By email: rdtaxexpenditures@hmtreasury.gov.uk

13 October 2020

Dear Sir/Madam,

Re: BVCA response to the HMT consultation on the scope of qualifying expenditures for R&D Tax Credits

We are writing on behalf of the British Private Equity and Venture Capital Association ("**BVCA**"), which is the industry body and public policy advocate for the private equity and venture capital industry ("**PE/VC**") in the UK. With a membership of over 700 firms, the BVCA represents the vast majority of all UK based PE/VC firms, as well as their professional investors and advisers. BVCA members invested over £43bn into 3,230 UK businesses in the period 2015-2019, the majority being SMEs, and companies backed by PE/VC currently employ 972,000 people in the UK.

R&D tax credits play an important role in the companies that BVCA members invest in and are an efficient way of ensuring that companies can easily claim money that they can reinvest in their future growth. We support the widening of the definitions identified in the consultation paper, especially when the UK faces competition from other jurisdictions that would like to attract high-value, R&D-intensive companies.

Venture capital, growth capital, and private equity funds have a strong track record of supporting and growing the types of R&D intensive companies that will help the Government meet its ambition for total R&D spend to reach 2.4% of GDP by 2027[1]. Our members invest in companies that are critical to the growth of the UK economy, including start-ups, university spin-outs, high growth tech companies, and established businesses in the most innovative sectors of the economy, which make positive contributions in terms of GDP and employment[2]. The BVCA Report on Investment Activity shows that our members invested a total of £1.3bn in IP rich firms across the tech sector in 2019, which included sectors such as biotech and life sciences that received £310m of investment across 105 companies[3].

We are pleased that the Government has already announced that the RDEC rate will be increased from 12% to 13%[4] and are grateful to be given the opportunity to comment on the consultation. Set out below is a summary of our response and detailed comments to the questions in the consultation document. We look forward to discussing these further with you.

Summary feedback

- We believe this is an overdue update to the R&D tax credit system. The regime was developed in 2000 and last reviewed extensively in 2010.
- The generation and use of data for R&D is increasing exponentially, and how software is defined under the current rules is out of step with how research is carried out on cloud-based systems.

[1] 2018 UK Industrial Strategy proposals
[2] See the BVCA Innovation Nation 2020 report
[3] BVCA Report on Investment Activity 2019
[4] As announced in the UK Budget 2020

British Private Equity & Venture Capital Association
5th Floor, Chancery House, 53-64 Chancery Lane, London, Wc2A 1QS
T +44 (0)20 7420 1800 F +44 (0)20 7420 1801 bvca@bvca.co.uk www.bvca.co.uk

- Data and cloud computing are integral to how R&D is conducted across all tech sectors and should be brought within scope of the tax credit system in a way that is efficient and cost effective for the taxpayer.
- These changes will ensure the UK remains internationally competitive and a leading destination to start and grow a high-tech business.
- The US tax regime accepts data costs as part of their tax relief scheme, and this is often utilised by Silicon Valley entrepreneurs and investors. Many EU countries (including Germany) also allow data and cloud costs to be claimed under their R&D regimes.
- By making it more affordable for UK SMEs to access, store and analyse data, the Government can give them a competitive edge against international competitors.
- We would welcome a wider discussion that goes beyond the scope of the consultation, to consider other ways these companies can be supported by the R&D regime.

Response to consultation questions

Question 1a: Are there uses of data that contribute to R&D but which do not currently attract relief through the RDEC and SME schemes? Please provide examples to support your response.

We believe that more of the costs incurred in the generation, processing or analysing of datasets should be eligible for relief under the R&D tax credits regime. It is now widely accepted that the use of these datasets is a key driver in the creation of new technology and is an area that has developed exponentially in the last decade[5].

According to current CIRD guidelines, relief can only be gained if a "technological advance" has taken place or a "technological uncertainty" has been overcome[6]. It is not always clear how this can be justified by the company making the claim and doesn't take in to account the use of large datasets that may not necessarily involve overcoming a "technical uncertainty". Whilst the CIRD guidelines are not within the scope of this consultation, clarity would be welcome on this issue in a way that would not require legislative change.

Many of these activities also require the use of third parties in the purchase of data, and companies are not able to claim for this under the current R&D regime. Companies incur high costs when producing large, sophisticated datasets that are used in AI and other types of advanced software, which are often key to the growth of start-up companies. These raw datasets also require processing and analysis before they can be properly studied, often using cloud-based software and storage. This is a costly but highly productive process where value is generated, but one where companies cannot claim under the current R&D tax credit system.

The types of data generation that the Government should consider including in the R&D tax credits regime include:

- **Medical data** (medtech);
- **Formulation of drugs** (life sciences);

[5] As outlined in the DCMS National Data Strategy in September 2020
[6] BEIS Corporate Intangibles R&D Manual – paragraph 15

- **Financial data** (fintech);
- **Seismic data** (engineering);
- **Market data** (tech generally)

Question 1b: To what extent are datasets employed in the R&D process consumed? To what extent do they retain value? Please provide examples to support your response.

Modern technology allows for more complex and sophisticated analysis and use of large datasets. The Intellectual Property (IP) that is developed by companies through the creation of these datasets is a key part of their value and potential for future value creation, especially in start-ups that are at the pre-revenue stage. Early stage venture capital fund managers are skilled at identifying and valuing these companies and which types of IP will be developed into successful products. It is through the success of the company and the investment they receive that new technologies can be commercialised and build the companies that drive growth in the UK economy.

It is not always easy to demonstrate how data sets are "consumed" in the R&D process in a way that prototypes are used for example. It is our view that data and the way it is utilised is a key part of the R&D process and in the development of IP-rich companies. Companies should be able to include this as part of their R&D claims, but find they are not accepted under the current regime. This is not because it is clearly excluded by the rules but because the language requires updating to reflect changes in how data is now utilised. We ask that this is addressed to ensure the R&D tax credits regime is clear and fair for all companies and applies to all UK companies and foreign companies that base their R&D arms in the UK.

Question 2a: Do you already claim for software costs under the current definition? If so, what was your experience of separating out the R&D specific costs for the purposes of the claim?

Software licence costs do qualify for R&D tax credits at present, but the current regime does not reflect the way modern companies use data. Software that is long established and recognised by HMRC is easily processed under R&D claims, but newer software often does not qualify or takes longer to be claimed for if it is not already established and recognised by HMRC. Software costs that are included as part of cloud computing are also hard to identify which make it difficult for companies to claim for these costs and for HMRC to identify them. Aspects of cloud computing such as storage rental, support and processor running times do not currently qualify, and these are important in the development of large datasets.

Greater clarity is required in the CIRD to help software providers, HMRC, and the companies that make the claims. This will require dialogue between all parties to simplify this process so that costs can be broken down and the correct R&D claims are calculated efficiently and accurately, and proved by clear methodology and due diligence.

Question 2b: Are there any software costs that currently qualify for R&D tax credits, that could be limited or excluded from relief without materially affecting R&D projects? Please provide examples to support your response.

None that we are aware of.

Question 2c: Are there any software costs, partially or wholly for R&D purposes, that do not currently qualify for R&D tax credits, that should be if the regime is to better reflect the nature of modern R&D? Please provide examples to support your response on whether these costs could be separated out straightforwardly.

Cloud computing licences are very expensive and play a key part in the development of data in the R&D process. They often make up a large proportion of a company's R&D expenditure, especially at the start-up stage, and cannot be claimed for under the current R&D tax credits system.

The new rules should explicitly state that such activities are eligible for R&D tax credits. Data providers are aware of the need to separate out project costs to make it easier to report R&D-attributed costs in R&D claims. If guidance is provided by the Government that is drafted in cooperation with software providers, this should make the claims easier to process by HMRC.

Question 3a: What experience do you have of claiming R&D tax credits in other jurisdictions, where expenditures pertain to data or cloud computing?

The US tax regime currently accepts data and cloud computing costs as part of their tax incentive regime and many EU countries also allow this (see Appendix 1). However, other regimes are often not as comprehensive as the UK has the potential to be, as they are either capped, provided as a percentage of fixed costs, or as a loan system linked to expenditure.

Recent data shows the UK was the number one destination for venture capital investment in Europe, with 1,425 deals totalling $14.31bn in 2019, representing 40 percent of European funding in 2019 overall[7]. However the gap is narrowing and the Government must take steps to ensure the UK remains the best place to set up and grow a business in the post-Brexit environment, especially given recent changes to Entrepreneurs' Relief[8] and the uncertainty created by Brexit.

Question 3b: What evidence can you provide that a scope expansion in these areas would drive you to make additional investments in research and development.

As outlined above, the formulation of datasets and the use of cloud computing would allow more companies to include R&D tax credits in their business plan and therefore make additional investments in R&D as they plan for future growth.

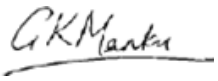
Question 4: Would changes to the R&D tax relief rules in the areas outlined above lead to any change in the commercial relationships between companies, insofar as expenditure is outsourced to a third-party provider?

[7] Crunchbase European Venture Report 2019
[8] UK Budget 2020

We do not believe they would. All the changes we identify above, even where third party data is used, would still be purchased by a company to develop. Although both companies would be able to claim R&D in the production of the data, they would do so independently depending on who owns the IP.

We would be grateful for an opportunity to meet and discuss the feedback provided in this letter. Please let us know if you have any comments or questions in the meanwhile.

Yours faithfully,



Gurpreet Manku
BVCA Deputy Director General

Appendix

Territories where data and cloud computing costs are eligible for R&D claims (based on PwC survey)

Territory	Data Acquisition costs eligible?*	Cloud Computing costs eligible?*
Australia	Yes	Yes
Austria	Yes	Yes
Brazil	Yes	Yes
China	Yes	Yes
Germany	Yes	Yes
Greece	Yes	Yes
Hungary	Yes	Yes
Portugal	Yes	Yes
Singapore	Yes	Yes
Slovenia	Yes	Yes
Turkey	Yes	Yes
US	Yes	Yes

** Where it has been identified that data acquisition or cloud computing costs can be included in claims, there may still be restrictions on the inclusion of these costs (e.g. in ratio to other costs such as staff costs, how the contract for these services is structured, etc) The purpose of the information in this table is to provide a general view and should not be relied upon as providing full details of the eligibility of costs.*