
Make changes to the R&D tax credit	4. **Introduce a de minimis qualifying R&D expenditure threshold for the**	Start-Up Coalition analysis, based on around 245 HMRC staff working

[16] National Audit Office (2024) 'HMRC Customer Service' https://www.nao.org.uk/reports/hmrc-customer-service/

scheme to drive further investment into the UK.	**R&D tax credits scheme**, with the purpose of reducing HMRC caseload and removing wholly non-compliant claims.	on R&D tax credits, found the following: *"If the £30,000 threshold was introduced, eliminating over 20,000 cases, the average case per hour reduces to less than 1.3. With this reduction of over a quarter of the caseload, HMRC would have greater capacity to target fraud where the value is higher, while maintaining effective functioning for legitimate cases"'* [17] This demonstrates the cost-saving from introducing a de minimis qualifying R&D expenditure threshold.
	5. **Extend the qualifying categories to include capital expenditure,**[18] such as plant and machinery, used solely for R&D purposes. This would anchor innovative investment in the UK.	Capital expenditure (spending on plant, machinery and buildings) has an essential and growing role in the R&D process. Capital investment accounts for 8.3% (roughly £2.1 billion) of all business R&D expenditure in 2019, up from 5.2% in 2010.[19]
	6. **Expand ERIS (Enhanced Research and Development intensive support) to include profitable SMEs.**	By investing in R&D, SMEs can improve their operational processes, making them more efficient and productive.

[17] Start-Up Coalition (2023) 'Fixing R&D Tax Credits' https://startupcoalition.io/u/2023/11/Startup-Coalition-November-2023-RD-Tax-Credits-Report_FOR-RELEASE-1.pdf

[18] Note, the current capital expenditure incentives (RDAs) only impact the corporation tax liability, they don't offer a cash credit for firms without a taxable profit - one of the major strengths of the R&D tax credits. This penalises growing firms that are yet to make a profit.

[19] ONS (2020) 'Research and Development in UK Businesses 2019' Table Eight, https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/datasets/ukbusinessenterpriseresearchanddevelopment

	7. **Revisit the merged scheme to improve clarity around subcontracted R&D and to support SMEs innovation,** recognising they often face greater challenges accessing funding for risky endeavours such as R&D.	According to recent FSB research, 64% of small firms which applied for R&D tax relief in the three years between 2020 to 2023 improved cashflow for their business, while over a half (55%) increased their investment in R&D. [20] Alongside this, 46% of small firms believed extra tax relief would encourage them to innovate.
Get started on a longer-term five-year plan for the delivery of R&D tax reliefs.	8. **Revisit the policy objectives of the R&D tax relief scheme**, with inward investment and UK competitiveness at the heart of this.	Note, while R&D tax relief doesn't directly contribute to the Government's target of R&D expenditure as a percentage of GDP, it encourages companies to boost their investment. R&D is essential to keep the economy growing. UK R&D expenditure represented 2.77% of GDP in 2022.[21] Note, this falls below many other OECD nations including the US, Belgium, Japan and Germany.[22]
	9. **Provide policy certainty by setting a new target for R&D spend as a percentage of GDP**, with updated research from HMRC on additionality and spillover benefits.	

[20] FSB (2023) 'New figures show SME investment in R&D was booming before Government axed tax incentive' https://www.fsb.org.uk/resources-page/new-figures-show-sme-investment-in-r-d-was-booming-before-government-axed-tax-incentive.html
[21] ONS (2024) 'Gross domestic expenditure on research and development, UK: 2022' https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/bulletins/ukgrossdomesticexpenditureonresearchanddevelopment/2022#:~:text=The%20government%20sector%2C%20including%20UK,included%20in%20the%202019%20release.
[22] OECD (2021) 'Gross domestic spending on R&D' https://www.oecd.org/en/data/indicators/gross-domestic-spending-on-r-d.html

Section 3. Improving HMRC's delivery of R&D tax reliefs

HMRC's under-delivery raises a fundamental risk to UK competitiveness, where investments are being delayed, halted, or missed, due to services not supporting businesses.

Currently, HMRC's services have been falling below expected service levels,[23] resulting in added costs for businesses and the Government. In May 2024, the National Audit Office revealed that new digital services had not reduced service pressures as much as predicted. This has resulted in consistent failure to meet targets, process correspondence and deal with telephone calls.[24]

This is an issue of time, resource, and ultimately cost. Instead of supporting a Government policy designed to promote growth, where the UK has a target to raise investment in R&D to 2.4% of UK GDP by 2027, the poor quality of delivery is directly hindering firms' ability to operate successfully in the UK.

While HMRC's initial efforts to address R&D tax credit fraud are commendable, there is a risk that a poorly regulated compliance process may be causing as much, if not more, harm to the UK economy than the fraud that HMRC initially allowed to proliferate. Currently, compliance implementation by HMRC is impacting the practical experience of businesses and the flagship national scheme to encourage R&D. techUK members consistently speak of legitimate claims being rejected, and an appalling experience when dealing directly with HMRC.

Areas of concern that techUK members' outline include:

- **Inconsistency** in their experience with HMRC customer service over the past 12 months. There have been examples of inappropriate use of HMRC powers, such as correction under FA 1998, Sch 18 para 16 to remove R&D claims without proper review and consultation and an overly sceptical approach to compliance checks.
- **An apparent lack of training and experience** from recently recruited officers, specifically for R&D claim compliance. Often the HMRC representative answering telephone helplines does not have the training to resolve the issue being raised.
- **A lack of accountability to address issues.** Members outline a reluctance to engage directly (call or meeting) on substantive points, relying on extended correspondence which only lengthens the process. Along with a system that is continually failing to deliver a fair enquiry process for several genuine

[23] NAO (2024) 'Value for Money: HMRC Customer Service' https://www.nao.org.uk/reports/hmrc-customer-service/
[24] Same reference as above.

claims, there is a perceived bias among caseworkers towards rejecting claims and disregarding the testimony of competent professionals.

Specific experiences when dealing with HMRC include:

- A **software company** developing a software platform for helping professional investigators to disrupt criminal networks engaged in illegal activity (money-laundering, trafficking etc) outline their recent experience with HMRC. The company invest heavily in R&D and based on their work; their product solves many technical problems for both business and Government. The R&D tax credit represents one of their main sources of funding and supports them to take R&D investment risks that they may not otherwise be able to afford to take. However, in April 2024, the company received notice on the eligibility of all their projects covered by their R&D credit claim. Since then, they have experienced HMRC ignore basic requirements for handling their case, and systemically ignored its compliance function.
- Another **software company** outline unclear guidance and inconsistency in HMRC's approach to software development as a qualifying expenditure. This is directly hindering their ability to claim the credit and therefore must be clarified. They note that HMRC rigidly apply an approach that the software and AI innovation much be 'grass-roots' development. Therefore, using a combination of different tools, techniques and technologies for new outcomes or improved processes, no longer seems to qualify.

To address this, we propose the Government should:

1. Use the 'R&D tax reliefs: Expert Advisory Panel' announced in Spring 2024 to inform recommendations around HMRC's administration, operation and delivery of the tax credit. This will ensure the Government regularly engage with claimants, advisors and professional bodies to increase transparency.

2. Re-introduce geography specific expert teams. This created sector specialists due to the clustered nature of R&D investments. This would help to understand the specific needs and challenges of businesses in different parts of the UK. As well as evaluating the impact of R&D tax relief on a sector-by-sector basis to better understand how the scheme supports the UK's high-growth industries. In turn, allowing for better targeting of regional incentives and advisory services to help businesses in undeserved regions access and benefit from R&D tax credit.

3. Commit to providing the human capital and data to deal with the volume of cases, and meet cases where self-assessment comes into question, with clear guidance and reasoning for challenging and/or rejecting a claim.

Section 4. Changes to R&D tax reliefs to drive further investment into the UK

Any immediate changes to the R&D tax reliefs should prioritise (i) changes to HMRC delivery and (ii) anchoring investment in the UK. Acting on this will create confidence in the UK's regime and drive further investment into business R&D, towards delivering on economic growth.

First, as mentioned above, HMRC currently lacks the capacity to handle the volume of small claims it faces. This is particularly acute due to the often-higher likelihood of error and fraud within these claims.

Start-Up Coalition's assessment of HMRC data revealed a significant drop off in the error and fraud rate as an estimated percentage of the value of claims at £30,000. According to the analysis, an application valued under £30,000 in claim size is now twice as likely to be non-compliant than an applicated valued over £30,000 in claim size.[25]

As Start-Up Coalition note, *when R&D tax credits were introduced in 2000, there was a minimum R&D threshold of £25,000. This threshold aimed to "keep administrative and Exchequer costs down, encourage businesses to increase R&D expenditure, and target businesses carrying out significant R&D." The threshold was later reduced to £10,000 to motivate SMEs to undertake smaller R&D projects, and it was eliminated entirely in 2012. However, by 2019-20, claims below £25,000 made up 50% of the total number of claims, resulting in an unsustainable volume*.

Further analysis around this can be found within Start-Up Coalition's recent **'Fixing the R&D Tax Credits report**.

techUK advise that a de-minimis qualifying threshold should be explored to reduce HMRC case load. The threshold must be assessed through close consultation with industry and the latest HMRC data around the error and fraud rate for valued claims. Such an introduction must be wary of impacting on SMEs cashflow.

To tackle this, we propose the Government should:

4. **Introduce a de minimis qualifying R&D expenditure threshold for the R&D tax credits scheme**, with the purpose of reducing HMRC caseload and removing wholly non-compliant claims.

Throughout HM Treasury's review on R&D tax reliefs, techUK called for the Government to maintain a globally competitive R&D tax credits scheme that is simple, predictable and drives R&D investment into the UK. At the heart of this, we called for a scheme that encourages businesses confidence, whether an SME or larger firm.

[25] Start-Up Coalition (2023) 'Fixing R&D tax credits' https://startupcoalition.io/u/2023/11/Startup-Coalition-November-2023-RD-Tax-Credits-Report_FOR-RELEASE-1.pdf

We recognise that the UK has a thriving tech sector, and R&D tax credits are instrumental in funding developments, whether in emerging technologies like AI or our vaccine developments for the NHS. But the Government can act to anchor investment in the UK and increase its competitiveness by extending the qualifying categories for the credit to include capital expenditure.

Acting on this will incentivise smaller and scaling businesses to make investments. This would also better align with international competitors such as France, Spain and Japan who all recognise capital expenditure – such as labs and buildings – within its R&D tax credits system. Alongside this, taking this approach would enhance productivity by upgrading research facilities, making the UK more attractive for capital investment from both existing R&D-intensive companies and new investors. As such, boosting the UK's competitiveness in attracting and retaining technology skills and activity.

Just a few statistics point to the opportunity of extending qualifying categories to include capital expenditure:

- **Capital expenditure (spending on plant, machinery and buildings) has an essential and growing role in the R&D process.** Capital investment accounts for 8.3% (roughly £2.1bn) of all business R&D expenditure in 2019, up from 5.2% in 2010.[26]
- **Better recognition of capital in UK R&D tax credits will make the UK tax system more internationally competitive**. The OECD currently ranks the UK's R&D tax relief scheme for SMEs as the 11th most generous of 44 countries. The UK's R&D tax relief scheme for large companies is currently ranked as only the 23rd most generous.
- techUK member ForrestBrown ran a survey with clients revealing that **61% of respondents said more tax relief for capital expenditure on R&D would incentivise their business to carry out more R&D**.[27]

To tackle this, we propose:

5. **Extending the qualifying categories to include capital expenditure, such as plant and machinery, used solely for R&D purposes.** This would anchor innovative investment in the UK, leading to higher growth and stronger public finances.

We recognise that the UK is home to some of the most innovative SMEs in the world and a natural place for businesses to engage in R&D. Indeed, the UK is currently

[26] ONS (2020) 'Research and Development in UK Businesses 2019' Table Eight, https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/datasets/ukbusinessenterpriseresearchanddevelopment
[27] Taxation (2022) 'Why those racing for Number 10 should pay attention to R&D tax relief' https://www.taxation.co.uk/articles/why-those-racing-for-number-10-should-pay-attention-to-r-d-tax-relief

ranked fourth on the Global Innovation Index 2023[28] and highest ranking G7/G20 economy.[29] Making up 99% of the UK business population, SMEs contribute to the growth of local economies, and their innovations often drive new ideas and technologies. Between the 2021 and 2022 tax year, 85,625 SMEs made R&D claims, representing 95% of all claims.[30]

Demonstrating the importance of the tax credit to bolster SMEs R&D investment, FSB research highlighted that 64% of small firms who applied for R&D tax relief in the last three years improved cashflow for their business, while over a half (55%) increased their investment in R&D. [31]

techUK's SME members demonstrate how the R&D tax credit has supported investment in their innovative activities:

- One **specialist developer of FPGA based hardware and embedded secure software applications** outline how the tax credit has helped to fund the ongoing design, development and manufacture of hardware prototypes. As an SME, undertaking advanced R&D is considered 'high risk' even by the standards of early-stage investors and/or early adopter end users. Consequently, their ability to recover a proportion of our R&D Expenditure via the R&D Tax credits has been invaluable. For instance, this has enabled them to prove that we can deliver our market leading functionality including incorporating Quantum Safe Homomorphic Encryption.

There are options the Government can take to improve the relief available to SMEs. This follows the recent introduction of the merged scheme for R&D expenditure credit (RDEC) and enhanced R&D intensive support (ERIS) from 1 April 2024.

First, the Government could expand ERIS (Enhanced Research and Development intensive support) to include profitable SMEs. Currently, the scheme only allows loss-making R&D intensive SMEs to deduct an extra 86% of their qualifying costs in calculating their adjusted trading loss and surrender corresponding losses for a payable tax credit at 14.5%.[32] Acting on this would help to address the cliff edge in

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[28] WIPO 'Global Innovation index 2023' https://www.wipo.int/global_innovation_index/en/2023/
[29] Department for Business and Trade (n.d.) 'UK Innovation' https://www.great.gov.uk/international/content/investment/why-invest-in-the-uk/uk-innovation/
[30] Leyton (2024) 'UK Small and Medium-sized enterprises (SMEs) business statistics' https://leyton.com/uk/insights/articles/uk-sme-statistics/
[31] FSB (2023) 'New figures show SME investment in R&D was booming before Government axed tax incentive' https://www.fsb.org.uk/resources-page/new-figures-show-sme-investment-in-r-d-was-booming-before-government-axed-tax-incentive.html
[32] GOV.UK (2024) 'Guidance: Research and Development (R&D) Tax Relief: The merged scheme and enhanced R&D intensive support' https://www.gov.uk/guidance/research-and-development-rd-tax-relief-the-merged-scheme-and-enhanced-rd-intensive-support#:~:text=company%20is%20connected-,Enhanced%20Research%20and%20Development%20intensive%20support%20%E2%80%94%20rates,tax%20credit%20rate%20is%2014.5%25.

the current scheme, where the amount of relief available reduces dramatically when a business commercialises its R&D.

Second, the Government should improve clarity around subcontracted R&D. techUK members anecdotally note implementation issues as the new rules around sub-contracting R&D bed in. Under the current scheme, where an SME is specifically sub-contracted by a large company to undertake R&D, the large company will be able to claim the R&D tax credit. Note, for periods beginning prior to 1 April 2024, the SME could claim the RDEC rather than the large company.

Ultimately, the Government should focus longer term on rewarding both profitable and loss-making SMEs with a higher rate of relief to support the risk they take on funding innovation.

To tackle this, we propose:

6. **Expanding ERIS (Enhanced Research and Development intensive support) to include profitable SMEs.**

7. **Following recent changes, revisit the scheme to improve clarity around subcontracted R&D and to support SMEs innovation,** recognising that they often face greater challenges accessing funding for risky endeavours such as R&D.

Section 5. A longer-term five-year plan for the delivery of R&D tax reliefs

At the heart of providing confidence for the tech sector is longer-term policy certainty. We know this is a priority of this Government, and our members stand behind this ambition. Indeed, the Government previously stated a priority of 'stability' for R&D tax reliefs.[33]

While the Government committed to maintaining the current structure 'over the next parliament', [34] there are steps that can be taken to provide greater certainty for business, better target fraudulent claims and support a future industrial strategy. Given the consultation process for a merged scheme has now ended, techUK and our members believe there is now an opportunity to ensure that the UK maintains a competitive R&D tax relief regime through a longer-term five-year plan.

techUK's members have significant R&D operations in computer programming, information services, research and development services, software development, aerospace and telecommunications sectors. These sectors all rank among the top ten sectors by R&D spending in the UK according to the ONS.[35] We reiterate that supporting investment in R&D across our membership will help to deliver on your missions – whether reducing waiting times for the NHS, securing the UK's energy security or securing the highest sustained growth in the G7.

While R&D tax relief doesn't directly contribute to the Government's target of 2.4% of GDP by 2027,[36] it encourages companies to boost their investment. Note, the target of 2.4% was first set in 2017.[37] Since then, the Government has exceeded this, with UK R&D expenditure representing 2.77% of GDP in 2022.[38] Posing a risk to the UK's international competitiveness however, this falls below many other OECD nations including the US, Belgium, Japan and Germany.[39] Setting an updated target for R&D spend as a percentage of GDP would provide longer term policy certainty and strategic direction for business.

[33] Labour (2023) 'A Partnership for Growth' https://labour.org.uk/wp-content/uploads/2024/02/A-Partnership-for-Growth.pdf
[34] Labour (2023) 'A Partnership for Growth' https://labour.org.uk/wp-content/uploads/2024/02/A-Partnership-for-Growth.pdf
[35] UK House of Commons Library (2023) 'Research and Development Spending' https://researchbriefings.files.parliament.uk/documents/SN04223/SN04223.pdf
[36] UK Parliament (2023) 'Research and development spending' https://commonslibrary.parliament.uk/research-briefings/sn04223/
[37] GOV.UK (2017) 'Industrial Strategy' https://www.gov.uk/government/publications/industrial-strategy-building-a-britain-fit-for-the-future
[38] ONS (2024) 'Gross domestic expenditure on research and development, UK: 2022' https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/bulletins/ukgrossdomesticexpenditureonresearchanddevelopment/2022#:~:text=The%20government%20sector%2C%20including%20UK,included%20in%20the%202019%20release.
[39] OECD (2021) 'Gross domestic spending on R&D' https://www.oecd.org/en/data/indicators/gross-domestic-spending-on-r-d.html

To get started on a longer-term plan, we propose:

8. **Revisiting the policy objectives of the R&D tax relief scheme**, with inward investment and UK competitiveness at the heart of this. Alongside this, set out a plan for how the credit will be reviewed and the milestones and conditions under which reforms to the credit will be considered. This would allow businesses to understand the likely evolution of R&D support over a five-year period.

9. **Providing policy certainty by setting a new target for R&D spend as a percentage of GDP**, with updated research from HMRC on additionality and spillover benefits.[40] This should complement HMT's plans to review the credit over a five-year period.

[40] Of note, comparing R&D expenditure with tax relief claimed is challenging due to different reporting periods, so publishing comparable figures would be beneficial.

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About techUK

techUK is the trade association which brings together people, companies and organisations to realise the positive outcomes of what digital technology can achieve. With around 1,000 members (the majority of which are SMEs) across the UK, techUK creates a network for innovation and collaboration across business, government and stakeholders to provide a better future for people, society, the economy and the planet. By providing expertise and insight, we support our members, partners and stakeholders as they prepare the UK for what comes next in a constantly changing world.

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