Association of Accounting Technicians response to the HMRC & HM Treasury consultation on R&D Tax Reliefs

Association of Accounting Technicians (AAT) welcomes the opportunity to provide a short response to this consultation on R&D Tax Reliefs. Many of the questions are not relevant to AAT as a professional body for accountants and therefore a general response follows instead.

International comparisons

AAT again notes the reference to the Government objective of reaching R&D investment equating to 2.4% of GDP by 2027 but as stated before[1], believes a more ambitious target should be set of ensuring the UK is in the top ten countries for R&D spend by 2027.

The 2.4% target is well below what leading countries are currently investing e.g. South Korea (4.3%) Japan (3.4%) Finland (3.2%) Switzerland (3.2%) Austria (3.1%) Sweden (3.1%) Denmark (2.9%) Germany (2.9%) USA (2.7%)[2] . Put another way, the Government hopes that in six years' time, the UK is investing the same percentage of GDP as Slovenia invests today. It is also worth noting that most of these countries have a stated objective to increase their R&D spend as share of GDP further still. For example, Finland has a 3.2% investment rate today but is intent on raising this to 4% by 2030.

AAT notes that the consultation document states that, *"The UK is unusual internationally in having two different schemes, the SME scheme and RDEC"* and suggests that this is sufficient reason to consider merging the two. Although this may be technically true, it is equally worthy of note that the country with the highest levels of R&D investment (South Korea) has not just one scheme, or indeed two, but several[3].

Rigour

The consultation document states that in some countries, such as the US, *"…a company can expect to be audited by the tax authorities on nearly any tax credit claim"*. There is no reason why the same could not be true in the UK. With regard to the responsibilities agents and the applicant company being better reflected in the claims process, AAT actively promotes member awareness and understanding of R&D Tax Reliefs[4] and has previously suggested Government consider imposing joint liability on agents and taxpayers alike[5].

Although the British tax system is designed so that accountability lies with the taxpayer, whether or not an adviser has been used, joint liability would probably be a more appropriate approach to take given this is likely to better reflect the reality of many tax advice situations. In Portugal the agent is liable for any fines and debts whilst the client is still responsible for ensuring the correct amount of tax is paid, ensuring no taxpayer unduly benefits from the mistakes or misdemeanours of their adviser.

AAT also notes the plethora of unqualified, unregulated agents providing advice to businesses in relation to R&D Tax Credits. In 2019, unregulated agents were estimated to have encouraged businesses to overclaim R&D Tax Credits by over £600m[6].

As AAT has highlighted on numerous occasions, this issue could be easily resolved by requiring anyone giving paid for tax or accountancy services to be obliged to be a member of a recognised professional body. Regrettably, in sharp contrast to the increasingly tight regulation of auditors, there does not appear to be any political desire to address the issue of unregulated high street agents, whether operating in the R&D space or any other areas of the economy. The fact that two thirds of complaints about agents relate to the third of agents who are unregulated should be a sufficient warning to policymakers that action – beyond the proposed introduction of mere indemnity insurance requirements - is urgently required.

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[1] **AAT response to HMRC/HMT consultation on the scope of qualifying expenditures for R&D Tax Credits, 2020: https://www.aat.org.uk/prod/s3fs-public/assets/aat-response-qualifiying-expenditures-r-and-d-tax-credits.pdf**
[2] **UNESCO Institute for Statistics, 2020: http://uis.unesco.org/apps/visualisations/research-and-development-spending/**
[3] **PwC Worldwide Tax Summaries, December 2020: https://taxsummaries.pwc.com/republic-of-korea/corporate/tax-credits-and-incentives#:~:text=Companies%20presently%20claim%20a%20tax,current%20R%26D%20expenses%20over%20the**
[4] **See 2018 AAT member magazine article below at Appendix 1**
[5] **AAT response to HMRC Consultation, "Raising Standards in the Tax Advice Market" August 2020: https://www.aat.org.uk/prod/s3fs-public/assets/aat-response-raising-standards-tax-advice.pdf**
[6] **Accountancy Daily, "HMRC hunting £612m in R&D tax relief repayments" November 2019: https://www.accountancydaily.co/hmrc-hunting-ps612m-rd-tax-relief-repayments**

Qualifying definitions

AAT notes that the government agrees with respondents to its 2020 consultation on the scope of R&D (including AAT) that there is a strong case for bringing data and cloud computing costs within the definition of qualifying expenditure and trusts this change will be confirmed later in the year.

Given the stated ambition of simplification, there may also be some merit in examining the possibility of abolishing Video Games Tax Relief (VGTR) and instead offering a broader R&D Tax Relief scheme to replace those on offer to the creative industries.

It is not just the US, Spain and Portugal that vary their rates of R&D support by sector and activity, those with the highest levels of R&D investment do so as well e.g. South Korea, Japan and Finland. In light of both the UK's "net zero" and "build back better" ambitions, it would seem both consistent and desirable to encourage greater additionality in the sphere of environmental R&D and this is therefore something that AAT would support. Perhaps a genuine "super deduction" like the 150% provided for in Finland from January 2021 until 2025 would be sufficiently game changing to deliver a step change in R&D.

Overseas restrictions

Although AAT notes understandable concerns about the UK having a very generous position on overseas expenditure that can qualify for UK tax relief, and acknowledges, "*There is no provision in the R&D tax reliefs requiring expenditure to take place in the UK*" this does not necessarily merit a clamp down.

In fact, this could be argued as being a key feature of the success of the UK R&D tax credit system. This is not a complete free for all for businesses seeking to exploit the system. There are some sensible, effective controls i.e. the R&D work must be under the direction and control of the UK entity and the costs must be charged to the UK entity. The fact that R&D work undertaken anywhere in the world can be claimed for, positively sets us apart from many of our peers. Indeed, Japan may have one of the highest R&D spends in the world but a lack of collaborative overseas innovation has been highlighted as a fundamental weakness of its system[7] – something that cannot be said of the UK.

Appreciating the need to distinguish between work that needs to take place abroad and which benefits the UK, and that which does not, AAT urges Government not to be too prescriptive in the establishment of rules as this could have the unintended consequence of discouraging much needed R&D. Some sort of broad reasonableness test, combined with increased HMRC auditing and enforcement, should be sufficient to ensure any abuse regarding overseas activities is limited.

Further information

If you have any queries, require any further information, or would like to discuss any of the above points in more detail, please contact Phil Hall, AAT Head of Public Affairs & Public Policy:

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[7] **McKinsey, A new era for industrial R&D in Japan, May 2020:**
https://www.mckinsey.com/business-functions/operations/our-insights/a-new-era-for-industrial-rnd-in-japan#

Appendix 1:

AT Magazine (AAT member magazine) 2018:

R&D tax relief: spread the word

DON'T FORGET TO ADD WHAT YOU'VE READ TO YOUR CPD RECORD: bit.ly/CPDRecord

WORDS PHIL HALL, HEAD OF PUBLIC AFFAIRS AND PUBLIC POLICY, AAT

As many as nine out of ten eligible companies fail to claim research and development (R&D) tax relief. This is damaging for them and the UK economy as a whole. However, the accountancy profession can help.

There are two key reasons for businesses' failure to claim: first, a lack of awareness (even those aware of the scheme often think they aren't eligible, when they are); second, a fear of completing the necessary paperwork.

Accountants must make eligible clients aware of the scheme. And they can play an important role in dealing with the necessary paperwork.

SME R&D relief allows companies to deduct an extra 130% of their qualifying costs from their yearly profit, as well as the normal 100% deduction, to make a 230% deduction in total. It also enables the qualifying company to claim a tax credit if it's loss-making, worth up to 14.5% of the surrenderable loss.

The company can claim SME R&D tax relief if it has fewer than 500 staff and a turnover of under €100m, but the company project must meet HMRC's definition of R&D, which requires the work to be part of a specific project to make an advance in science or technology, not an advance within a social science like economics. It can be researching or developing a new process, product or service. It could even be improving an existing one.

Further information can be found online by searching for the helpful HMRC booklet *Research and Development Tax Relief: Making R&D Easier for Small Companies*.

Although HMRC's most recent statistics show 83% of all R&D tax credit claims are made using the SME scheme, it's not all about small companies. The R&D expenditure credit (RDEC) gives corporation tax relief to companies that undertake R&D.

Accountants must make eligible clients aware of the relief

RDEC replaced the large company scheme in April 2016. Originally calculated at 10% of the company's qualifying R&D expenditure, it has now risen to 12%. Again, the company must show how the project meets HMRC's definition of R&D.

If accountants keep all this in mind, they can help to educate companies about the incentives available when they innovate – a great business opportunity for them and their clients.

CONSULTATION UPDATE

AAT responded to almost 70 public consultations in 2017, ensuring AAT members' views and interests were protected and promoted. And we have hit the ground running in 2018 too, making numerous responses.

Below are a few examples, but all responses can be found at: **aat.org.uk/about-aat/aat-policy-work**

Rent-a-room relief
The Treasury is considering making changes to the £7,500 rent-a-room relief. While digital platforms such as Airbnb have had a significant impact on this market, that must not be used as a justification for restricting it. There are various economic and social benefits to the landlord, renter and wider economy that the Treasury must consider before making any decision to amend the current system.

Corporate Governance
AAT members made their feelings clear about the government's Corporate Governance proposals via the 2017 AAT Corporate Governance survey. Members called for longer holding periods for long-term incentive plans, a maximum pay ratio of 20:1 and strong employee representation on boards. The Financial Reporting Council is now consulting on the subject; again, AAT is making members' views clear.

Making Tax Digital
This is the third time that HMRC has consulted on interest and late payment penalties under Making Tax Digital. HMRC is creeping ever closer to adopting the position AAT first recommended, but only time will tell. AAT has again set out the reasons why HMRC's proposal for late payment penalties to commence after 14 days is unacceptable, and why 30 days is a much better option.

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