



RESEARCH AND DEVELOPMENT (R&D) TAX CREDITS STATISTICS 2022:

WHAT THEY SAY ABOUT THE HEALTH OF UK R&D

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INTRODUCTION

This whitepaper looks at HMRC's recently published **Research and Development (R&D) Tax Credits Statistics: September 2022**.

As well as analysing the stats for the tax year 2020 to 2021, we also highlight newly revised figures for 2019 to 2020 to provide fresh insights into the health of UK R&D.

WHY DO R&D TAX CREDIT STATISTICS MATTER?

Investment in R&D is seen by many as a barometer for prosperity. Growth in R&D expenditure is a sign of strong private investment, which leads to exciting scientific and technological innovations stimulating much-needed economic growth.

Since 2000, UK businesses that carry out innovative R&D projects have been able to claim financial support through R&D Tax Reliefs. These tax reliefs are essential for SMEs, as it allows them to expand and reinvest in more R&D, further contributing to growth.

This is why HMRC's yearly R&D statistics are so important. By breaking down R&D expenditure and tax relief support claimed regionally and by industry sectors, we can understand the health of business innovation in the UK.

WHAT DO THE 2022 R&D TAX CREDIT STATISTICS REVEAL?

Unfortunately, the most recent numbers show that R&D investment has taken a big hit. The 2020 to 2021 tax figures show that R&D expenditure is 11% lower than the previous year and that there was a 10% decrease in the average value of claims.

These figures undoubtedly reflect the difficulties that many businesses have faced due to COVID-19, but our review shows that growth for the tax year 2019 to 2020 was much lower than previously reported by HMRC. This suggests that other factors beyond the pandemic could have affected investment and innovation in the UK, such as the withdrawal from the European Union and the subsequent government changes.

These changes came when the UK was already on the back-foot following years of lagging behind our international neighbours' investment in R&D.

In this white paper we explore the following key observations from HMRC's latest R&D Tax Credit statistics:

- // R&D expenditure and cost of support claimed figures for 2019 to 2020 have been revised down
- // HMRC's R&D statistics for 2020 to 2021 include estimated "uplifts"
- // Revisions in next year's publication could show a worse picture
- // R&D expenditure has declined for the first time since the 2009 to 2010 tax year
- // Year-on-year expenditure has declined for several UK regions, including East of England
- // Year-on-year expenditure has declined for several industry sectors, including Manufacturing
- // Falling R&D expenditure is a blow to the government's ambitious growth plan
- // Future R&D funding may be further depressed by planned reforms coming in April 2023



R&D EXPENDITURE AND COST OF SUPPORT CLAIMED FIGURES FOR 2019 TO 2020 HAVE BEEN REVISED DOWN

The newly revised statistics show that while R&D spend has declined in the 2020 to 2021 tax year, it was already slowing down in 2019 to 2020.

Although HMRC does not draw attention to it, their figures are revised the year after all claims have been submitted. These revised figures are more accurate as they do not include HMRC estimates of R&D claims yet to be received. If we look at the original estimates against the revised figures (as summarised below), we can see clues as to how the most recent numbers may be revised next year:

R&D EXPENDITURE: ORIGINAL ESTIMATES VS. REVISED FIGURES

Year	Estimated R&D expenditure (£M)	Revised R&D expenditure (£M)	Revision percentage
2020/21	38,145	TBC	TBC
2019/20	47,470	42,835	-10%
2018/19	35,250	41,780	19%
2017/18	31,320	36,760	17%

R&D COST OF SUPPORT CLAIMED: ORIGINAL ESTIMATES VS. REVISED FIGURES

Year	Estimated R&D cost of support (£M)	Revised R&D cost of support (£M)	Revision percentage
2020/21	6,590	TBC	TBC
2019/20	7,445	6,865	-8%
2018/19	5,345	6,310	18%
2017/18	4,330	5,150	19%



Last year HMRC reported £47.5 billion of R&D expenditure for the 2019 to 20 tax year, 15% higher than the previous year. However, the revised figure was actually much lower at £42.8 billion. In other words, R&D expenditure growth was just 3% (not 15% as initially estimated). HMRC also said that the total amount of support claimed was £7.4 billion, an increase of 19% from the previous year. The revised figure is now down to 6.9 billion, so the increase was just 10% (not 19% as originally estimated). These newly revised stats show that growth had already slowed down at the cusp of the pandemic.

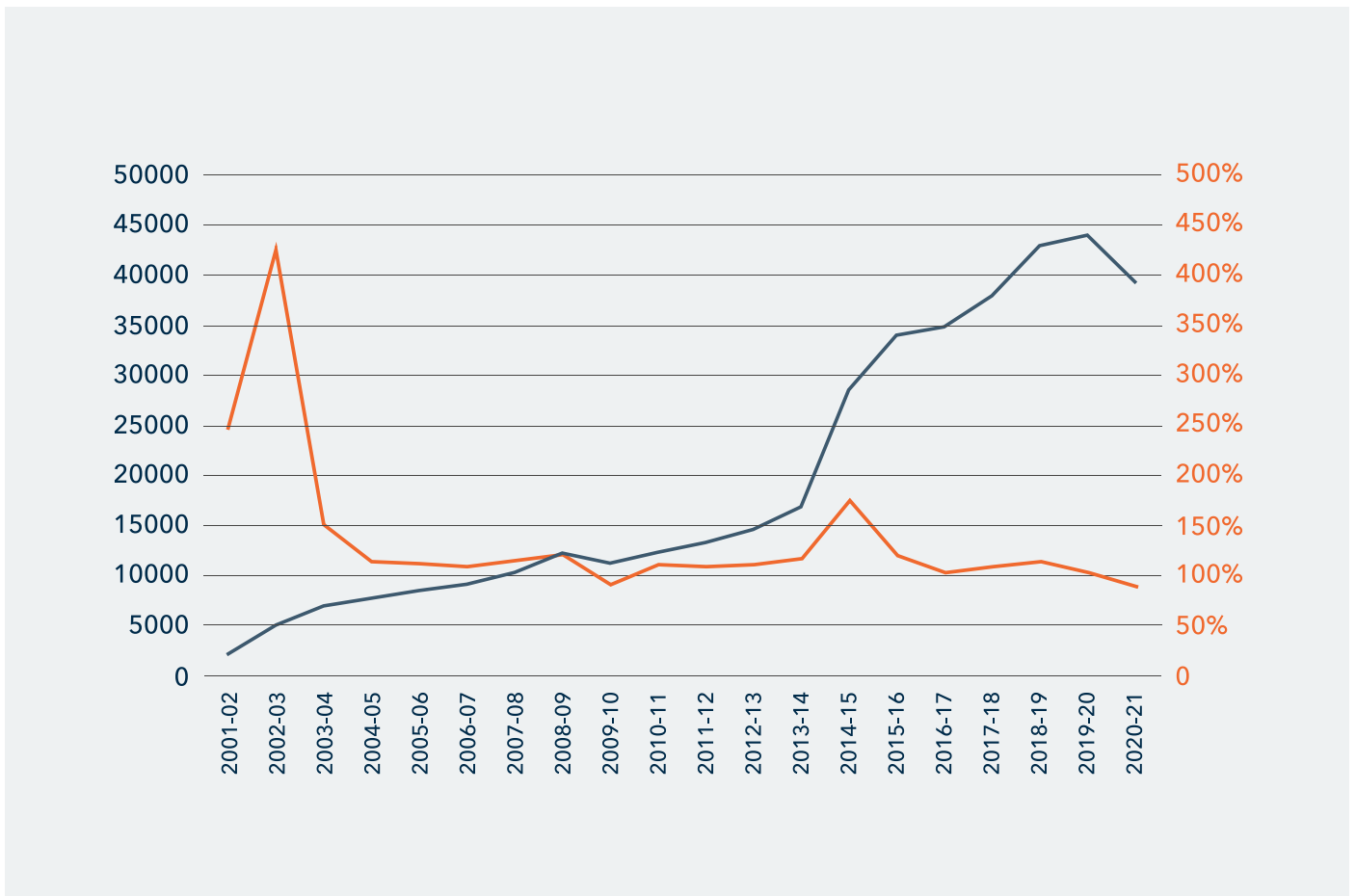
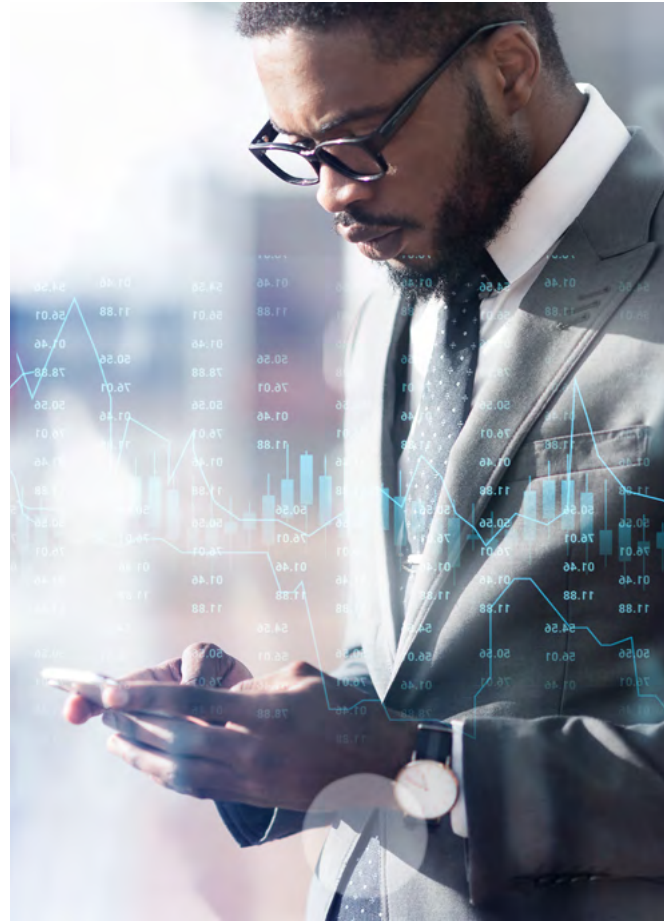
R&D EXPENDITURE HAS DECLINED FOR THE FIRST TIME SINCE THE 2009 TO 2010 TAX YEAR

For the first time since the 2009 to 2010 tax year (when the UK experienced a recession following the financial crisis) year-on-year growth in R&D expenditure has declined.

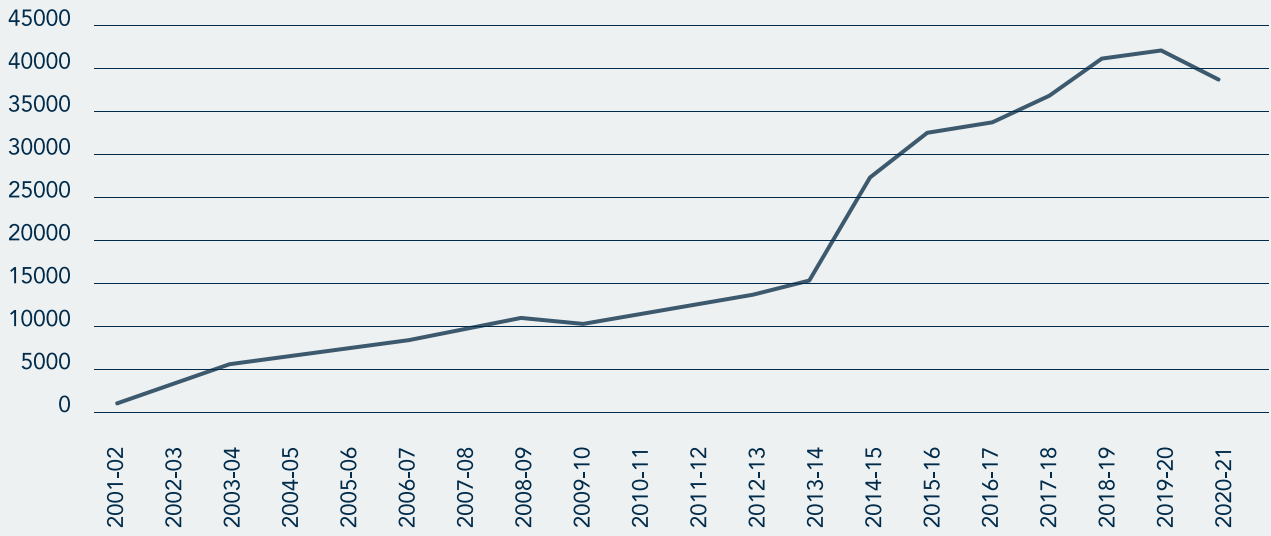
Our table below shows that growth in R&D expenditure has stagnated since the 2015 to 2016 tax year, when growth in the UK's economy slowed in the runup to the European Union membership referendum.

The government had hoped to supercharge science and technology R&D in the UK by announcing the **largest ever research and development budget**, worth £39.billion.

The estimated 11% decline in R&D expenditure for the 2020 to 2021 tax year will therefore be very concerning for the Department for Business, Energy & Industrial Strategy and for UK businesses.



R&D expenditure since 2001-02 (£M)



YEAR-ON-YEAR EXPENDITURE HAS DECLINED FOR SEVERAL UK REGIONS, INCLUDING EAST OF ENGLAND

By comparing the latest figures to previous tax years, it's clear that there continues to be a dominant concentration of R&D tax relief in London and the South East of England (see table below).

REGIONAL VARIATIONS IN R&D EXPENDITURE

Region	Total Expenditure 2018-19 (£M)	Total Expenditure 2019-20 (£M)	Total Expenditure (Estimates) 2020-21 (£M)	2018-19 to 2019-20 Change	2019-20 to 2020-21 Change
North East	775	875	610	13%	-30%
North West	2,645	2,555	2,525	-3%	-1%
Yorkshire and The Humber	1,595	1,645	1,470	3%	-11%
East Midlands	1,875	2,005	1,810	7%	-10%
West Midlands	4,250	3,165	2,595	-26%	-18%
East of England	5,155	5,065	4,640	-2%	-8%
London	12,240	13,225	11,970	8%	-9%
South East	7,455	8,305	7,470	11%	-10%
South West	2,020	2,270	1,770	12%	-22%
Wales	785	765	675	-3%	-12%
Scotland	1,765	2,045	1,740	16%	-15%
Northern Ireland	725	800	795	10%	-1%
Unknown	120	120	80	0%	-33%
Total	41,415	42,835	38,145	3%	-11%

Looking at the last few years, the North West, West Midlands, East of England and Wales have all suffered year-on-year declines in R&D expenditure. Of course, these pre-2020 declines cannot be attributed to the pandemic. Every region except Northern Ireland and the South East is below the 2018 to 2019 tax year levels of expenditure.

While the East of England is often described as the next hotspot for R&D investment because of the innovation cluster around Cambridge, the year-on-year decline in R&D expenditure in this region also raises concerns for investment in this famous research hotspot.

YEAR-ON-YEAR EXPENDITURE HAS DECLINED FOR SEVERAL INDUSTRY SECTORS, INCLUDING MANUFACTURING

R&D expenditure continues to be focused in the Manufacturing, Information & Communication, Professional, Scientific and Technical industry sectors (see table below).

INDUSTRY SECTOR VARIATIONS IN R&D EXPENDITURE

Industry Sector	Total Expenditure 2018-19 (£M)	Total Expenditure 2019-20 (£M)	Total Expenditure (Estimates) 2020-21 (£M)	2018/2019 - 2019/2020 Change	2019/2020 - 2020/2021 Change
Agriculture, Forestry, Fishing	275	370	375	35%	1%
Mining & Quarrying	1,070	685	445	-36%	-35%
Manufacturing	13,070	11,525	9,825	-12%	-15%
Electricity, Gas, Steam and Air Conditioning	200	215	195	8%	-9%
Water, Sewerage and Waste	225	215	175	-4%	-19%
Construction	1,895	2,440	2,015	29%	-17%
Wholesale & Retail Trade, Repairs	2,405	2,635	2,395	10%	-9%
Transport & Storage	400	455	315	14%	-31%
Accommodation & Food	70	150	85	114%	-43%
Information & Communication	6,160	7,220	7,270	17%	1%
Financial & Insurance	3,035	3,175	2,585	5%	-19%
Real Estate	70	105	60	50%	-43%
Professional, Scientific & Technical	9,025	9,885	9,615	10%	-3%
Admin & Support Services	1,280	1,460	1,325	14%	-9%
Public Admin, Defence & Social Services	<10	<10	<10	0%	0%
Education	535	545	140	2%	-74%
Health & Social Work	200	280	285	40%	2%
Arts, Entertainment & Recreation	850	840	665	-1%	-21%
Other services activities	225	270	255	20%	-6%
Other or unknown	430	360	135	-16%	-63%
Total	41,415	42,835	38,145	3%	-11%

Despite the large proportion of expenditure in Manufacturing, there are worrying signs for the sector as it has experienced a year-on-year decline in spend. A concerning year-on-year decline was also seen in the Mining & Quarrying, Water, Sewerage and Waste, Arts and Entertainment & Recreation sectors.

It's more positive to see that while there was an overall year-on-year decline in expenditure, Agriculture, Forestry, Fishing, Information & Communication and (perhaps unsurprisingly due to COVID-19) Health & Social Work managed to buck the trend by seeing a very small level of year-on-year growth.



FALLING R&D EXPENDITURE IS A BLOW TO THE GOVERNMENT'S AMBITIOUS GROWTH PLAN

The newly published statistics are in stark contrast to the government's aim to achieve a trend growth rate of 2.5% for the UK economy.

The UK has long underinvested compared to peer nations. The government reports that UK private sector investment is lower than the OECD average and UK business investment remains lower than pre-pandemic levels. Weak investment is estimated to be responsible for around half of the productivity gap to France and Germany.

A competitive business tax system supports investment, innovation and economic growth in the UK. Since 2010, successive cuts have been made to the main rate of Corporation Tax, reducing it from 28% in 2010 to 19% in April 2017. This has resulted in the UK having a headline Corporation Tax rate which is significantly lower than the rest of the G7. The government has committed to increase the main rate of Corporation Tax to 25% from April 2023. Given this context, we urge HMRC and the government to concentrate on increasing R&D Tax Relief as a mechanism to stimulate economic growth in the UK. Otherwise, there is a risk that we will continue to see declining R&D investment across the different UK regions and industry sectors.

FUTURE R&D FUNDING MAY BE FURTHER DEPRESSED BY PLANNED REFORMS COMING IN APRIL 2023

The recent energy, financial and political crises, exasperated by the Russo-Ukrainian War, could bring further turbulence to R&D investment and growth in the future.

Nonetheless, financial support by way of R&D Tax Credits remains a valuable avenue for reclaiming a substantial portion of R&D costs.

This makes it even more disappointing that HMRC have announced that they are introducing restrictive changes to R&D Tax Relief entitlement and application processes from April 2023. In summary, these changes will require pre-notification of first-time R&D claims and remove R&D Tax Relief for externally provided workers outside the UK.

At Leyton, we are deeply concerned that the planned reforms risk reducing R&D investment by making it harder for SMEs to claim essential tax relief as well as make them less competitive by hindering access to international talent.

Beyond the planned changes, HMRC has recently updated its guidance to further restrict relief for SME R&D expenditure where it is considered to have been subcontracted to that SME.

While we disagree with HMRC's common assumption that all R&D activities will fall under the relevant contract, many claimants will not have the appetite to dispute this point with HMRC.



MOREOVER, MOST R&D ADVISERS WILL NOT HAVE THE RESOURCES AVAILABLE TO LEYTON TO DEFEND CLAIMS.

AT LEYTON WE HAVE A DEDICATED ENQUIRIES TEAM THAT IS SUPPORTED BY EXTERNAL LEGAL ADVISERS.



Without this **enquiry support**, we can predict that many genuine R&D projects will not receive the correct funding from HMRC.

The recent "uplifts" in HMRC's R&D statistics do indicate that there is perhaps some internal pressure to demonstrate increased R&D expenditure. Indeed, central government may have concerns if we see a continued decline in R&D investment.

However, we consider that the coming changes will inevitably reduce genuine R&D activity.

HOW LEYTON UK CAN HELP

ARE YOU LOOKING
FOR SECTOR-SPECIFIC ADVICE
FOR YOUR **R&D TAX CLAIM?**

Our team of highly qualified tax and technical consultants are based throughout the UK and have field experience across a wide range of software, science and engineering industry sectors.

This uniquely allows us to work across different industry sectors to understand and identify all the areas where you can claim R&D Tax Credits.

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LONDON

Harmsworth House
1st Floor
13-15 Bouverie Street
London
EC4Y 8DP

+44 207 043 2300

EDINBURGH

3 Queen Street
Edinburgh
EH2 1JE

+44 207 043 2300

GLASGOW

8th Floor
Lomond House
9 George Square
Glasgow
G2 1DY

+44 141 471 9327

BRISTOL

1 Victoria St
Redcliffe
Bristol
BS1 6AA

+44 207 043 2300

MANCHESTER

10th Floor
Manchester One
Portland Tower
53 Portland Street
Manchester
M1 3LD

+44 161 768 8438

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