



HMT & HMRC: R&D Tax Relief Consultation

OGUK, on behalf of its members, welcomes the opportunity to provide a response to HMT on their review of the R&D Tax Relief regime. OGUK is the leading representative organisation for the UK offshore oil and gas industry. Our membership includes over 400 organisations with an interest in the UK's upstream oil and gas, and other energy sectors. As the champions of industry, we work on behalf of the sector and our members to inform understanding with facts and evidence, engage on a range of key issues and support the broader value of this industry in a changing energy landscape. From exploration through to decommissioning and located across the length and breadth of the UK, our members are critical to safely providing security of energy supply, while supporting around 270,000 jobs and contributing billions of pounds to the economy each year.

OGUK support HMG's ambition to scale up R&D expenditure and recognises the importance an effective R&D regime, particularly in a net-zero context, has for the UK economy. The support of the R&D regime will continue to be an important fiscal measure in the UK now and throughout the transition to net-zero as technologies continue to be developed and scaled. The oil and gas sector are fully aligned with supporting the UK achieve net-zero by 2050, having developed its own Roadmap 2035¹ in 2019 and emission reduction targets for the sector in 2020². We welcome the recognition from BEIS on the need for a tripartite relationship in decarbonising the UK including the publication of the North Sea Transition Deal³ delivered in partnership with BEIS and the Industrial Decarbonisation Strategy⁴. This ground-breaking deal is a commitment from both industry and government that will ensure the UK achieves their net-zero future. To achieve this, it will require building on the deal with appropriate and integrated policies to fully unlock the potential of the North Sea Transition. This includes avoiding deindustrialisation and offshoring of activity through premature decommissioning of assets or forgone development opportunities that will be key in supporting the UK's energy needs. A fit for purpose R&D regime will ensure the UK continues to attract the necessary inward investment to scale critical low-carbon technologies such as electrification, CCUS and hydrogen. We welcome the focus the UK has put on scaling R&D investment to 2.4% by 2027 and see this as a key enabler on embracing the UK's energy transition.

The UK R&D regime has been pivotal in stimulating investment in new technologies and has been highly successful since its inception in 2000. R&D expenditure has several direct, indirect, and induced benefits for companies, regions, and the UK in general. The coupling impact of expenditure and innovation will be key in scaling up low-carbon technologies and creates the opportunity for the UK to be an international leader in innovation. To be successful in this, the regime must continue to integrate with wider UK policy and ensure that the regime remains flexible enough to respond to the UK's needs. An example of this would be the ability for companies to continue to utilise both funding and R&D regimes, in tandem, to support investment and innovation into processes.

¹ <https://roadmap2035.co.uk/>

² <https://oilandgasuk.co.uk/product/production-emissions-targets-report/>

³ <https://oilandgasuk.co.uk/nstd/>

⁴ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/970229/Industrial_Decarbonisation_Strategy_March_2021.pdf



For the oil and gas sector, the R&D regime has a differing level of importance for companies across the sector but one which has been key in promoting innovation in both traditional O&G operations and in a low-carbon context. At present, the O&G sector including their supply chain accounts for <1% of the total R&D expenditure in the UK. However, to achieve the potential of the transition deal and net zero, we need to significantly scale our low carbon technologies. This will require attracting funding and investment to support innovation along with promoting the UK as a place to do business. We welcome this review of the efficiency of the current R&D regime along with the wider ongoing conversation around simplifying the channels for accessing R&D and innovation funding. The UK must continue to offer a bespoke R&D tax relief that allows companies of all size to capture and offset risk for the benefit of innovation.

Our response to selected questions highlights the importance that an efficient R&D regime has in supporting the drive to net-zero, on both a UK economy wide level and within the low-carbon energy sector. At the same time, government must continue to ensure that any intervention continues to be driven by the need to correct market failures and to minimise distortions of competition both within the UK and with trading partners. This will be achieved by a fit-for-purpose and predictable R&D regime that ensures companies are able to make the necessary economic assumptions and planning.

We trust you find our response useful and look forward to engaging in further detail on the points raised below.

OGUK Sustainability
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Response to Questions:

Question 1: Do you consider yourself to be a research-intensive firm? How does your business benefit from the R&D reliefs (e.g. cashflow, 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?

Research and development (R&D) have an important role to play within the sector but is to be seen as a means to an end as is the case across other sectors of the economy. The sector makes up less than 1% of total R&D expenditure⁵ in the UK due to much of the sector's R&D activity contained within operator's global balance sheets. However, the commitment from companies to R&D and overcoming challenges has been intrinsic in the scaling and success of the North Sea. We have a diverse ecosystem of companies within our sector who utilises both regimes to offset their risk as appropriate. This has been key in supporting innovation across both our operators and the breadth of our supply chain. Our SME's companies are an integral part of the sector and one which relies on the support of the current SME regime to continue to provide tangible benefits to the O&G industry.

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?

OGUK recognise the need for simplicity and to minimise burden, however there are contrasting needs for both SMEs and larger companies. Retaining two separate regimes ensures risk can be captured and mitigated to suit business models efficiently across the economy. Therefore, we strongly encourage the government to continue to recognise the needs of both parts of the economy when considering reforms to the R&D regime and recognise that retaining a separate R&D regime for SME's (albeit reformed for the current environment) is critical.

The SME regime is bespoke and one which has allowed companies to be incentivised and supported in their investment into R&D expenditure. The loss carry-back method has been particularly important in attracting start-ups to the industry on top of the benefits of enhanced corporation tax deductions. Retaining such a regime will be key in continuing to attract the talent and innovation to the sector that will be crucial in scaling low-carbon technologies.

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?

The premise of the R&D regime was to promote innovation across the UK economy, and for the O&G sector both regimes have worked in parallel over the years allowing for the whole industry to embrace and progress innovation. We strongly feel that the two regimes, whilst working coherently in our sector, should be reviewed in isolation when recognising the direct and indirect impact of the regimes. For our sector, the contrast between SME and larger companies is illustrated by which point risk of the product or technology is recognised. Additionality should not be considered in a linear function when reviewing the R&D regimes, instead we think the regimes should be considered from the

⁵ Office of National Statistics

perspective of the wider scale impact the investment has had (i.e. the support for innovation and supercharging start-ups in some instances).

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?

The oil and gas sector by nature is not solely a research and development industry, as may be the case in other sectors, and therefore investment decisions are not solely reliant on R&D relief. However, the integration between several policies including R&D relief and the ability to recognise costs does impact the investment decision. Ensuring any fiscal policy, including R&D, is implemented in a way which supports ambition and provides predictability will ensure opportunities can be fully embraced. This is increasingly important not just in the RDEC regime but also the SME regime which provides support for start-ups and inspires innovation in the UK.

[OGUK response will cover questions 5-8 as one based on the nature of our response and the position within the sector]

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?

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?

Question 7 How can the responsibilities of HMRC, agents and the company be better reflected in the claims process?

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?

OGUK acknowledge the points raised by HMT regarding the challenges in the market and claiming R&D expenditure however we strongly believe that the panacea to this is not to further increase process and information requirements. The O&G sector a highly structured and well-regulated sector well able to address R&D issues and as a result the questions raised regarding agents are not something that significantly impacts us. The regime must remain efficient and flexible and any added value additional assurance on claims could bring must be weighed against the time value of this. We strongly believe that requirements should be clear from the outset, meaning a level playing field and no one company should be treated differently from another based on the amount of information given. OGUK would support HMRC providing further literature to support companies claiming under the regimes and would encourage the reference to identification of risk to the company to be used as a signpost.

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?

The R&D regime should remain flexible and fit-for-purpose recognising that there could be an uptick in specific key growth sectors overtime such as the scaling up and overcoming of tech barriers in low carbon solutions. OGUK would encourage HMT to continue to monitor the interaction of R&D regimes with wider policy to ensure synergies can be maximised as the UK transition to net-zero.

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?

The CCC report clearly identified the scope of the investment challenge in reaching the net-zero objective. Energy sector investment is likely to roughly double from the current levels of £20- 25bn per annum to around £50bn. Securing this investment in the UK by UK-anchored companies will require developing fiscal instruments that provide some protection in which investment in these technologies becomes incentivised. The HM Treasury interim report on net zero identified several market failures that could prevent investment from reaching the required levels across a range of different technologies.

The wider range of market failures are specifically associated to new and emerging sectors and as a result it is important that multiple policy levers are coordinated. This will be key to overcome the challenges of early-stage technology development for the like of CCUS and Hydrogen deployment and in fuel switching to low carbon energy supply. Ensuring early engagement in these technologies will be important in mainstreaming and growing the technologies and markets which in time will minimise the needs for such protective fiscal instruments. Similar actions have been manifested in the wind sector and this has led to significant growth of the sector. The success of low carbon technologies will be critical in the UK's decarbonisation pathway and the recent publication of the government and industries "North Sea Transition Deal"⁶ sets the groundwork and commitment to achieving this.

OGUK welcome the recognition from HMT regarding the potential for incentivising green technologies through R&D tax reliefs. As a sector we have committed to reducing our emissions by 50% by 2030 which will require significant decarbonisation of our sector and will see us supporting other industries to decarbonise through CCS and Hydrogen etc. Decarbonisation technologies must be developed and scaled and should be considered in association with existing low-carbon technologies in support of the transition. We strongly believe that the current ratio between research and development in terms of expenditure must be overcome to ensure core decarbonisation and other low-carbon technologies reach commercialisation. OGUK recognise that a range of innovative technologies, that could be crucial for decarbonisation, will struggle to mature to commercialisation with many ideas failing to progress through the middle Technology Readiness levels⁷. OGUK would be keen to engage with HMT in the long term how the balance between R&D expenditure could be optimised to promote effective development strategies, including supercharging development expenditure for the benefit of scaling innovative ideas to the point of commercialisation.

⁶ <https://oilandgasuk.co.uk/nstd/>

⁷ https://ec.europa.eu/research/participants/data/ref/h2020/wp/2014_2015/annexes/h2020-wp1415-annex-g-trl_en.pdf

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?

OGUK recognises the contrast in R&D expenditure across the UK with some areas traditionally having higher spend, such as the South East of England on account of the industries present. The scaling of R&D expenditure in the UK should be seen as an economy-wide uptick and any reformations to regimes must continue to support R&D activity across the whole of the UK. HMT should ensure that any revisions to the R&D regime compliment wider policy work.

Question 12 Are there any other areas of qualifying expenditure that should be included within the reliefs? How would this influence your investment decisions?

We would encourage HMT and HMRC to continue to review and monitor the R&D trends in the UK as we scale up towards 2027 goals and the regime should remain flexible enough to respond as appropriate. Changes to qualifying reliefs needs to be in line with the direction of travel of the UK and provide companies with predictability and stability to support investment decisions.

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?

Due to the UK O&G sector's upstream activities and intra-commercial models, expenditure on technical advances often form part of a capital project meaning the expenditure is capitalised and is not allowable as R&D relief. There would be a significant benefit, particularly to low carbon technologies, in the instance where R&D relief was allowable in relation to capital expenditure. This would enable companies to claim R&D incentives on their R&D capital expenditure, regardless of accounting treatment, and could be a key lever in achieving the 2.4% R&D target by 2027 in the UK through utilising the regime.

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?

OGUK do not believe that HMRC should have control over defining where R&D should take place. The growth of R&D, particularly in low carbon technologies, has both a direct, indirect, and induced impact on achieving the UK's net zero ambitions and that promoting the UK should remain the priority. There are number of examples whereby technologies have been developed overseas, sometimes as part of a consortium, and then brought to the UK market that have been of significant benefit.

Question 16 How could the government distinguish between work that needs to take place abroad and which benefits the UK, and that which does not?

As noted above, OGUK do not believe that HMRC should have control over defining where R&D should take place. The growth of R&D, particularly in low carbon technologies, has both a direct, indirect, and induced impact on the UK's ability to scale these technologies in the race to net zero and that promoting the UK should remain the priority. There are number of examples whereby technologies have been developed overseas, sometimes as part of a consortium, and then brought to the UK market that have been of significant benefit.

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?

We would encourage HMT and HMRC to continue to review and monitor the R&D trends in the UK as we scale up towards 2027 and ensure the regime remains flexible enough to respond as appropriate. As noted above, we believe strongly that the panacea to scaling R&D expenditure is not to create additional burden or process and would encourage HMRC to review the balance between process and value add. As noted above, any requirements implemented should be clear from the outset meaning a level playing field is achieved.