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R&D Tax Credits Consultation
HM Treasury
1 Horse Guards Rd,
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1 June 2021

Dear Sir/Madam

R&D Tax Reliefs
We welcome the opportunity to respond to the consultation document on **'R&D Tax Reliefs'**.

BDO is a leading adviser in the mid-market, working with businesses across all sectors to support their R&D work.

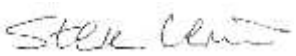
R&D relief has a proven track record in encouraging business investment in innovation and it is vital that the government continues to improve its attractiveness post-Brexit and as corporation tax increases are implemented. We note that the government is committed to "increase total UK R&D investment to 2.4% of GDP by 2027" and believe that the R&D review offers a great opportunity to attain this goal by both updating and simplifying the relief to make it both more accessible and more predictable for companies to use. As the overall level of UK subsidy to business (including R&D spend) is much lower than in a number of countries – including EU competitor countries - we hope that the government will help to remedy this position by increasing the tax reliefs available for R&D in the UK to help meet its R&D investment goal.

A key reform will be to remove the current cliff edge in tax relief rates when companies move from using the SME scheme to the RDEC scheme – the current rules inhibit the scaling up of successful small businesses growing through innovation. We believe that this can be achieved by combining the two schemes within one new set of rules that are more straightforward to understand and use.

We have carried out a survey of our R&D clients on the future of R&D and we attach a summary of the findings: we have quoted feedback from the survey at various points in our response.

If you would like to discuss our response, please get in touch.

Yours faithfully



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For and on behalf of BDO

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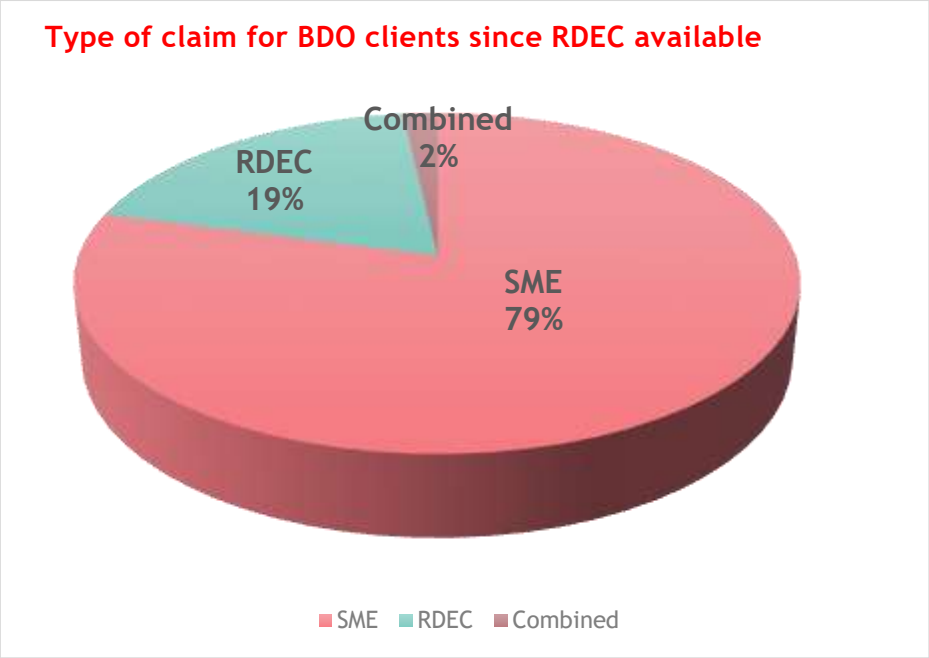
Question 1

Do you consider yourself to be a research-intensive firm? How does your business benefit from the R&D reliefs (e.g. cash flow, 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?

As you will see, the majority of our clients submit claims under the SME scheme, and relatively few make claims under both the SME and RDEC scheme. The higher effective rate of relief available under the SME scheme is more attractive to clients and we believe that this inhibits businesses from expanding (beyond the SME scheme size criteria) in situations where R&D relief has a material impact on their financial position. The recent Cambridge study makes a similar point that businesses using the relief tend to be bought up rather than scale up as they develop.



Based on indicative data from the 3,500 R&D relief claims that BDO has supported clients on since the introduction of the RDEC.

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?

In our experience, the current cliff edge in tax relief rates when companies move from using the SME scheme to the RDEC scheme inhibits the scaling up of successful small businesses growing through innovation: put simply, the financial cost in terms of lost R&D relief under the SME scheme potentially deters businesses from expanding beyond the 500 employee limit under the SME scheme.

For this reason alone, we believe that combining the two current schemes could be beneficial as it would also allow for much simplification by removing one tranche of qualifying rules and making the system easier to administer.

Additionally, the different accounting treatment that typically results from the two different schemes creates confusion in the financial statements, particularly when transitioning between the SME and large company schemes.

However, our survey findings indicate that the great majority of respondents are against the idea of combining the schemes. We believe that this may be because they fear it would lead to a reduction in the rate of relief available under the SME scheme (which many see as "generous").

However, with the right approach, we believe that it would be possible to both combine the basic qualification rules for both schemes but maintain a differential in rates of relief to ensure that the SME scheme remains attractive and globally competitive. This differential could be extended to encompass other criteria, and we recommend that creation of a single tax relief is considered, as follows:

We suggest that the schemes are unified with one qualification criterion for the company (a UK resident business) and one enhanced baseline rate of relief (say 15% - more in line with competing R&D locations) for the costs of the R&D work. The government could then choose to supplement the relief in various way where the project or organisation concerned met additional criteria, for example:

- An additional 10% for companies that meet a significantly enlarged SME criterion
- An additional 5% relief where the R&D work is carried out in certain locations
- An additional 5% relief for R&D projects that reduce CO2 emissions
- Additional percentages in relief for companies operating in certain sectors (eg ongoing Covid-19 vaccine development, battery technology, graphene and possibly UK growth industries such as Fintech)
- An additional 5% relief for R&D projects that result in an increase in the company's headcount by a certain number.

In combining the schemes the government would have the opportunity to adopt the most beneficial elements of both – for example, allowing large companies to claim for subcontracted costs (26% of respondents to our survey would see this as a valuable enhancement to the current RDEC rules). This would be an effective way to both enhance the UK R&D tax relief offer to companies and simplify the current rules.

We would suggest a second consultation identifying those preferred locations, sectors and other factors that could benefit from such supplementary rates, along with rates of relief. While an SME top up (or a sliding scale of top-ups depending on size) will be essential, the other examples above are purely illustrative.

A second consultation could also address some of the design issues within RDEC, such as those preventing dispersed R&D being claimed (see response to Q15 below).

This would give the government scope to create highly targeted tax incentives for important sectors of the UK's future economy in accordance with its policy objectives, whilst still removing a layer of complexity in the current structure by combining schemes.

Alternatively, if the schemes cannot be combined in a way that works for all parties, we recommend that the government simplifies both the SME / Large company definition, as it adds considerably to the complexity of the legislation. This leads to some strange results, for example, where a small private equity-backed company is controlled by the PE, the company

frequently has to claim under the RDEC scheme, when in reality its access to wider funding and support is no different to a 40% owned portfolio company.

We would also recommend that the VC exemption is extended to 100% owned PE companies where there is no long term control and alignment of the rules for aggregation between enterprises and natural persons to remove the adjacent markets test.

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?

We believe that the differences in the rates of additional investment generated by the two schemes is more a function of the external funding available to large companies compared to SMEs than the relative attractiveness of the two schemes. It should be remembered that for many early stage SMEs the availability of the R&D tax reliefs is a major factor in their creation and funding cycle – put simply, without R&D relief as a key element of their business model, they would simply not start trading in the UK. Even where R&D has less impact on the business model, certainty around the availability of financial support has a significant impact: a recent OECD study shows that retrospective support for R&D (like the UK system) has a lesser impact on R&D spend than external funding through grants.

For large companies, the RDEC offers a proven route to tax relief and in our experience, the availability of relief allows businesses to routinely invest in innovation, knowing that the funds are being invested tax-efficiently. In addition, the projects of larger companies naturally tend to be larger and run for longer than SME/start-up projects.

Moreover, the ability of larger corporates to benefit from the 'Above the line' RDEC allows them to account for RDEC within divisional EBIT calculations. This means that the engineers and scientists driving the innovation can directly benefit from the RDEC and where international comparables are relevant, UK innovation may have lower return on investment targets. This helps the UK as a destination of choice for locating R&D. Where divisions do have this oversight and control, this can also help with regional investment in R&D activities, and it should be remembered that SMEs can also be measured on EBIT (e.g. PE-backed companies), therefore an "ATL for all" approach as set out on Q2 would be helpful.

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?

We have seen many multinational clients base their decisions on where to locate their R&D function on the rate of tax relief available. For example, the rate of R&D relief in Ireland is 25% (as it is in Germany), with a 30% rate in France.

Obviously, the rate of R&D relief available in a particular country is not the sole criterion for a location decision, but it is an important factor for companies with international flexibility. Other financial factors include the rate of corporation tax and payroll tax costs for the research workforce: OECD research has also shown that there is a direct correlation between an increase

of FDI (Foreign Direct Investment) and a lower effective tax rate. With the UK's rate of corporation tax due to increase, it would seem clear that the UK's rate/s of relief on R&D will need to increase even to maintain the UK's current level of attractiveness to international businesses.

Although we refer to businesses that 'routinely invest in innovation' above, we do not believe that many of these would proceed in the UK without R&D relief. In our view, it is more likely that such investment would be made overseas as, without the security of tax relief, it would be harder for executives to justify investment in innovation in the UK.

Early stage SMEs are simply looking to build their business, and UK R&D relief is a support for this; they are not looking to have overseas R&D operations, so this would not influence them. However, larger stage SMEs are also increasingly international, and becoming more tax-savvy. This means they are also increasingly taking tax factors (including R&D relief) into account when considering overseas operations.

We feel it is also important to highlight that Brexit has also caused some, potentially unforeseen, impacts on funding for R&D activities carried out in the UK contracted by other European countries, such as France or Spain, leading to an immediate competitive disadvantage. For example, under the French R&D scheme (and in common with several European R&D schemes) the contractor company can include the costs of any (certified) subcontractor within their claim so long as they are based in the EEA. This means that contracts awarded to UK companies pre-Brexit are now more expensive for the overseas contractor post-Brexit (as the overseas R&D relief is now unavailable). This leaves UK companies at a competitive disadvantage, and we are aware of at least one client who is losing business now because of this. Aside from the longer consultation into UK R&D tax relief, we would recommend an immediate series of grants available so UK companies are not disadvantaged in winning subcontracted R&D from Europe.

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?

For SMEs, it would significantly improve the attractiveness of R&D tax relief if claims could be made (and paid out/offset against other tax liabilities) on a more timely/frequent basis to support their working capital needs – nearer to real time tax relief. Allowing companies the option of making quarterly R&D claims as soon as possible would be a useful initial step in the move to quarterly filing for companies under the Making Tax Digital initiative: in our survey 34% of respondents said that this was the most important procedural change HMRC could introduce for R&D claims.

In addition, this would be useful to RDEC claimants who currently are unable to offset RDEC against quarterly instalment payments of tax until RDEC claims are submitted.

We recognise that this will lead to a significant increase in the number of claims made and, therefore, some form of advance clearance system would seem attractive. However, in our experience, the way that the current advance assurance system works creates a significant disincentive for companies to opt for it – so much so, that we suggest that this facility is removed unless it can be made much less onerous in terms of initial investigations from HMRC. It is interesting to note that very few of the respondents to our survey have used the current advance clearance system. If there is to be a continuing clearance system, then HMRC must invest far more resources to ensure that it can meet fast turnaround times.

This would work better if the SME and RDEC schemes were combined under the RDEC approach, since the SME relief available is more dependent on the company's overall tax position. Companies would also need to self-assess the RDEC 7 steps to determine whether a credit should be available to the business. Finally, companies would need to confirm whether the going concern requirement would be satisfied. These may need to be self-assessed by the business, based on the facts and evidence available at the time.

If the schemes are not combined, it would be useful to have a facility (outside of the CT return) to submit annual SME claims at/after the year end. This would allow smaller companies which are perhaps not sophisticated enough, or do not have the resource, to be able to submit quarterly claims to nevertheless benefit from some acceleration of their claim over the usual corporation tax filing date.

We also recommend that companies that provide more information to HMRC should be given priority in the processing of their claim – for example, those supplying the narrative report as outlined in our answer to Q8.

Question 6

When did you first claim, and what prompted you to do so? Do you use an agent? If so, why? What 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?

Data from our survey shows that 40% of respondents engaged an agent to help them understand the definition of R&D and how it relates to their business, with a further 32% saying that an R&D claim is more likely to be successful if supported by a reputable tax adviser.

Nevertheless, our experience of R&D clients is that there are a significant proportion of R&D claimants that wish to engage with agents on a contingent fee basis - which is established practice in the market. A key driver here is that there is no obvious financial downside to the claimant company from operating on this basis. However, we are aware that HMRC has issued other consultations covering aspects such as professional indemnity insurance, which could improve behaviours from such smaller niche agents.

Changing embedded practices will be challenging, but different jurisdictions have sought to address this issue. For example, in the USA, it is not possible to make an initial R&D claim if the agent is engaged on a contingent fee basis. In France, all fees for R&D claims must be deducted in calculating the qualifying expenditure (reducing the R&D tax relief obtained) – this approach may reduce the attractiveness of contingent fees. The Australian tax office also takes a more interventionist approach and requires that advisers must be registered in order to provide R&D advice.

Question 7

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

Any reforms to the claims process should be focused on achieving certainty for businesses as quickly as possible. There are particular areas where the current arrangements work poorly: for example, HMRC enquires related to software can end up with HMRC's Chief Digital Information Office and take many months to resolve before a claim is approved/resolved.

We believe that HMRC should apply a limited time window, say six months, for launching an enquiry into an R&D claim, with a further fixed period of six months to resolve the investigation. Handling enquiries in a short space of time should ensure that any additional information needed can be obtained quickly (whereas if an enquiry starts three years after a claim, it is often much more difficult to compile any additional data, as relevant parties may well have left the business).

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?

45% of respondents to our survey supported the idea of HMRC creating an online portal to allow submission and tracking of R&D claims outside the normal tax return process. This would provide more visibility on claim progress for claimants and facilitate the making of claims on a quarterly basis - also supported by 34% of respondents (see Q5).

HMRC processes have advertised either a payable tax credit payment or an enquiry within 28 days for 95% of submissions since inception of the SME scheme. For many of our clients this is not the case, and it can lead to frustration within their businesses and compromise satisfaction with the scheme if it isn't met. Moreover, as there are also further Risk Checks in some instances, and where the payable credit exceeds a £250,000 authorisation limit, it would be useful if the HMRC portal stated precisely where the claim is at all times since submission – and not just after processing.

As advisers, we valued the ability to call an R&D unit to discuss a claim that was "stuck". The removal of this, and introduction of a centralised e-mail address has significantly impacted the level of HMRC customer service. It has also created a 'gulf' between larger businesses allocated a CCM who are able to discuss and proactively manage the R&D process with a high level of customer service, and any claims handled by HMRC's Wealth mid-size business compliance team, where the claims process is opaque and customer service is not a priority.

Currently, HMRC recommends that companies submit a supporting R&D narrative report. In our experience, whether or not such documentation is submitted appears not to contribute to the likelihood of an enquiry. We would suggest making the provision of supporting documentation a requirement to making a claim, unless exceptional circumstances exist (eg projects subject to the Official Secrets Act).

In addition to these procedural points, we also recommend that part of any new investment in R&D reliefs that the government makes should be to provide additional resources to HMRC to improve its capabilities and handling speed to create a service that is fit for the 21st century. Without such investment, it does not seem likely that UK R&D investment rates will increase in the substantial way that the government is seeking.

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?

Given the government's zero-carbon agenda, it might be possible to broaden the criteria for "development" to cover enhancement of existing products to improve energy efficiency/output even if this does not specifically include a technological advancement or the presence of technological uncertainty. Such project work could perhaps only qualify for the basic level of the new R&D tax relief (as set out in our answer to Q2), but this would help to drive positive results for the government.

Whilst not based on the R&D definition, HMRC's stated interpretation that only Phases I – III of clinical trials work are likely to involve R&D seems out of touch with the life sciences/drug discovery sectors and their work. Feedback from our survey suggests that there is merit in extending the interpretation to include Phase IV testing but, if the definition is maintained as it is, we would suggest this is specifically reviewed to update the guidance – ideally, in the way that the HMRC software guidance was updated.

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?

As set out in our answers to Q9 and Q2 above, we agree that the government can and should use R&D tax reliefs as a lever to achieve specific social value - 82% of respondents to our survey agree with this approach. Given the government's carbon reduction targets, higher R&D tax reliefs for projects aimed at achieving energy efficiency and lower CO2 outputs seem like a very obvious policy choice.

It would also be possible to go further and set specific additional reliefs (above the flat rate standard relief we suggest) to incentivise investment in specific industries and sectors that are seen as crucial to the development of the UK economy.

If the government requires a tool to create specific disincentives, the R&D rules could simply be restricted to exclude companies operating in certain sectors from R&D tax reliefs. For example, as the sale of diesel cars is to be phased out, is there still a case for any R&D on diesel cars to qualify for relief?

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?

We foresee a number of practical difficulties in introducing differential regional rates of R&D relief (even as a top-up amount as suggested in our answer to Q2). The main difficulty will be in precisely establishing where the R&D work is actually carried out: is it where the researchers are based, where the company head office is, or where the person controlling the R&D is based? Indeed, who is the person who actually controls the R&D – is it the technical leader of the project or the person/team that supervise the day to day work? If the R&D location, is it to be

based on where the majority of the workers involved operate, and how do you take account of those that work from home?

In our survey we asked whether differential rates of R&D relief should be available in different regions within the UK: a clear majority of respondents (79%) did not support this idea.

Question 12

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

Although the UK R&D regime is currently broadly competitive with the rules in competing jurisdictions, it is true that the scope of qualifying costs varies between jurisdictions – for example, software license costs are specifically allowed in the Netherlands whereas, in France, amortisation of R&D assets are allowed and these are uplifted by 75%, and 43% of overhead staff costs can be claimed. Therefore, if the government is seeking to enhance the attractiveness of the UK as an R&D location following Brexit, broadening the base of qualifying costs is one way to compete: for example, there is some support for including cloud computing costs (26% of respondents to our survey).

When speaking to our clients, some of the costs they readily associate with R&D projects which are currently not allowable expenses are:

- Leasing/rental costs – both for plant and machinery used in R&D and rental of property where R&D is carried out.
- Regulatory costs – where such legal/regulatory costs must be incurred in order for the R&D activities to start
- Patent costs – once R&D work has resulted in some form of IP, the costs of protection are not included.
- Travel costs which are not reimbursed expenses – travel costs incurred wholly for an R&D project by the company are not allowed, whereas if these costs are paid by an employee and are reimbursed they are allowed. Our clients see no reason for this distinction and nor do we.

However, the comparative ease of use of the UK R&D schemes should not be overlooked as a competitive factor. Therefore, allowing a fixed percentage of overhead costs as part of a claim may be a simple solution.

Alternatively, rather than widening the cost base, it could be simpler still to increase the core rate/s of relief, as set out in Q2. It is quite possible that this would achieve a greater increase in R&D spend in the UK than adding further complex rules around specific costs.

We are frequently reminded by our clients that the intellectual property for their innovations is portable and can be moved, internationally if need be. Therefore, the overall effective rates of R&D relief obtained by companies (taking into account all variables – including classes of qualifying cost) that the UK offers need to remain competitive with other jurisdictions.

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?

In recent years the relatively high level of the capital allowance AIA (at £1m) has meant that the majority of our mid-market claimants do not exceed the annual limit. Therefore, the availability of R&D allowances has relatively little impact on them at current rates of relief.

For our larger clients, the new super deduction capital allowance at 130% will obviously be more beneficial than RDAs at 100%. However, if the super deduction ends as planned in April 2023, we can see merit in increasing RDAs to 130% at that time for all sizes of company.

Other jurisdictions address the capex issue in different ways: for example, the French R&D scheme allows depreciation charges rather than RDA. As we have distortions caused between intangible and tangible fixed assets, there may be value in scrapping RDAs and replacing them with a mandatory qualifying expense category equivalent to the annual impairment/depreciation/amortisation on capital assets.

Clearly, the exchequer would gain in the short term, as a 100% first year allowance is being replaced with a depreciation charge, but it would probably increase the costs of R&D relief after a while, as the depreciation charge would add to all future R&D claims.

Question 14

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

The UK capital allowances change on a frequent basis as the government see a current need to boost investment (for example the current 'super deduction'). This creates inconsistency for businesses, and for the next two years RDAs are not as beneficial as the super deduction. Under a new R&D tax credit we would like to see capital expenditure qualify for relief at the same rate as revenue expenditure for the tax year it is incurred, or the rate of RDAs increased as mentioned in Q13.

Sectors that have to invest heavily in capex (or leasing capital equipment) to support their R&D (eg manufacturing businesses) are currently less incentivised than sectors focused more on intangibles (eg software businesses). A change to the R&D relief for capex would help to even this out, and would support UK's R&D in capex-heavy sectors.

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?

Subcontracting, generally, creates complexities in that it is very much driven by legal concepts underlying the provision of or for services, and the distinctions are not always clear nor the contracts easily decipherable by business owners or by tax practitioners without specialist legal input. Irish tax law underlying their R&D tax credits allows for tie-breaker clauses to be included within the legal contracts so that the owner of the R&D tax credit is readily identifiable. Maybe this sort of solution should be available under UK law too.

There is one other distortion within UK tax law revolving around what is referred to as "dispersed R&D". Broadly speaking, under UK law only the company carrying out R&D can claim tax credits. Where a company is an SME, they can also claim (65% of) subcontracting costs; however subcontracting costs cannot be claimed under RDEC principles. This means that where some of the R&D process is subcontracted by large companies (such as in life sciences, where testing work is often outsourced), the contractor cannot claim as they're subject to RDEC, and third party subcontractor companies such as Contract Research Organisations (CRO's) cannot claim as it's not their R&D (whereas, within a group situation the same work would qualify for R&D under CTA 2009 s104W). This position is not replicated in any other tax jurisdiction, and CRO's are now moving activities away from the UK so that they can benefit from overseas R&D tax credits.

85% of the respondents to our survey said that the overseas costs they claim for R&D relief represent less than 25% of their total costs.

There will be some circumstances where the research facilities and expertise of workers overseas makes their use attractive or essential for certain R&D projects and, of course, many situations where labour costs overseas are less than in the UK.

However, where externally provided workers are used outside the UK, Brexit gives the opportunity to be more prescriptive about qualifying costs. Therefore, if the government wished to, it should be possible to limit the amount of costs claimed for overseas EPWs and subcontractors to a maximum of (say) 15% of any UK R&D claim and a new regime. An alternative would be to allow companies to opt for an IP-based rule (similar to that introduced with the SME repayable credit cap), ie overseas costs would qualify only when the associated IP generates income that is taxable in the UK – longer lookback claim periods (say six years instead of two) would be required to make this practical.

We believe that such restrictions would not have a significant detrimental impact on mid-market businesses in the UK and would help to boost UK employment and the associated benefits by ensuring more research is carried out in the UK.

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?

Film tax relief already employs a points-based system to assess whether or not a film qualifies as 'culturally' British. It would be possible to create a similar points-based system related to R&D work carried out overseas to assess the benefit provided to the UK as a result of the relevant R&D work.

However, we believe that such a points-based system would be difficult to build and complex to operate for companies. A simple limit on the amount of costs claimed for overseas R&D costs or an IP benefit-based approach (see Q15) would be much simpler for companies to understand and for all parties to implement.

Another option could be to allow a higher percentage of eligible qualifying expenditure for UK costs and a lower percentage for overseas costs (i.e. similar mechanism to the current 100% for staff, 65% for EPWs). This would incentivise companies to base their costs in the UK where possible, but not preclude them from "offshoring" their costs where the relevant expertise is not available in 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?

The ability to include the cost of qualifying indirect activities in R&D claims is valued by UK companies – 28% of respondents to our survey chose it as the most attractive feature of the current UK R&D tax credit rules.

However, we recognise that achieving a fair costing apportionment can be difficult and lead to both investigations and disputes. Other jurisdictions allow a proportion of overheads as part of an R&D claim (eg France) as a short cut to address this issue.

We believe a framework solution is the most practical for all parties. Where indirect activities costs relate to staff, we believe that the R&D rules could return to the pre-2003 rules setting out a clear 80/20 test for staffing costs to be included, ie:

- If 80% or more of the individual's time is spent directly supporting R&D work, then their payroll costs should qualify in full
- If the proportion is between 80% and 20%, then the relevant proportion of their staffing costs should qualify
- If the relevant proportion is less than 20%, then no related staff costs should qualify.

This would also have the effect of eliminating claims for small percentages of staff costs.

Alternatively, allowing a proportion of overheads (perhaps with the percentage determined by sector) by reference to staff costs could be a practical way to do this. In reality, many of our larger clients use this methodology in their own accounting, as for many innovative businesses their staff costs are the largest category of qualifying expenditure. This would, therefore, have the benefit of reflecting the commercial reality for many businesses.