

Sage Budget 2021 representation, 29 January 2021 update

Sage sets out below how to back the UK's SMEs to drive the post-Covid economic recovery and resolve the UK's long-term productivity challenges.

An earlier version of this document was submitted into the Budget 2021 call for representations through the HMT portal on 14th January 2021. This updated submission includes added detail of the indicative benefits/costs of the proposed policy, along with additional edits to summarise the initial submission.

Technology adoption by SMEs has played and is playing a critical role in economic output in the midst of the crisis, as well as helping to establish longer term productivity gains. Technology has been a lifeline to help businesses to continue to adapt and stay resilient and is set to play a critical role in driving a strong, sustainable recovery.

Our submission presents detail of a proposed tax incentive to support SMEs to fulfil their desire to adopt new technology faced with such challenging circumstances. This is based around the concept of introducing an incentive to allow 200% of the upfront and subscription costs of new technology by an SMEs or entrepreneur to be tax deductible, up to a cap of £4000 in additional relief. The productivity benefits, economic growth and additional job creation that would result from the increased technology adoption stimulated by this incentive would result in a positive effect on fiscal revenues.

If the Chancellor was to introduce this incentive, indicative modelling shows from April 2021 we would see the following benefits over a year:

- £22.3bn in additional SME revenue
- £10.5bn uplift in economic output as a result of improved productivity
- 187,000 additional jobs created
- £290m net fiscal revenue

According to analysis by Capital Economics, the fiscal benefits of this added economic activity would return £1.68bn to HMT, against a total of £1.4bn in policy and administration costs, providing a positive net fiscal impact of £290m¹.

1) The need for financial incentives for tech adoption

As the UK Government looks ahead to 2021 and the potential for a post-pandemic recovery, HM Treasury must be laser focused on supporting SMEs and prioritise policies that will enable them to return to growth. The lessons of past economic crises show us the importance of ensuring that recoveries are SME-led. After the 2008 financial crisis, from 2010 onwards the vast majority of job growth came from SMEs, who accounted for the creation of 73% of new private sector jobs².

While the last 12 months have undoubtedly been incredibly tough for SMEs, the impacts of COVID-19 have caused a profound shift in the attitudes of UK small business. As we look tentatively towards economic recovery in 2021, these behavioural shifts provide some positive trends that HMT can harness to swiftly return the economy to growth. This is particularly noticeable when looking at SME technology adoption.

¹ Analysis conducted by Capital Economics for Sage, see section 2 for details and Appendix I for methodology

² Sage & Nesta, 2016, <http://stateofsmallbiz.com/>

Coming into the crisis, just 20% of SMEs said their processes had been fully digitised and just half of businesses said that investing in technology was a priority³. After 6 months of responding to the pandemic, this landscape had dramatically shifted, with 73% of businesses saying they had adopted new technology⁴. While this shows a remarkable transition in SME behaviour, these businesses are also clear that they need to further digitise their business to ensure they are match-fit for the post-pandemic economy.

According to Sage polling of SME leaders in 2020, two-thirds of SMEs said they want to invest more in technology⁵.

But while the desire is there for SMEs to invest in tech, help is needed to unlock that investment. 6 in 10 SMEs say they currently do not have the ability to invest at the level they need⁶ and only 41% of planned investment stood to be realised.

If HM Treasury acts to help support businesses and entrepreneurs to make these critical investments and capitalise on the unprecedented interest in tech adoption, there is the potential to achieve a step change in the levels of digitisation by UK SMEs. The below section outlines the significant economic benefits that would be derived from backing an SME tech-driven recovery.

2) Benefits of incentivising tech adoption

When polled in September 2020, nearly 9 in 10 SMEs said that if the Government introduced financial incentives to help their business adopt new technology⁷, it would be beneficial for helping them improve their performance.

When asked of their preferred incentive to help them adopt digital tools, an enhanced tax incentive through a 200% deduction of new tech expenditure was the most popular. 37% of SMEs preferred this potential measure, compared to 36% for digital vouchers, 16% free skills training and 11% a grant of £1000 to spend on tech⁸.

The above responses and additional engagement with stakeholders led Sage to narrow our analysis to focus on the potential introduction of a tax incentive. This proposed measure clearly resonated with SMEs and has many benefits of ease of administration and access (see section 3).

The below table presents some indicative economic analysis of this potential tax incentive, which has been produced for Sage by Capital Economics. The analysis is based on the concept of self-employed individuals and SMEs being able to write off 200% of their expenditure on new technology from their annual tax bill, up to a cap of £4000 in additional tax relief (using the precedent of the current Employment Allowance).

This indicative analysis shows the incentive would be fiscally positive to the Treasury, returning £1.68bn in fiscal benefits when compared to £1.4bn in policy costs⁹.

³ Polling for Sage, 500 decision makers in UK SMEs, fieldwork conducted 26/05/2020 to 27/05/2020

⁴ Polling for Sage, 1011 decision makers in UK SMEs, fieldwork conducted 01/09/20 to 04/09/20

⁵ ibid

⁶ Polling for Sage, 662 decision makers in UK SMEs, fieldwork conducted 29/11/20 to 01/12/20

⁷ Polling for Sage, 1011 decision makers in UK SMEs, fieldwork conducted 01/09/20 to 04/09/20

⁸ ibid

⁹ Full methodology from Capital Economics provided in Appendix I

A full breakdown of the increases to business revenue, productivity and employment can be found below. The table sets out the benefits and fiscal costs over one year.

Area of analysis	Total indicative impact of tax incentive policy with cap of £4,000
Economic benefits	
<i>Additional business revenue (£m)</i>	22,300
<i>Gross value added (£m)</i>	10,500
<i>Additional employees hired (thousand)</i>	187
Fiscal benefits from additional activity (£m)	1,680
<i>Employee taxes</i>	830
<i>Value added tax</i>	730
<i>Corporation tax/income tax</i>	120
Fiscal costs (£m)	1,400
<i>Policy costs</i>	1,120
<i>Administration costs</i>	280
Net fiscal cost (£m)	290

The benefits and returns outlined above are calculated based on the projected increase in technology adoption from SMEs that would result from the introduction of this proposed tax incentive. The projected gains across increased SME revenue, productivity (GVA) and job growth present strong evidence that a targeted tax incentive for new technology adoption would both be a very effective policy to spur post-pandemic growth and would provide value for money to the taxpayer.

The fiscal costs of the programme could be reduced by lowering the cap of additional relief or narrowing the eligibility to a sub-group of SMEs or self-employed individuals. However, it is fair to assume that narrowing the scope and availability of the incentive would also risk reducing the number of businesses or entrepreneurs who would benefit from the scheme.

A full methodology for the economic modelling presented is included in the Appendix.

3) Why a tax incentive is an effective mechanism to boost digital adoption

There have been many suggestions of ways to improve the take-up of digital tools by SMEs. However, in this section, we outline why a tax incentive as outlined above has several delivery benefits:

- **Simplicity of administration for Government:**
 - This could be administered by HMRC simply adding in an additional box into the existing tax return forms. To make this nudge clear to an SME, the box could be titled along the lines of “software or other productivity enhancing technology at 200% allowance”.
 - By linking this to the existing business tax process, HMRC provides the benefit at the end of the tax year without the need to process direct payments to businesses (unlike vouchers or grants). Many businesses will also have been paying VAT on the subscriptions to the Exchequer before accessing the benefit in their tax return.
- **Simplicity of access for SMEs:**
 - This proposed incentive fits seamlessly into existing business tax processes. This means it is clear and easy for a business to access, without admin burdens that create barriers to access and limit take up.

- **Only available once a business is using tech:**
 - It would also ensure that SMEs only receive a benefit when they have actually adopted the technology and have implemented it into their business.
- **Leveraging professional adviser:**
 - It is well known accountants are the most trusted advisers to businesses. By linking technology adoption incentives to the tax system, this will naturally create advocates for the scheme in the accountant community. These accountants will act as an additional nudge and adviser to encourage businesses to adopt tech, helping to deliver the behaviour change at scale

4) How an enhanced tax incentive for digital adoption would work.

In this section, we outline in more detail our thoughts on how this incentive would operate in practice. In order to provide a clear nudge to encourage and support technology adoption at scale, a financial incentive would have to meet the following criteria:

- Be simple for an SME or entrepreneur to understand and access, so the scheme is taken up and delivers an impact at scale.
- Be easily deliverable by Government, to reduce the administration burden.
- Provide enough flexibility for the SME or entrepreneur to identify the appropriate technology that will improve their business performance.
- Encourage new digital adoption within a business, rather than reduce the cost of existing use of tech.
- Criteria would need to be set to make sure the incentive was appropriately targeted to SMEs, without creating such a compliance burden that would deter uptake.

Below we have outlined how an enhanced tax incentive could work operationally to meet these principles:

- 200% of the upfront and subscription costs of new technology by an SMEs or entrepreneur could be permitted to be tax deductible in their annual tax bill. To ensure simplicity of both administration by Government and access to the scheme by SMEs, the tax incentive could be delivered by simply adding an additional box in a business' annual tax return.
- HMT could set an upper limit on the level of the enhanced deduction to provide certainty of expenditure. For example, using existing precedent, the digital adoption incentive could be set at a similar level to the Employment Allowance and permit a maximum additional deduction from a tax bill of £4,000.
- To incentivise intended behaviours, clear and simple criteria would need to be set by Government. For example, using the same legal test as allowable business expenses, this could be defined as "any new subscription software or other productivity enhancing technology that is necessary for your business". The business or entrepreneur could only claim this incentive on technology that had been newly adopted.
- To target the scheme directly to SMEs without creating complexity, the tax incentive could be limited to businesses with a taxable turnover below the threshold of a medium-sized business, currently identified by UK Government at £36m.
- Similarly, for self-employed entrepreneurs looking to access this incentive, the enhanced deduction could be limited to providing benefit at a level calculated at the basic rate (20%).

APPENDIX I – Full methodology of Capital Economics economic modelling of proposed tax incentive for digital adoption

- *To note, the below methodology was written by Capital Economics and provided to Sage on 21st January 2021*

Methodology

We have conducted some indicative modelling on the impact of a policy to incentivise investment in digital technology by UK SMEs. The policy proposal is that SMEs would be able to claim a reduction against their tax bill of 200% of the value of the upfront and subscription costs.

The survey

- A survey of 1,000 UK SMEs was conducted by Portland Communications in 2020; SMEs were asked about their need for investment in digital technology. They were asked:

a) The amount they need to invest in digital technology over the next year, ignoring any budget constraints

b) The amount of the investment in digital technology that they currently plan to invest over the next year without any support

c) The amount of the investment in digital technology that they would invest with the following policy in place 'When adopting a new technology, SMEs would be able to claim a reduction against their tax bill of 200% of the value of the upfront and subscription costs'

- The SMEs were asked about the impact of the investment in digital technology on their business if it were to happen. They were asked to estimate:

a) The amount of time that would be saved

b) Increase in revenue

c) Increase in employees

d) Increase in profits

- The SMEs were asked whether they would take up the policy if it were introduced

Scaling

- In order to scale the results from the survey to the whole economy we used publicly available statistics to estimate the number of businesses, employment and gross value added in business size categories based on number of employees: 1, 2-9, 10-49, 50-99 and 100-249
- We used BEIS' Business Population Estimates for employment and the number of businesses
- We used the OECD's Structural Business Statistics to estimate the split of GVA between the size categories and scaled to the total GVA from the Office for National Statistics

Economic impact calculations

- First, for each business size category, we estimated the increase in GVA if all SMEs invested the total amount that they said needed to. We did this by using results from the survey on the % of hours saved and applying this to total UK GVA. Second, we aggregated the survey

results to determine the difference between the amount companies would invest in digital technology anyway and the amount they would invest with the policy in place for each business size category.

- **GVA:** For each business size category we multiplied the average additional investment as a share of total investment needed by the % of businesses that said they would use the policy and the total GVA benefit estimated if all investment was made
- **Revenue:** We applied the ratio of revenue to GVA nationally to our GVA benefit estimate
- **Employment:** We applied the ratio of GVA per employee nationally to our GVA benefit estimate

Fiscal calculations

- **Employee taxes:** We used a tax calculator to estimate the income tax and national insurance generated on the median UK income and applied this to our estimate of the increased employment as a result of the policy
- **Corporate tax:** We applied a 19% tax rate to our estimate of the increase in profit as a result of the policy, which was based on results from the survey
- **Value added tax:** We estimated VAT revenue per pound of GVA by dividing total UK VAT revenue by total UK GVA and applied this to our estimate of GVA benefit
- **Policy cost:** We have estimated the cost of the policy by multiplying the number of businesses that said they would take it up by the average cost per business in each size category. The average cost was estimated by assessing the cost for each business, capped at £4,000 where applicable, and averaged across the sample

Example cost per business: Business X will invest £6,000 extra with the policy in place. Business X can write off 200% of the value against tax. This means the government funds the corporation tax at 19% of £12,000 investment, which equates to £2,280

- **Administration cost:** We have assumed administration costs of 25% of the policy cost
- **Net fiscal cost:** The policy and administration costs are subtracted from the tax revenue generated

Caveats

- These are indicative estimates.
- The survey question that asked about the amount companies would invest with the policy in place did not explicitly mention a limit to the funding the government would provide, which could have led to overestimates. In the same survey, businesses were asked the same questions in relation to two other policies which explicitly stated limits of £3,000 and £5,000. Given the responses did not differ markedly between the policies, we have assumed that the answers would not have differed significantly had a £4,000 cap been explicit.
- The survey did not include the self-employed: we have used the answers from one employee businesses as a proxy.

APPENDIX II

About Sage

Sage is a FTSE 100 tech company and the global market leader for software that provides small and medium businesses (SMEs) with the visibility, flexibility, and efficiency to manage finances, operations, and people. This technology includes integrated accounting, payroll and HR native cloud systems, as well as on-premise and connected cloud.

We are passionate supporters of the UK's small and medium sized business community. Our 2,500 Sage colleagues in the UK support over 1 million SMEs through our products, partners, and advice.