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Taxation

Excellence in Taxation

Improving access to R&D tax credits for small business Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 We refer to the consultation document published on 16 January 2015 on Improving access to R&D tax credits for small businesses. We are pleased to respond to this consultation.

2 Improving access – Q1: the relevant factors

- 2.1 We agree that the factors identified in the consultation document – awareness, design, understanding and administration are matters affecting access to the tax relief. In particular, in our experience, the main barrier is awareness of the relief and an appreciation that it is of much wider application than the stereotypical lab scientists in white coats.
- 2.2 We suggest, therefore, that the main driver behind any reform should be an increased effort to break down the barrier of awareness and build an appreciation of the scope of R&D tax credits. All of HMRC, the professional bodies and agents have a role to play in this.

3 Awareness

- 3.1 *Q2 Engaging businesses to help increase take-up of R&D tax credits*
- 3.2 As mentioned above, agents have a role to play in raising awareness – however in general terms this is unlikely to be practical as cold calls or other marketing approaches tend to meet with natural resistance from small businesses who will not,

typically, like to feel they are being sold to. However, it is also recognised that HMRC cannot improve awareness alone. We suggest that help could be sought from bodies such as the following (not an exhaustive list):

- Chambers of Commerce – these are local bodies already providing a broad range of advice for both new and established businesses, which often includes advice on sources of funding. R&D tax credits should form a part of this, particularly given the complex and crucial rules around the interaction of the relief with other forms of grant funding. We suggest there is a training need for the Chambers to be able to give basic advice, armed with an awareness of the issues with grant funding. For more complex advice Chambers should be encouraged to signpost to reputable firms of tax advisers or R&D specialists.
- Local Enterprise Partnerships could also play a similar role.
- A number of Innovation and Growth Hubs are springing up around the UK at the moment, often based in universities with a remit to help bridge the gap from academia to business. This is another key stage where awareness of R&D tax credits can be raised, particularly from the point of view of being an accessible source of funding where bank funding cannot yet be secured, as well as helping inform decisions on business structure. Again these hubs could have a signposting role to tax advisers and/or R&D specialists.
- As R&D has broad application across a number of business sectors, specific trade press can also have a role to play – perhaps by means of HMRC placing tailored articles or advertorials in these magazines to raise awareness amongst the readerships. Again, in a culture where smaller businesses have an aversion to cold marketing approaches, an awareness raising release from HMRC is likely to grab their attention more than an accountancy firm advertisement.
- Bodies awarding other grants could also have a role to play; for example Innovate UK (formerly Technology Strategy Board). If they receive enquiries about specific grants which are European State Aid, for example, they could be trained to ask in the initial enquiries about whether the company has claimed, or could claim, R&D tax credits, and, if not, suggest they investigate these.

This is definitely an area where HMRC could work better with these other government funded agencies.

3.3 The consultation document also asks who the right people within a company are for targeting information. All of those suggested are potentially the correct people to target. Depending of the organisation of the particular company, all may have a role to play in formulating a claim. There is no specific 'right time' to receive the information. Information whenever received may be helpful. It may be useful to consider providing information at times when HMRC already contacts a company. For example, HMRC could include a notice about the relief to be sent with a CT600 notice to file, or incorporated into the Budget changes document which is already included with Corporation Tax compliance documentation.

3.4 *Q3 Contacting HMRC*

3.5 The postcode finder, which then directs the company to the right R&D unit is relatively easy to find on the HMRC website with fairly straightforward search parameters.

4 Design

- 4.1 We note that there is an error in the consultation document's numbering of questions. In the main body of the documents there is no question 4 and two question 8's. For the remainder of this response, we are using the correct numbering in the Summary of Consultation Questions.
- 4.2 *Q4 – definition of R&D*
- 4.3 We suggest that the definition of R&D in the BIS Guidelines could be improved and amended to make the scope of R&D much clearer. The experience of some of our members is that many small companies that have read the BIS Guidelines come to the conclusion that they do not qualify in circumstances where our members think that R&D tax credits are available. In particular the BIS guidelines do little to dispel the 'white coat myth'.
- 4.4 The examples given in chapter 2 of the consultation document illustrate how broad the scope of the relief can be; having these same examples included at the start of the BIS guidelines would be of great help.
- 4.5 We do not believe a change to align the definition to accounting practice is the right answer. In particular, many small companies will use the Financial Reporting Standard for Smaller Entities to complete accounts as quickly and efficiently as possible. We think it is unrealistic to expect such companies, and their accountants to reclassify R&D Costs into a specific accounts heading. Amending the definition in this way would, in effect, result in passing on the question of what constitutes R&D from the tax adviser to the company's accountant. It would also put HMRC in the difficult position of ruling on the correctness of a company's accounts. This situation is likely to be worrisome to many small companies as a challenge to the accounts can have knock-on effects on borrowing etc.
- 4.6 *Q5 - rules over which costs qualify*
- 4.7 In general the rules over which costs qualify for relief are not a barrier, however there are two areas which could be improved:
- The definition of Qualifying Indirect Activities – simply adding in more examples of such qualifying costs would improve the understanding of these rules; and
 - A simple guide to how to deal with subcontractor situations (covering which party can claim and what constitutes connection, at the very least) would be extremely useful.
- 4.8 Another issue that can arise for start-up companies is that the founders are often advised to pay themselves a small salary and take dividends. This reduces the R&D tax relief available as only the small salary element (in respect of those people) is eligible.
- 4.9 *Q6 - Simplification of design features*
- 4.10 Again the rules relating to subcontractors are difficult and could be simplified/clarified.
- 4.11 In addition, the rules on calculating the payable tax credit for an accounting period which straddles a change in tax credit rate are very hard to follow. We are informed that a member recently had a very clear explanation of the rules from the Cardiff unit,

and it appeared that this was a question that is frequently asked. We suggest that a better example of this, or perhaps a simplification that simply says the taxpayer should use a hybrid tax credit rate, would be of considerable assistance.

4.12 *Q7 – changes for small companies only*

4.13 We believe that any changes should be made as general ones. We do not believe there is a need to distinguish between small and medium companies, unless there is a particular appetite to make the small company version of the relief even more generous. However, this would also create another transition between schemes with different rules.

5 Understanding

5.1 *Q8 R&D Manual – what works well?*

5.2 We suggest that the current format of the R&D manual is fine for HMRC and for tax agents, as those parties are used to the layout of HMRC manuals and, typically, agents at least, have good search engines (CCH and Tolley, for example) to help find the right section.

5.3 We suggest, however, that the R&D manual is far too detailed for businesses themselves; particularly small and medium sized businesses. In trying to raise awareness and encourage qualifying companies to claim R&D tax relief, the manual will probably be a barrier for a finance director who is doing his own research: when faced with such a vast manual of information, we strongly suspect that many will swiftly conclude that the relief is too complicated and time consuming to merit further research.

5.4 *Q9 Is dedicated external customer guidance needed? If so, does the commercial market already provide what is needed?*

5.5 As suggested above, we do believe that separate taxpayer guidance would be helpful and this needs to be readable and kept simple. In order to meet these primary aims, such guidance cannot be expected to cover all aspects of R&D tax relief, but should provide guidance on the simpler aspects of relief and qualifying activity. We suggest that it would be sufficient to include only a summary of more complex areas where it will be necessary to seek further advice, either from HMRC or from an experienced adviser.

5.6 The commercial market does provide guides such as this, but often at a cost. Consequently this is a gap that HMRC could look to fill.

5.7 *Q10 How to organise HMRC guidance*

5.8 We suggest that guidance organised around a task or event would be more useful for customers.

5.9 *Q11 Top issues for small companies*

5.10 The top issues for small companies are:

- The definition of R&D – It is not clear what this is from the BIS guidelines, as mentioned above.

- Impact of grants – in particular it is not always straightforward to identify whether a grant constitutes notified State Aid.
- Consistency (or often lack of) between R&D inspectors.
- Subcontractor situations – in particular what constitutes a connection, and who can claim relief.
- Transitional rules where there is a change in tax credit rate in an accounting period.

5.11 *Q12 Who uses the current guidance*

5.12 We believe that both companies and intermediaries use the basic guidance on the gov.uk website, but input from our members indicates that few companies (except large ones with qualified finance directors) use the HMRC manual.

5.13 *Q13 Preference as to guidance*

5.14 As we say above, the current format of the manual is perfectly adequate, especially for intermediaries. That said, the addition of case studies and a decision tree near the start would be a huge improvement. Changes to the BIS guidelines as discussed above would also assist general understanding.

5.15 Online forums, webinars, podcasts, YouTube and so forth is undoubtedly a growing area and will be popular with younger entrepreneurs starting up in business – perhaps less so with established businesses, at least at the present time.

5.16 Guidance embedded within accounting software would, we suggest, be too complicated as the variances in individual cases would be too great. However, links within such software to available guidance would be a welcome and useful addition.

6 Administration

6.1 *Q14 Would proposed approach improve take up of R&D tax credits?*

6.2 We would welcome the proposed approach of an advance assurance and consider that this would be most helpful to smaller companies. We suggest that this would be a useful second stage in terms of raising awareness as, initially, the company needs to be aware that its activities may qualify and then be aware of the availability of the advance assurance procedure.

6.3 An online service is a good idea; a company owner may well click through an interactive decision tree to see if he might qualify more readily than read explanatory text. Such a decision tree would warrant testing with stakeholders and we recommend that the steps and questions for such a tree are put out for opinions in a subsequent consultation. Although this will delay implementation, it would ensure that the end product would be sufficiently useful that it is worth spending the time to get it right from the start.

6.4 *Q15 Design of advance assurance service*

6.5 As mentioned above, the service will be of most use to small and micro sized companies who are making their own enquiries and are perhaps reluctant to appoint an adviser until they know it is worthwhile to do so. If the service works well, though, it should not operate to the exclusion of medium sized companies. The scheme should also allow agents to be part of the process at the option of the taxpayer.

6.6 Our members' experience of specific issues that companies face on their first claim include, in particular, confidence in their justification of proportions of staff time (particularly where there are not detailed timesheets kept – a rare practice in the smallest companies and in start-ups) as well as confidence that the work they have done meets the qualifying definition of R&D.

6.7 We would suggest that an assurance should be valid for three years for a specific project or type of project – for example if the business solves multiple problems of a similar nature in its own particular field or sector.

6.8 With regard to advertising the service, our suggestions above in the answer to question 2 would also apply here; that is HMRC should consider using trade press, Chambers, LEPs, HMRC mailers and grant bodies.

6.9 *Q16 Link advanced assurance service to finance*

6.10 A slick online process of advanced assurance may be of significant help in gaining other funding. Investors will often be interested in whether the business might qualify for R&D assistance, and an indicative assurance based on the relevant facts would be very useful for those considering finance. As such, we suggest the availability of such a tool should be brought to the attention of banks and institutional investors as something they could signpost to prospective customers / investment targets.

6.11 *Q17 Improving claims generally*

6.12 A particular issue our members have found in recent months is ensuring that the R&D unit are aware when a claim is submitted. If amended returns are filed by post direct to the R&D unit, this is not a problem. However it is more problematic where the claim forms part of the online CT submission. We understand that recent advice from the Cardiff unit is that, when filing a claim as part of an online CT submission, the taxpayer or its agent should separately email the R&D unit to let them know the claim is there. In the absence of this extra notification, it can be several weeks before someone looks more closely at the submission and thinks to pass it on to the R&D unit.

6.13 With this in mind it would be helpful if the HMRC corporate tax system had a flag to pick up where an e-filed CT600 includes an R&D claim figure and automatically notifies an R&D unit. This will help get claims through faster, but will also help the R&D units to meet their stated targets of processing 95% of tax credit claims within 28 days.

7 Impact assessment

7.1 The impact assessment is necessarily limited at this stage of the process, and we expect that it will evolve over time. There will clearly be an element of HMRC time in administering the advance assurance scheme, but this should be at least partially mitigated by less time raising questions or enquiries.

- 7.2 While improved take-up of the scheme will inevitably carry an Exchequer cost, however it will be expected that the tax credits will help companies to expand, creating more jobs, boosting the economy and ultimately increasing the tax take from thriving businesses.

8 The Chartered Institute of Taxation

- 8.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
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