Response from
The Institute of Chartered Accountants of Scotland
to
HM Treasury

Research and Development Tax Credits

21 February 2011
The Institute of Chartered Accountants of Scotland welcomes the opportunity to comment on the review of the Research and Development Tax Credit regime. Our responses to the questions posed in part IIB of the Corporate Tax Reform document issued in November 2010 are set out below according to the numbering used therein.

1) **Question 4A:** We support the proposals in the Dyson Review that suggests focus should move more towards high tech companies, particularly SMEs and the structural enhancement sought should be to increase the rate percentage of support to them. It is questioned whether in certain large businesses and sectors, such as major oil and gas explorers, the market failure needs the support at the level it is. More support for SMEs could be at the expense of some large and highly profitable claimants in order to be better focussed. However we would not suggest that the large scheme be withdrawn wholly, as there are SMEs which benefit from it where certain conditions are not met, such as grant funding. In addition, there are UK companies currently undertaking research and development which are part of larger international groups. We would suggest a “territorial SME” concept could be another approach to focus: where a UK company would be an SME if its overseas parent were ignored, it could maintain eligibility for relief. We agree with the view that the system is stabilising and becoming better known and used, with the assistance of HMRC specialist units. As interesting as, say, the Canadian system is, in balance we are not supportive of significant changes as stability and comfort with current rules is supportive of the ease and accuracy with which claims can be submitted. The easing of certain administrative or record keeping burdens should be considered particularly for smaller claims.

2) **Question 4B:** Relief should be given for costs incurred on consumables for the purpose of a qualifying project which is then aborted and the consumables are reused as a matter of a responsible disposal process. This is elaborated on under the comments on “production” at point 5 below.

3) **Question 4C:** We are not of the view that internal use software should be excluded; in this technological era it is extremely unlikely that any scientific development would not require or have integral software processes. Exclusion of such costs would therefore appear arbitrary and contrary to the principles of establishing more support for high tech companies and their innovative developments. An exclusion for large company claims may be a compromise here. We would repeat the comment under Question 4A that the fewer changes made, the more effectively the system can be used by taxpayers to support R&D.

4) **Question 4D:** The definition used by BIS has now become established as the basis for claim. Any major changes to it will cause a considerable administrative burden and potential confusion for SMEs in particular. As noted above, stability will be warmly welcomed. What would also be welcomed would be focus on achieving a “level playing field” by publicising more practical examples and lists of examples of projects, spend etc where relief has been given.

That would give a consistency and clarity of how the definition is applied which is a different point from one which changes the definition.

5) **Question 4E:** Clearer guidance rather than a statutory test would probably give a result which allowed sensible and consistent interpretation in practice from the specialist HMRC units. We do not consider the latest guidance on production gives the appropriate “dividing line” in all circumstances. At present if there is an experimental
innovative process under development which uses consumables, and the by product or waste is disposed of through any commercial process during or after the project, the costs are excluded from relief. One example given was where a newly developed material was being tested, but which had not proved effective. The material had to be processed through the existing business process for waste materials due to environmental restrictions on material disposals. The waste material process produces by-products which have some secondary commercial value. That made the material costs ineligible as the waste was mixed into a commercial end product. Had the company been able to throw away the material it would have benefited from the relief. This restriction unduly limits relief which should be available and does not encourage the related innovation to take place in the UK. We propose therefore that where the production related restrictions would otherwise have applied where a material disposal mechanism is driven by environmental purposes, or materials are used only in by product or waste processing, the related costs should not be excluded from relief. Alternatively, any resulting proceeds could reduce the claim made. “Green” or environmentally friendly organisations should not be unduly penalised by such a restriction.

6) **Question 4F:** Additional investment by the smallest companies is most likely to best be encouraged by greater financial support (as in point 1 above) and a lower administrative burden.

7) **Question 4H:** The documentation requirement in support of a claim may present challenges of paperwork. In particular, where a cost apportionment of salaries is needed, a cumbersome timesheet system is usually required and will be used by a small research company solely for the purpose of satisfying HMRC detailed record keeping requirements. The cost/benefit if such systems may be difficult to justify on cost or administrative grounds particularly in small, cash strapped organisations. Consideration should be given to allowing simplified systems such as flat rate percentages to be agreed for either years or project lives and remove this ongoing detailed need.

We look forward to the next step in the consultative process.