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From the Physical Secretary and Vice-President Professor JE Enderby CBE FRS
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Dear Mr Harris

Mechanisms to deliver the large company R&D tax credit

There is evidence that R&D tax credits for large companies are valuable stimuli for innovation. I welcome the proposal of a scheme complementary to that for SMEs.

Although each of the three options offered in this consultation has merit, option 1, the simple volume scheme, is the best for a number of reasons. Just one of these is that although the other schemes would give greater incentive in particular situations, it is important to give incentive for R&D whenever the spend on such work is reasonable. Option 1 also has the benefit of simplicity and the merit of greatest consistency with the existing SME scheme.

Option 2, a two-tiered volume scheme, has the disadvantages noted in the consultation and could even favour those with more cyclic investment in R&D. Cyclic investment can be appropriate, but should not attract greater incentives.

The third option, a baseline volume scheme, has elements of the incremental scheme rejected earlier and has least to recommend it.

The consultation comments on the earlier discussion about sub-contracted costs (Annex A, A.13 – A.15) and A.15 states the Government's current view. As noted in A.14, there are also good arguments for allowing a claim by the principal commissioning the work, rather than the subcontractor. It is the principal that is taking the risk, and more is likely to be invested in R&D if tax credits are attributable to R&D and transparently reduce its cost and thus the risk.

There will be cases where only one, principal or subcontractor, could claim under the more favourable rules for SMEs. Even if the Government does choose that the company actually carrying out the work should claim the credit – as indicated in A.15 – it would be unfortunate if the allowance was less than it might have been, or even lost if a parameter (such as a threshold)

did not permit the Government's preferred claimant to claim. In such cases, at least, the tax credit should be apportioned so that any that cannot be claimed by one party goes to the other.

It is stated in paragraph 3.5 of the consultation that the definition of R&D that qualifies for tax credits will be that currently used for the SME R&D tax credit. Many consider this definition too narrow; at the very least, it is important that this is interpreted in such a way that work to achieve incremental advances, and development work that is an essential requirement for achieving tangible returns, are included. Too narrow a definition can also make applications for tax credit more complicated.

The tax credits for R&D by SMEs are likely to benefit innovation in the UK. I hope that the parameters for the R&D tax credits for large companies will be set in such a way, and at such levels, that they provide real incentive for innovation.

Yours sincerely

John Enderby