Innovation and tax incentives – what is in store

OMB Tax voice

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David O'Keefe contemplates the potential for development

Since Theresa May gave her speech to the CBI on 21 November 2016, there has been a lot of speculation around her comments on research and development in the UK. Perhaps predictably, Philip Hammond did little to flesh out the PM's comments and reduce the speculation in his Autumn Statement on the 23rd November 2016.

So what is being proposed?

The short answer, of course, is that we don't know for certain but by reading between the lines it is possible to speculate a little.
Overall, I think the Government is giving two broad messages: there needs to be greater support for companies to commercialise their R&D in the UK and there needs to be greater investment - by business but also by Government - into R&D activity. Positive messages but what are they likely to mean in practice?

The answer will end up being a mix of tax and non-tax measures.

On the tax side, the Chancellor has indicated that we are going to see a review into possible changes to the R&D tax relief regimes with a view to making them more effective. Unfortunately, at this stage there are really only some small clues as to the likely direction of this review. Paragraph 3.30 of the Autumn Statement document says

> "To ensure the UK tax system is strongly pro-innovation, the government will review the tax environment for R&D to look at ways to build on the introduction of the 'above the line' R&D tax credit to make the UK an even more competitive place to do R&D."

We will have to wait until later in the year before we see the detail of this review but we can still speculate. On the plus side, though, there was no Christmas reading on this one!

The "'above the line' R&D tax credit" in Paragraph 3.30 above is a reference to the R&D Expenditure Credit (RDEC) introduced for large companies with effect from 1 April 2013. Until 1 April 2016 it was possible for companies to choose to remain with the CTA 2009, Part 13 superdeduction (130%) relief. For expenditure incurred on or after 1 April 2016 the RDEC is the only R&D relief available for large companies.

SMEs can find themselves having to use the RDEC in certain specific situations where their expenditure is excluded from the SME relief. There has been some speculation that this review will be looking at the possibility of phasing out the current SME relief and replacing it with RDEC (or a variant thereof).

I prefer to go with the view that the reference to the RDEC, rather than R&D relief more generally, is simply that it will be easier to focus on large company relief for the time being. Two factors support this theory, I believe. First, there have already been a lot of changes to R&D, with the SME relief significantly enhanced since 2010. Second, the SME regime is an EU State Aid and any changes to it would require approval from the EC. Given the current "brexit" environment it is easy to believe that the Government would really rather not have to go to the EC for such approval right now. This latter point also argues against the idea of a change to RDEC for SMEs.

The commercialisation point is one that has been raised time and again. The R&D relief is very much focused on the technological problem solving phase of innovation, once any kind of commercial scale-up starts, HMRC are looking to restrict the availability of R&D relief. Indeed, the most recent tightening up in this area was in FA 2015. If the Chancellor is intent on making changes to the R&D relief regime to improve its effectiveness then he could do a lot worse than relax some of the recent restrictions on R&D in this "commercialisation" phase – what HMRC likes to refer to as "production".

There is also a concern that too many companies, particularly SMEs, are failing to take full advantage of the existing R&D incentives to help them boost their R&D activities. A part of the problem here is a lack of resourcing at HMRC; they simply do not have the resource to properly promote this regime as well as effectively managing the compliance aspects. There are lots of new claim preparers rushing into the market and I suspect that quality is suffering and not being picked up by HMRC.

Indeed, this may be a little controversial but I would suggest that consideration should be given to handing responsibility for promoting R&D relief to the new UK Research & Innovation. HMRC really does do its best to promote the relief and encourage uptake amongst SMEs but the reality is that smaller companies in particular are wary of HMRC and this hampers their efforts. This would also allow HMRC to concentrate its efforts on doing its job of helping claimants get the compliance right.

On the non-tax side we are going to see a mix of new Government investment into R&D and a review of "patient capital" – another name, I assume, for long term funding – for innovative firms looking to scale up and commercialise inventions. There are some clues to suggest that there may be a focus on specific technology areas. Robotics and artificial intelligence, industrial biotechnology and medical technology, satellites, and advanced materials manufacturing are specifically mentioned.

The Government's Green Paper "Building our Industrial Strategy" was published on 23 January 2017. The paper starts to flesh out the non-tax proposals but gives no further clues on the direction of the review of R&D relief.