

R&D Tax Reliefs– Consultation

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UK Finance is the collective voice for the banking and finance industry.

Representing almost 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. Our members include businesses that are large and small, international, national and regional, corporate and mutual, retail and wholesale.

General Comments

1. We welcome the opportunity to respond to the HM Treasury and HM Revenue & Customs ('HMRC') 'R&D Tax Reliefs – Consultation' ('the Consultation').
2. The banking and finance sector is of major importance to the UK economy: it employs over a million people and contributed £75.6bn in tax revenue in 2019/20 (10.1% of total UK tax receipts)¹. The UK is the world's top net exporter of financial services, above the United States. It is also one of the world's leading centres of technology, innovation and fintech. The availability of the R&D credits in the UK encourages jobs to remain in the UK and the creation of Intellectual Property ('IP') in the UK. When multinational banks are making decisions about where to locate employees, the availability of R&D credits is one of a number of factors in the decision-making process, given the number of countries that also operate such regimes.
3. Financial institutions provide a broad range of financial services to business and personal customers, which necessitates continual appraisal and assessment of associated technologies. The industry is highly regulated but is nevertheless changing constantly in terms of the technologies associated with customer-centric channels and meeting the requirements of all stakeholders.

Specific Questions

Question 1 Do you consider yourself to be a research-intensive firm? How does your business benefit from the R&D reliefs (e.g. cashflow, reduced tax liability)? If your company is an SME that claims under both the SME tax relief and RDEC, what is your experience of using each scheme and how do they compare?

4. The development of new and innovative technology (in digital banking, payments processing, cyber security, fraud prevention etc) is of a paramount importance to banks and financial services firms operating in the UK.

¹ <https://www.thecityuk.com/assets/2021/Reports/4015f6e911/Key-facts-about-UK-based-financial-and-related-professional-services-2021-v2.pdf>

5. The banking sector in the UK operates one of the largest technology estates, and seeks to exploit and develop technology solutions that push the boundaries of technical capability available, whilst overcoming technological uncertainties that simply do not exist elsewhere. Many of the technology solutions developed by UK banks are considered best in class.
6. Most of the R&D activities undertaken by banks are focussed on the 'development' aspect of R&D where advances in technology usually arise from:
 - the development and improvement of software solutions, applications, and digital banking products to meet the needs of customers and clients.
 - the modernisation and future proofing of existing technology architecture and systems to ensure they are resilient and secure, and continue to meet evolving regulatory requirements.
7. Some UK Finance members have responded that the RDEC scheme operates well. In particular they note that the fact that the RDEC scheme provides a credit to the claiming company's Profit and Loss Account (P&L) 'above the line' is particularly beneficial, in comparison to the relief provided by the previous scheme, which was given through the tax line, in the form of a super-deduction and reduced tax liability. For those members that account for the RDEC P&L income as a credit against the underlying technology development expenditure, they note that their technology function is continuously re-investing the credit in future technology development projects. They value the increased visibility of the R&D reliefs in the financial statements and they observe that the direct impact of the RDEC claim on the technology investment expenditure has raised awareness of the incentives associated with directing investment spend on innovative R&D projects.
8. Fintech companies are also R&D intensive. Smaller Fintechs consider that the benefit helps with their cashflow. Some members have responded that the SME scheme has allowed them to surrender R&D losses in exchange for cash, which enabled them to invest in technology and employ more people locally. Fintech members that have claimed under both reliefs have observed that the information required to do both sets are similar, however, for obvious reasons, the RDEC is less generous than the SME tax relief.

Question 2 Is there a case for consolidating the two schemes into one? What do you value about the design of the current schemes that might be lost if they were unified?

9. We are not sure what the benefit would be in consolidating the schemes. In our view, the independence of the RDEC scheme from a company's tax position is its most valuable feature and therefore, we would welcome the retention of the following design elements of the scheme i.e.:
 - The ability to recognise the R&D tax credit as a grant against cost (or 'above the line' credit) from an accounting perspective which makes it easier for companies to factor R&D tax relief into their investment decisions; and
 - Cash credit payable to loss-making companies which provides a cash flow advantage (on the assumption that claims are processed efficiently by HMRC).
10. Members have observed that the accounting treatment of the tax credit under the SME scheme, as compared with the RDEC scheme, is odd and should be made uniform.

Members prefer the current treatment for RDEC scheme, namely report above the tax line and offset against operating costs (akin to a government grant) and not through the tax line (as required under the SME scheme).

11. If the government is considering the consolidation of the two schemes into a single coherent system, the key design elements of the RDEC scheme (as described above) should be retained and it is imperative that the new system is not accompanied by increased complexity or result in an additional compliance burden on the claimant companies. It is important that the relief is straightforward to claim with reasonable levels of compliance and documentation requirements as well as predictable outcomes for the claimant companies. It would also be appropriate to level up the benefit of the reliefs.

Question 3 What do you think explains the difference in additionality between the two schemes? How could the schemes be improved to incentivise the R&D your business does or might consider doing? Can you give evidence to support your suggestions?

12. In relation to the SME scheme, a suggested improvement in relation to cash surrender would be to remove the condition for the cash surrender claim as the lower of trading losses versus R&D tax loss. This is because it makes it difficult for SMEs to plan effectively for their investment project, as they can never be completely sure of what can be surrendered for cash until the trading loss is known.

Question 4 To what extent do the rates of relief available to you impact your investment decisions and/or your choice of location? Is the balance of relief between the two schemes appropriate? Is there any evidence of significant deadweight where investment decisions would proceed without relief?

13. UK Finance welcomes the government's desire to ensure that the rates of relief offered for R&D are internationally competitive. The availability, as well as generosity, of R&D tax reliefs is one of many factors that feed into the decision-making process of when and where to deploy R&D investment. A competitive rate of relief could be a key contributing factor in the overall investment decision and/or location strategy. The stability and consistency of the RDEC scheme is equally important as it allows our members to make longer-term investments that go beyond a 12-24 month horizon.
14. To further enhance competitiveness, UK Finance would encourage further consideration to be given to expanding the activities that qualify as R&D under the UK regime. Common activities in financial services, such as financial modelling and advanced algorithmic development which often achieve mathematical advances and are ordinarily classed as high-intensity R&D in many jurisdictions across the globe, currently do not qualify as R&D under the UK regime in their own right. The UK is therefore missing out on significant positive output from these advances encouraging even greater investment in innovation.

Question 5 Would a departure from the ordinary Corporation Tax self-assessment system be justified? Should more information and assurance be required from companies at the point of claiming? Should a company providing more information upfront be treated differently?

15. UK Finance members already undertake a significant amount of work to prepare and submit well-documented R&D tax relief claims to HMRC.

16. Members have indicated that they would welcome improvements to the claims process. For example:
- Clear guidance from HMRC on the information they expect to see on submission of R&D claims. This could be in form of standardised/pro-forma documentation to support claims;
 - Changes that would make the R&D claims process more 'real time' and reduce post-submission questions / lengthy claim review periods, through provision of 'agreements in principle' or 'advance assurance' to R&D claims prior to submission of the final R&D claim documentation; and
 - Greater transparency from HMRC during the review/enquiry process so that the claimant companies can address HMRC's concerns quickly and directly.
17. We would also recommend that claimant companies who proactively discuss their claim methodology/process with HMRC in advance should have their claims processed and agreed more quickly and efficiently.
18. In addition, where companies or groups have established a solid track record of robust consistent claims, HMRC should consider the agreement of a simplified approach to making claims. This could be in the form of submitting condensed R&D reports and be conditional on regular analytical reviews to ensure no significant discrepancies subject to any meaningful change in the activities and/or expenditure qualifying under the R&D rules.
19. While some members have suggested that they do not see any obvious benefits in separating RDEC claims from the CTSA system, as it is merely a mechanical process for processing claims, others have observed that the CTSA system may contribute to timing issues. For example, it has been noted that addressing detailed technical queries following the submission of the corporation tax return incorporating the claim, e.g. sometimes 2-3 years following the period in which the eligible expenditure was claimed, can be challenging from a practical perspective. The practical challenges are felt to be exacerbated by the fact that there is often a high turnover of technical delivery teams. They also observe that obtaining detailed historical information after the conclusion of projects is time consuming and diverts significant technology project resource from current projects.

Question 6 When did you first claim, and what prompted you to do so? Do you use an agent? If so, why? is your experience of how agents' fees are structured? How could the expertise and specialist knowledge of agents assisting with R&D claims be improved?

20. As R&D is a relatively specialist part of the CT system, most UK Finance members utilise the services of reputable professional services firms. Such firms demonstrate a good understanding of the sector and the specific business. Agents are used to assist with the claims process – from assisting in project management and timelines for submission deadlines, to technical input in discussions with business and technology colleagues and the finalisation of the detail and specifics of claims. The fees are generally structured on a fixed fee and contingent fee basis. We understand that the firms used by our members participate in the Research & Development Consultative Committee (RDCC).

Question 7 How can the responsibilities of HMRC, agents and the company be better reflected in the claims process?

21. UK Finance members would encourage amendments and improvements to the HMRC advance assurance process. Engagement as required with HMRC by companies and their agents could be established as part of the process, together with agreement on responsibilities for any review and changes to the points agreed under the process.
22. We would also urge HMRC to explore how the claim review process could be made more timely and efficient, as the speed of technological change and staff turnover can make it challenging (in terms of time and resource) to address queries raised perhaps years after the work took place. This is further exacerbated in software/technology claims where the technology baseline capabilities can completely change in a 12-month period.

Question 8 What other changes might help claims to be dealt with more smoothly, while ensuring better compliance? Is there a way HMRC and advisers can work more effectively to improve the quality of external advice available to companies? If you claim R&D tax reliefs in other countries, how does the claim process differ and what are your views on this?

23. Whilst we recognise that HMRC needs to identify and address compliance risks (for example, the overclaiming of relief), there appears to be an increased scepticism from HMRC around the validity of claims around software / technology / IT. For example, from recent experience, HMRC has been subjecting RDEC claims (mainly covering technology/software projects) submitted by some of our members to a disproportionate amount of scrutiny, even though the claims are generally well-documented and at the 'prudent' end of the spectrum.
24. In addition, we also have the following observations regarding HMRC's approach to enquiries:
 - During fact-finding meetings, HMRC's CDIO team often approaches the discussion with the claimant company's competent professionals on the basis that no R&D has taken place (rather than trying to work constructively with the competent professionals to understand the qualifying R&D activities that have taken place). We feel that the approach taken by the CDIO team is likely to disincentivise claimant companies from engaging constructively with HMRC so we would welcome a more positive approach.
 - The competent professionals (being the experts in their fields) are the ones who should be determining whether qualifying R&D activity has taken place, as the BEIS guidelines intended. In our experience, the CDIO team has the tendency to oversimplify technological advances/uncertainties on software/technology projects (sometimes by assessing past technological advancements based on today's technology baseline capabilities). It is also not unusual to see the CDIO team disagreeing with the assessment of the competent professionals despite the CDIO team's limited experience in a specific area.
25. All of the above creates uncertainty and distrust, leading to protracted enquiries taking up valuable time and resource for both HMRC and the claimant companies. We would, therefore, welcome a shift or a reset in the approach taken by HMRC when examining and agreeing R&D claims submitted by large business claimants.
26. In addition to the above, we would also welcome a refresh of the BEIS guidelines with clear guidance on the meaning of R&D for tax purposes for different industries/sectors. In our

view, the guidelines/R&D definitions have not kept up with the rapid changes seen across various industries/sectors.

Question 9 Is there evidence to suggest areas of activity other than those currently covered by the R&D definition drive positive externalities which should be recognised by the tax system?

27. No comment.

Question 10 Do you think R&D tax reliefs could better incentivise R&D with specific social value, for example developing green technology? Could R&D tax reliefs be used to disincentivise R&D in certain fields?

28. Some UK Finance members believe there is a role for R&D tax reliefs to incentivise R&D with specific social value. Other UK Finance members suggest that a more targeted approach, such as enhanced capital allowances or 'super deduction' for end users (where the technology was specifically developed in the UK), might be more suitable measures for encouraging the development and adoption of green technology in the UK.

29. UK Finance members do not support using the R&D tax regime to disincentivise R&D in certain fields.

Question 11 What is your experience of conducting R&D in different regions across the UK? How do R&D tax reliefs benefit these activities, and how could the offer be improved to better support these activities?

30. No comment.

Question 12 Are there any other areas of qualifying expenditure that should be included within the reliefs? How would this influence your investment decisions?

31. Investment decisions for financial institutions will primarily be driven by business requirements and changing customer needs and expectations. Amendments to the definitions of qualifying expenditures to take account of the advancement in 'cloud' and data technologies should be considered. There has been a gradual but noticeable shift towards software leased and accessed via the cloud (away from software stored on servers). Therefore, cloud computing costs should be included within the reliefs by the same rationale as software costs (if utilised for R&D purposes). Please also refer to our response to Q13 and Q14.

32. Currently the definition of R&D for the UK regime excludes mathematics which prohibits some financial modelling/quants activities from being claimed and requires such work to be stripped out of costs which can be challenging. This is a substantial area of research for some member banks, which have suggested it would be helpful if the scope was extended to include this activity.

33. As providers of commercial finance to businesses, our members also consider that the UK might consider full recognition of capital expenditure – such as on premises, lab facilities etc – within its R&D tax credits system. This would bring UK practice into line with other countries. It is further noted that the current system has inconsistent treatment between loss-making firms and profit-making firms, with loss-making UK firms get nothing back on R&D capital expenditure through the tax system. This differential treatment is an important

consideration in the context of Covid-19 related economic impacts, when many firms are expected to make a loss.

Question 13 What proportion of your R&D expenditure is treated as capital for the purposes of corporation tax? What would be the impact on your R&D activities of increased relief for capital expenditure?

34. We would welcome the expansion of the scope of relief through the inclusion of capital expenditure as qualifying expenditure for R&D tax relief purposes (and abolishing the existing RDA regime altogether). The consolidation should simplify the regime and incentivise the investment in capital assets used for R&D activities.

Question 14 Do you currently claim RDAs? If not, why not? What do you like and/or dislike about RDAs?

35. As above, we would welcome the expansion of the scope of R&D tax relief through the inclusion of capital expenditure as qualifying expenditure for R&D tax relief purposes (and abolishing the existing RDA regime altogether).

Question 15 How much of the activity in respect of which you claim R&D in the UK is undertaken outside of the company, and how much of that is not undertaken in the UK? What are the benefits and drawbacks of subcontracting, whether overseas or domestically? What are your commercial/other reasons for carrying out work overseas rather than in the UK?

36. UK Finance welcomes the ability to include costs on R&D activity performed overseas in the form of Externally Provided Workers ('EPWs') and would advocate that this ability is retained. The ability to include costs on R&D activity performed overseas ensures that makes the UK R&D regime remains one of the most competitive regimes globally, and helps promote the UK as a leading location/hub for cutting edge R&D activity, boosting productivity and wider economic growth.
37. In addition, in a post Covid world, as the FS industry evolves into a global collaboration unit working beyond borders, connecting their workforce remotely across the globe, access to a global talent pool will play a pivotal role in driving innovation that benefits the UK economy by generating intellectual property that resides in the UK, and creating revenues and profits in the UK increasing UK tax revenues.

Question 16 How could the government distinguish between work that needs to take place abroad and which benefits the UK, and that which doesn't?

38. It can be determined through recharge of the cost to the UK.

Question 17 How can we identify the supporting activities which are most valuable for R&D, while providing a clear boundary to assist companies in claiming and HMRC in administering?

39. Qualifying Indirect Activities (QIAs) are an established and accepted part of the existing R&D tax relief schemes. They are now well understood and should not be changed. However, in our members' experience, QIAs do not normally form a very material element of R&D claims and therefore, the removal of QIAs from the scope of relief is unlikely to

significantly affect investment decisions. The same applies to utility costs (i.e. heat, light and water).

If you have any questions relating to this response, please contact Sarah Wulff-Cochrane, Principal, Taxation Policy, UK Finance (sarah.wulff-cochrane@ukfinance.org.uk).