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CT Reform
Corporate Tax Team
HM Treasury
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VIA EMAIL ONLY: corporatetaxreform@hmtreasury.gsi.gov.uk

Dear Sirs

SCOTTISH LIFESCIENCES ASSOCIATION RESPONSE TO CONSULTATION ON THE R&D TAX CREDIT

I am writing on behalf of the **Scottish Lifesciences Association (SLA)** to communicate the SLA's views on the R&D Tax Credit consultation announced by the Treasury in June 2011.

Established in 2010, the SLA seeks to represent the interest of the Scottish life sciences industry to Government to ensure that policy and support for the industry is maintained and increased. We represent nearly 70 member companies who operate across the full spectrum of the life sciences sector. **Our mission is to sustain and grow life sciences in Scotland as a key sector of the country's economy.**

The SLA welcomes the Coalition Government's continued commitment to the R&D Tax Credit initiative as a central part of its Plan for Economic Growth. The Government's recognition of the importance of strong patent protection to innovation is particularly welcomed. In the Scottish life sciences sector, strong patent rights are often a vital foundation for companies within this innovative sector. Furthermore, due to the exceptionally high research and development costs which are associated with bringing new products and therapies to market, coupled with the high risk of failure, the provision of strong and robust patent rights is a necessity to secure initial investment.

The SLA has main points to make, as set out in the remainder of this letter.

Above the line accounting

Whilst most of our members are SMEs, we feel that the option to account for the credit above the line as well as the existing method should be adopted.

QIA

Given the increased complexity surrounding this, we feel that increasing the rate of relief to allow companies with less base cost to obtain a higher relief should be used to balance the removal of QIA.

Subcontractor relief

We welcome a system to ensure that subcontractors can claim under the Large company scheme and have offered a potential solution for life science companies

Removal of PAYE/NI cap

We welcome the removal of the PAYE/NI cap

If we can provide you with any further information relating to these issues, please do not hesitate to contact our Director of Policy, John A Brown at johnabrown@scottishlifesciencesassociation.org.uk

Best regards

A handwritten signature in black ink, appearing to be 'SJ', with a long horizontal stroke extending to the right.

Scott Johnstone

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Appendix

Detailed response to consultation questions

Question 1: What difference, if any, to the levels of R&D investment in the UK would a move from the current superdeduction to an ‘above the line’ credit against tax make, if the level of benefit to the company, in terms of reduced cost of R&D, remained broadly the same?

The majority of the SLA members are not claiming under the large company scheme and therefore feel that it is not that important where it is recorded in the accounts. Some of our larger members would however benefit from this and therefore we would support this going forward as it would allow the R&D benefit to be more clearly attributed to the R&D departments and therefore encourage more R&D in Scotland.

Question 2: What tax treatment would allow loss-making companies to account for the credit ‘above the line’? Given the potential complexity of offsetting the tax credit against other taxes apart from CT, would loss-makers need the credit to be payable if there was insufficient CT cover?

Again not that relevant to our member base however any cash benefit in the short/medium term to a loss making organisation would encourage more R&D

Question 3: If the payable credit was introduced for loss-making companies, should the benefit be less than that available to profitable companies, to recognise the value to the loss-makers of being able to utilise the credit immediately?

Whilst arguably loss making companies are more in need of the full credit, we believe that given loss making companies currently do not receive any immediate cash benefit from making an R&D claim under the current Large company regime, they would accept that there should be a discount from the face value of the excess credit if it is paid to the company (for example, rather than paying the unused credit pound for pound making any unused credit which is paid to the company at the rate of 50p for every £1 of credit).

Question 4: Are there any additional issues around added complexity to the schemes that should be considered?

Investments in R&D often have to be made over the medium to long term. For businesses this involves significant expenditure in creating or expanding facilities or teams. For decisions on where to locate these investments to be affected by incentives such as the R&D reliefs, businesses need to know that the incentives will remain available and in a similar form over the period of the investment, often tens of years rather than years. We view this consultation as a once in a decade opportunity to make the UK R&D incentives more effective and then to send a clear message that they will be stable for the next ten years or more.

Clearly, any significant changes to the regime may result in uncertainty at the outset as companies need to understand the new elements of the regime. However, this is the same with all changes to tax

regimes and we believe it would be simpler to instigate all changes at one time and create a regime that will remain effective for years to come.

Question 5: The majority of respondents in favour of the change were large companies. What separate compliance and complexity issues would arise if the SME scheme also moved to ‘above the line’ credit system?

We believe there needs to be an option to adopt the ‘above the line’ credit to enable Large companies and SMEs to decide whether they would rather the ‘above the line’ credit. We believe that once the new regime is instigated and companies understand the new rules, having two separate Large and SME regimes would not result in any further complexity or compliance that the existing regimes.

Question 6: Should the relief for Qualifying Indirect Activities be retained? Does it provide significant benefit to companies currently claiming QIA?

Given that EU state aid limits effective cashback credits to 25%, we would suggest that it may be better value for money to increase the rate of relief such that companies need less base cost to get to the 25% limit and at the same time eliminate the complex QIA rules, which would provide a simpler regime.

Increasing the rate of relief is likely to have a significant impact on R&D investment decisions. Whilst it is recognised the cost to the Exchequer is not inconsiderable, this cost could be mitigated by changing other aspects of the relief. Given the significant impact this could have on decisions to invest in R&D in Scotland the benefits are likely to significantly outweigh any cost.

Alternatives to QIA

We note that the change in practice to allow inclusion of QIA has had a beneficial impact. If it is felt QIA is important element of the regime for those companies who claim it, we would suggest improving the methodology for calculating QIA to remove the ambiguity and differing treatments of claims by HMRC inspectors, by re-introducing the ‘80’ rule.

In the early periods of the SME R&D relief regime, and for the first year of the large Company regime, the legislation set out that no staff costs could be included for individuals who spent less than 20% of their time directly engaged in R&D and that for those individuals who spent more than 80% of their time directly engaged in R&D then 100% of their staff costs could be included in the claim. In between these percentages the proportion of staff costs which could be claimed was the exact percentage of time spent directly engaged in R&D.

However, this rule was withdrawn from 9 April 2003 with part of the explanation for withdrawal being that it discriminated against businesses where individuals may be spending less than 20% of their time on R&D for whom no claim was therefore available. The result of the abolition of the 80:20 rule was that even for those individuals who spent practically all of their time doing R&D, it was necessary to exclude a small percentage which related to unavoidable activity on things such as performance reviews, filling in timesheets, arranging meetings and undertaking training etc. This generally meant that it was practically impossible for an individual to be included in an R&D claim at 100% of their time from 9 April 2003 onwards. This significantly increased the amount of work needed in order to exclude a small proportion of qualifying staff cost for those who were heavily involved in direct R&D.

Following the change in practice these other activities are again considered to qualify. This again leads to the possibility of those heavily involved in direct R&D being included in the claim at 100% of their

time. Evidencing this can be onerous, particularly where personnel do not complete time records. Where prior claim processes have been established to exclude the training, personnel and administrative activity undertaken, it is now necessary to establish what proportion of time is spent on these activities and add this to the R&D time.

In summary, abolition of the QIA rules and reinstatement of the '80' element of the 80:20 rule is likely to result in a net reduction in cost to the Exchequer and simplify the regime whilst not diminishing the incentive to invest in R&D.

Question 7: Would either the certification process or joint election process (or alternative process) be effective in delivering the intended certainty for both contractor and subcontractor to allow the subcontractor to claim the large company credit?

The proposal to extend the relief to include routine work undertaken by subcontractors is a welcome one. As is stated, the work that they undertake is an essential part of wider R&D projects and we believe it is correct to offer incentives to companies who are performing such work.

The question of how HMRC can confirm the link between the work undertaken by such companies and their customers' R&D is interesting. This particular point could if not formulated correctly add significant complexity to the administration of the scheme and may act as a barrier to companies making a claim if not carefully considered.

We have spoken to SLA members in the clinical trials space and understand that a relatively simple solution may be apparent. The subcontractor is provided with a protocol reference for the trial which their work is supporting. As part of the R&D claim it will be easy to provide HMRC with this code which can then be entered into following website www.clinicaltrials.org. The website will confirm the stage of the clinical trials to which the work relates, thereby providing verification of R&D being performed by the customer.

Of course this possibility does not exist in other areas or life sciences and other sectors and we appreciate that adoption of the above may serve to favour the life sciences sector if other sectors are required to certify or make a joint election. In most cases the knowledge of whether qualifying R&D is being undertaken will be with the customer. This will essentially give them a position of power when negotiating contracts and may allow them to use the provision of a signed election as a tool to drive down price. Has this been considered as a consequence of the requirement? One outcome could be that the customers negotiate themselves into a position whereby they are receiving a significant proportion of the benefit from the R&D relief which is intended for the subcontractor.

From a practical perspective, would simply naming the customer as part of the claim to the R&D relief be a possibility? We believe that this would give HMRC the information that they would require to confirm whether the customer is claiming R&D by checking their corporation tax file. Also a summary of the work being undertaken and the background to the work could be requested under enquiry (or be provided with the claim as most of our clients do) in a way similar to that done for current "traditional" claims. It is our view that requesting a certification or joint election makes the scheme more onerous for subcontractors when compared with traditional claims and is essentially only based on taking the word of the customer. Would further investigation also be required? If yes it is difficult to see the value of the certification or joint election.

We also wanted to highlight one point which your question doesn't cover but which will be very important to the proposed extension. This is in relation to the production issue. If the relief is to be extended to include subcontractors, it will be necessary to provide particular clarity in the form of guidance on the issue of production.

Previous informal guidance released on production has stated that in order for a claim to be allowed, the 'main purpose' of the production must be identified as R&D rather than to produce items to sell.

Of course in the case of subcontractors, the main purpose will be to produce something for their customer. However, the item produced will be regarded by the customer as essential to their R&D. This guidance will no longer therefore be useful. As stated specific guidance is required and may be needed to be significantly different from the position in relation to traditional R&D claims.

Question 8: Are there any particular safeguards that companies think would be effective but not add significant to compliance burdens to ensure the removal of the PAYE/NICs cap on the payable credit is not abused?

We welcome the change of the removal of the PAYE/NIC cap, particularly for SMEs who have significant R&D spend but a small workforce. This will provide these companies with an increased incentive to invest within their R&D activities and receive the full benefit in respect to their qualifying R&D costs, without being limited on their cashback.

Question 9: Would companies welcome reform of the going concern definition so that it more closely matched that used for the EIS/VCT schemes?

We welcome this as the majority of our SMEs are funded by business angels.

Question 10: The Government would welcome comments or evidence to support the assessment of the impacts of the changes under consultation?

N/A