

HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

By email: RDTaxReliefs@hmtreasury.gov.uk

13 March 2023

Re: R&D Tax Reliefs Review - Consultation on a single scheme

The BVCA is the industry body and public policy advocate for the private equity and venture capital (PE/VC) industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based PE/VC firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by PE/VC currently employ 1.9 million people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

R&D tax credits play an important role in the companies that BVCA members invest in and are an efficient way of supporting companies to reinvest in their future growth. Venture capital, growth capital, and private equity funds have a strong track record of supporting and growing R&D intensive companies. Our members invest in companies that are critical to the growth of the UK economy, including start-ups, university spin-outs, high growth tech companies, and established businesses in the most innovative sectors of the economy, which make positive contributions in terms of GDP and employment¹.

The BVCA represents the investors and their portfolio companies who are driving these important technologies that will drive growth, and we welcome your recognition of the importance of what they are working to achieve. The SME R&D tax relief in particular provided crucial cash support for smaller, high growth, innovative businesses, convincing entrepreneurs to start and grow their companies here, helping to attract private investment from VCs and accelerate the development of scientific breakthroughs in areas such as deeptech and life sciences.

The changes to the SME rate announced in the Autumn Statement will have a damaging impact on genuine R&D-intensive innovative companies. This reduction of one of the most effective government policies that supported small and scaling businesses in these sectors will reduce cash flows for these companies at a time in their lifecycle when they often struggle to get significant external investment to bring their innovation to market, and will therefore have knock-on impacts on investment and employment. While we welcome the chance to comment on the impact of a merged scheme, we ask that a solution is found as soon as possible to provide financial support for SMEs in strategic areas such as life sciences and deeptech. We ask that the changes we outline in the responses to questions 12 & 13 apply from April 2023.

We would also question whether implementing a merged version of two existing schemes, and in particular with a short implementation date of April 2024, is missing an opportunity for a more thorough review of the way in which the tax system can best incentivise R&D activity. It has frequently been difficult to establish whether the government's main focus for reform is incentivising R&D or reducing fraud and error, as each of these would suggest different directions that reform should take. Whether the merged scheme proceeds or not, we would advocate that the government takes a wider and longer-term

¹ See the BVCA [Innovation Nation 2020](#) report
[British Private Equity & Venture Capital Association](#)
+44 (0)20 7492 0400 | bvca@bvca.co.uk | www.bvca.co.uk

view of what an optimal R&D tax relief scheme should look like, without confining itself to the attributes of the two existing schemes.

Another important point is that the content of the rules is only part of the picture. If the government is to succeed in incentivising businesses to invest in R&D, it is equally important that the procedures for claiming relief are not so onerous as to act as a deterrent. This would defeat the policy intention. Our members' experiences of claiming relief are that the process is far from straightforward, with a lack of transparency and certainty as to how the merits of a claim will be assessed. As part of the implementation of any new rules we would urge the government to produce clear, comprehensive and timely guidance, and to invest appropriately in training the HMRC personnel who assess the claims, so that businesses are supported to claim tax relief for the full range of R&D activity for which this relief is intended.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact [Chris Elphick](#) or [Rachel Gauke](#)).

Yours sincerely,



Michael Moore

Director-General, BVCA

BVCA responses to specific consultation questions

Q1: Do you agree a new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?

Yes. While this is not important to every company (particularly at the smaller end of the spectrum), the additional visibility of an "above the line" credit is valuable for many businesses.

Q2: Does the taxability and subsequent different post tax net benefits impact your decision making when allocating R&D budgets?

SMEs will often not know until they prepare their end of year accounts whether they will be profitable or loss-making, and therefore will only at that point know the value of their R&D claim. The RDEC system, under which the value of the tax incentive does not depend on whether the company is profitable, is therefore preferable as it greatly assists the financial planning that is essential to a company's commercial viability.

Q3: If you use RDEC now, is there anything in your view that should be changed?

The seven step process for calculating the RDEC is onerous. Any merged scheme would extend to smaller companies that are not currently within the scope of RDEC and so have not previously needed to engage with these rules. The complexity of the existing RDEC calculations would impose an excessive compliance burden in comparison with the scale of smaller companies' administrative functions. We would therefore urge the government to simplify the calculations.

We would also advocate making R&D tax relief available for capital expenditure. There does not appear to be any policy reason why relief should not be available for capital investments. The cost implications for the exchequer could be managed by only allowing relief for a certain percentage of the expenditure per year, as with the rules for capital allowances.

Q4: Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?

Yes. This is a natural outcome of merging the schemes.

Q5: If so, where R&D activity is subcontracted, do you think that the customer should claim the tax relief, as in the SME scheme, or the subcontractor, the person carrying on the R&D, as in the RDEC?

It is essential for R&D-intensive companies to be able to claim relief for R&D spent on subcontractors. Small companies cannot afford to construct large-scale facilities and so must outsource important aspects of their work to larger providers, including universities and hospitals. The subcontracting model allows entrepreneurs to set up small R&D-intensive companies, enabling the testing of more discoveries and increasing the chances of scientific breakthroughs. Denying SMEs the ability to claim for subcontracted R&D would have a significant chilling effect on this type of investment.

This will not, however, be the case in every commercial scenario, and in other situations it will make more sense for relief to be claimed by the subcontractor. In order to provide maximum flexibility, and to avoid commercial decisions being distorted by tax considerations, we would advocate allowing companies to elect as to which party can claim relief for subcontracted R&D.

Q6: Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?

We repeat our answer to the previous question.

Q7: Do you have an alternative model you think could apply to all claimants in the new scheme? Please provide qualitative and quantitative evidence with your proposal.

We refer to our introductory remarks about the opportunity for the government to conduct a more thorough review of the way in which the tax system can best incentivise R&D activity.

Q8: What are your experiences of the PAYE / NICs cap?

In our members' experience, the cap is complex to calculate and rarely results in a company being found to have exceeded the cap. The complexity is a particular issue for the RDEC, where the cap operates on a project by project basis, creating an administrative burden in obtaining the necessary data concerning the personnel involved in each project. This would be especially onerous for SMEs, which have limited capacity for carrying out the necessary analysis.

We would also question whether the cap is still needed at all, given the recent changes to rules that restrict relief to R&D conducted in the UK. Removing an unnecessary additional administrative step would be a welcome reduction in the compliance burden associated with the current rules.

Q9: Are there any ways the Government could simplify the PAYE / NICs cap whilst ensuring there is protection against abuse?

Please see our previous response.

Q10: Which of the SME and RDEC PAYE & NICs cap should the Government implement in the new scheme?

We would favour the SME cap because it is assessed by reference to the whole organisation rather on a project by project basis, making it simpler to calculate. Again, however, we would question whether a cap remains necessary at all.

Q11: Should the Government change the way either cap is calculated if it is taken forwards? And if so, how?

Please see our previous responses.

Q12: Do you consider the government should provide more generous support for different types of R&D or more R&D intensive companies relative to less R&D intensive companies?

We believe that the government should provide further support for R&D intensive companies, in areas such as deeptech & life sciences. These companies are at the cutting edge of new technology but have much longer investment horizons than mainstream tech companies and are often more capital intensive.

The halving of the SME R&D tax relief that was announced in the 2022 Autumn Statement has already negatively impacted investment decisions, resulting in cancelled hiring plans and movement of investment from the UK. A delay to the SME rate cut to allow for proper consultation as part of the merging process is the best way to continue to support SMEs. Changes such as a de minimis threshold of £10,000 and anti-fraud measures could be brought in immediately to help address this.

If the “further support” is not via tax credits, it must be of equal value and low bureaucracy as the tax credits it is replacing (such as a KIC test outlined below). A grants scheme (via Innovate UK) is unlikely to be a quick and effective delivery mechanism due to lack of administrative capability at scale, the complexity and lack of certainty for businesses in the application process.

We welcome the commitment to provide further support for R&D intensive businesses, but we need details urgently to restore confidence.

Q13: In the event this were to be done, how might this best be achieved within an overall cost envelope?

We propose a new SME Knowledge Intensive Companies test that gives enhanced incentives for companies creating IP in the UK. Such companies suffer from the greatest R&D investment market failure, but also exhibit exponential business and R&D investment growth (i.e. even higher future R&D) resulting from the R&D expenditure when successful. Current HMRC analysis of SME scheme effectiveness does not provide a full assessment of these benefits nor a sector-specific breakdown, which is needed.

In terms of the cost envelope, we would suggest that the necessary funds will be raised by a combination of the limitation of R&D to activities conducted in the UK, the changes introduced in the Autumn Statement 2022, and tackling fraud and error.

Q14: If the schemes are merged do you agree the Government should implement the merged scheme for accounting periods starting on or after 1 April 2024?

We would suggest that this is much too short a timeframe to put in place the processes that will need to be set up to implement a new scheme.

Q15: How can Government ensure SMEs are supported in the transfer into a new scheme?

We refer back to our introductory comments about the need for companies to be supported in making claims through appropriately trained HMRC staff, and clear and timely guidance. This is even more

important when transitioning to a new system, when there will inevitably be uncertainty about the operation of the rules.

In this context we would express our concern that our members' experience is that businesses which seek to make use of the Advance Assurance Scheme appear to be at much greater risk of becoming the subject of an HMRC enquiry. The purpose of the Advance Assurance Scheme should be to provide support to businesses. If it is viewed as a backdoor route to HMRC information gathering, this acts as a further barrier to the policy intention of incentivising R&D.

Q16: Does claiming for expenditure on qualifying indirect activities influence your decision to undertake R&D?

We would be in favour of retaining the ability to claim for expenditure on indirect activities where there is a sufficiently close link to the R&D activity. This would reduce complexity, and provided that the rules are appropriately targeted there should be no policy reason to exclude this type of expenditure.

Q17: Do you think a threshold should be implemented? If one was implemented, at what level should it be introduced?

We would be in favour of a de minimis in order to target the relief at serious R&D activity. We would also suggest that the government considers whether some limited categories of highly innovative R&D could be excluded from the de minimis.

Q18: What is the average amount of R&D expenditure per year per firm in your business or sector?

We do not hold this information.