



THE SCOPE OF QUALIFYING EXPENDITURES FOR R&D TAX CREDITS

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ICAEW welcomes the opportunity to comment on the Scope of qualifying expenditures for R&D tax credits published by HMRC on 21 July 2020, a copy of which is available from this [link](#).

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EXECUTIVE SUMMARY

1. ICAEW welcomes the consultation on the scope of qualifying R&D expenditure to ensure it is both well targeted and reflects modern R&D processes. In the light of the impact of COVID-19, it is clearly a crucial time for the economy so continued review and reform of this relief to encourage appropriate investment and innovation is essential.
2. We understand HMRC's desire to ensure that any changes to the current scope of R&D will help drive decisions to make new investments, thereby providing relief in a cost-efficient manner which ultimately maximises value for the Treasury. We also note that the consultation seeks to identify areas where current eligible costs could be considered as routine work and should not be receiving relief.
3. While we empathise with this approach, the consultation focuses on R&D expenditure in the context of cloud computing and use of data and the impact of any changes on other sectors should also be considered carefully. In the existing economic climate this is not a good time for many British industries to implement restrictions on available tax reliefs. Similarly, given the current and ongoing risk of global pandemics, some sectors which rely heavily on R&D expenditure (such as life sciences) have become of crucial global importance. It is important that such industries do not receive less government support and that investment in them continues to be encouraged in the public interest.
4. However, our discussions with members did indicate that there is some, limited, capacity to restrict qualifying expenditure on the basis that it did not appear to contribute to the R&D project or was 'routine' in any event. We discuss this in more detail below.
5. Some members did suggest that more thought could be given as to how specific sectors could be supported. If the overall objective is to increase genuine R&D activity by expanding the scope of qualifying expenditure, a focus on cloud computing and data was viewed to be quite a niche approach to achieve this.

DETAILED RESPONSES TO THE QUESTIONS POSED IN THE CONSULTATION

Question 1a: Are there uses of data that contribute to R&D but which do not currently attract relief through the RDEC and SME schemes? Please provide examples to support your response.

6. Members thought that the definition of 'consumed' did cause some issues. Some of their clients were not comfortable with the idea that data had been 'consumed', given that there may be some ongoing value to the data. This means that the expenditure would not qualify for R&D, albeit it did contribute to the R&D process. Where the interaction of live data was crucial to the information gathered, this was less of an issue. Similarly, it was suggested that industries outside of the financial and insurance markets are more likely to be impacted by this definition as a lot of the value of financial data centres around how the markets are performing in real time and against each other. It is often easier to illustrate that the data was of no value after the project had finished. Data around weather was also given as an example which had caused difficulty in meeting the definition of 'consumed' as it was held and still used by the business.

Question 1b: To what extent are datasets employed in the R&D process consumed? To what extent do they retain value? Please provide examples to support your response.

7. Please refer to above question at 1a.

Question 2a: Do you already claim for software costs under the current definition? If so, what was your experience of separating out the R&D specific costs for the purposes of the claim?

8. Members would welcome clarification and consistency on the costs for leasing computers in the cloud. There are examples of inconsistencies in HMRC approach. For example, there are

occasions where these were not allowed as HMRC's view was that these costs are akin to rent which does not qualify. However, this was not always the case, with some companies achieving relief for such costs.

Question 2b: Are there any software costs that currently qualify for R&D tax credits, that could be limited or excluded from relief without materially affecting R&D projects? Please provide examples to support your response.

9. Members think that examples of this are likely to be limited. The only example we identified was around background software licenses. To illustrate, Microsoft Office licenses might be purchased for every employee as standard but then they would form part of the R&D cost in respect of employees involved in the project. Arguably the marginal cost of any additional software might be a more appropriate measure of the actual R&D spend. However, members did not think that this would materially affect claims because the amounts involved are small in comparison to the projects as a whole.

Question 2c: Are there any software costs, partially or wholly for R&D purposes, that do not currently qualify for R&D tax credits, that should be if the regime is to better reflect the nature of modern R&D? Please provide examples to support your response on whether these costs could be separated out straightforwardly.

10. Software developed in-house will often not attract R&D relief whereas purchased software is often eligible. This is largely driven by the accounting treatment, with in-house developed software being capitalised in the balance sheet. This can result in situations where no R&D relief is achieved whereas, if the company had bought the same software instead of developing it in-house, the costs would have been eligible for relief. This inconsistency appears at odds with the policy intent of the legislation and should be addressed.

Question 3a: What experience do you have of claiming R&D tax credits in other jurisdictions, where expenditures pertain to data or cloud computing?

11. We understand in Australia rental costs can be claimed but core technology (such as baseline Microsoft office) is ineligible. In France we are advised you can claim the depreciation on capitalised data and cloud computing costs.

Question 3b: What evidence can you provide that a scope expansion in these areas would drive additional investments in research and development?

12. Members thought that this is a challenging question and difficult to answer. Non-technology businesses might be more likely to invest in cloud computing capacity. Overall, members considered that there might be some increase in investments and this would largely benefit technology businesses, but we are not in a position to quantify the impact.

Question 4: Would changes to the R&D tax relief rules in the areas outlined above lead to any change in the commercial relationships between companies, insofar as expenditure is outsourced to a third-party provider?

13. The changes would provide an incentive to use cloud computing, although this reflects current trends in any event.

Question 5a: Are there expenditures on indirect activities which should be limited or excluded from eligibility for relief? Please provide examples to support your response.

14. The UK Department for Business, Energy & Industrial Strategy ("BEIS") has explicitly defined the types of projects that qualify for R&D through the release of its BEIS guidelines. As the definitions around qualifying indirect activities largely stems from this guidance, members have queried whether there will be a review of these? In the absence of such a review it would be difficult to facilitate any change in approach. Members also believe that there is often a degree of judgement and subjectivity in allocating indirect costs and, generally, they

would not expect to see qualifying indirect costs to be bigger than the qualifying direct costs with a typical proportion being 10-20%. Clearly there will be differing approaches between advisors on this topic but a higher proportion could be an indicator of an incorrect allocation of indirect costs involving non-qualifying R&D spend.

Question 5b: Are there other expenditures on routine work which should be limited or excluded from eligibility for relief? Please provide examples to support your response.

15. Members reported that there is some inconsistency in the outcome of applying the law as it currently stands which should be addressed. For example, certain routine work in isolation would not qualify but if it is part of a wider group project it would attract relief. For example, if routine testing is sub-contracted externally, it often will not qualify. However, if this work is sub-contracted internally as part of a group project, the costs will qualify. This outcome seems at odds with the policy intent and consideration should be given to removing any inequity.
16. It was also noted that any changes to qualifying indirect activities will result in winners and losers and this consultation in itself will create uncertainty in some sectors (particularly non-technology businesses). As discussed in our executive summary, it is important that any changes consider the impact on all sectors, including those of heightened importance such as life sciences.

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 <https://goo.gl/x6UjJ5>).