ROYAL ACADEMY OF ENGINEERING

Tax incentives

Summary

Tax incentives, particularly R&D tax credits, the Enterprise Investment Scheme (EIS), and the Seed Enterprise Investment Scheme (SEIS), support business R&D investment in the UK.

R&D tax credits can encourage large multinational companies to invest in R&D in the UK, as they decrease the relative cost of the work. For small companies, the tax credits can promote R&D investment by increasing cash flow to respond to opportunities as they arise.

Small companies find EIS and SEIS invaluable, helping them to attract finance for high-risk R&D activities.

These schemes should be maintained to provide a stable and competitive fiscal environment, supporting companies and investors to make long-term R&D investment decisions.

R&D tax credits are highly valuable and facilitate business investment in R&D

The UK's R&D tax credits scheme was established in 2000 and offers tax relief depending on a company's corporation tax bill, R&D investment, size, and profit status. Companies can claim tax relief for expenses such as R&D staff, energy and software. From 2016 to 2017, businesses received £3.4 billion in tax relief on £24.8 billion of eligible R&D expenditure[1].

For small companies, tax credits increase their available finance. Unlike innovation grants allocated to specific projects, this allows them to respond to emerging business opportunities and threats as they arise, including through further R&D investment.

"R&D tax credits reduce the relative cost of conducting R&D in the UK, which helps us keep R&D here."

Andrew Cowell FREng, Managing Director, Mercedes AMG High Performance Powertrains Ltd

"R&D tax credits have been invaluable to us. They recognise the value of the R&D investment we have made, and allow us to continue to invest."

Eric Hawthorn FREng, Managing Director, Radio Design Ltd

HMRC estimates that **for every £1** spent on R&D tax credits, **between £1.53 and £2.35 is additionally spent** on R&D by companies in the UK[2].

Companies interviewed find the UK R&D tax relief scheme **attractive and competitive**, despite many comparator countries operating similar schemes.

Why do businesses value the UK's R&D tax credits scheme?

- The definition of R&D is broad, covering a wide range of engineering activities, from process engineering in manufacturing to software development for digital products.
- Companies can claim relief on external R&D spend with their suppliers. This is an important mode of R&D for many companies and drives broader economic growth through the supply chain.
- Staff costs associated with the direction, design and financing of R&D projects are eligible for relief. This helps to keep highly-skilled innovation staff in the UK, even if some of the work is conducted overseas.
- The generous definition of SMEs is helpful, providing valuable support to startup companies who reach 500 staff members.
- The process for claiming credits is relatively straightforward. Many companies value HMRC's pragmatic approach as it does not require significant technical input, although small companies can still find it burdensome.

"The nature of our R&D means that some of our work has to be done abroad, near to natural resources. However, R&D tax credits can be claimed on the design and direction of R&D, which helps us maintain many of our strategic R&D team in the UK."

Head of Tax, large company

EIS and SEIS

EIS and SEIS can leverage business investment in R&D in the UK by offering tax relief on investments in high-risk unquoted companies, attracting investment in UK innovation and contributing to the formation of a vibrant UK startup ecosystem.

Small companies find these schemes invaluable, helping them to attract finance for high-risk R&D activities, and reducing pressure on companies to secure investment from venture capitalists too early on in their growth cycle.

"EIS and SEIS have greatly helped us attract investment from angel investors. This has reduced the pressure on us to seek venture capital or private equity investment too early, allowing us to focus on innovation and company growth."

Pawel Kisielewski, Chief Executive Officer, CCm Technologies

To increase business R&D investment:

- R&D tax credits, EIS and SEIS should be maintained to provide a competitive and stable tax environment that enables companies and investors to make long-term investment decisions.
- HMRC should continue to work with companies, particularly small companies, to minimise the administrative burden of claiming tax relief.

This explainer is part of a series based on interviews with individuals responsible for making decisions on R&D across a wide range of engineering companies.

See ***Introduction*** explainer to find out more.

1 *Research and Development Tax Credits Statistics*, HM Revenue and Customs, 2018.
2 *Evaluation of Research and Development Tax Credit*, HM Revenue and Customs, 2015.