Autumn Statement 2023 – Representations

Sage's submission to HM Treasury's call for representations

Summary

As the UK's largest FTSE 100 tech company, founded and headquartered in the North East, Sage welcomes the opportunity to submit its representations to HM Treasury ahead of the Autumn Statement 2023.

Sage is proud to be a British-listed company, operating in one of the most dynamic, entrepreneurial economies in the world. But we are becoming increasingly concerned that the UK is falling behind other nations when it comes to policy to enable digitisation of our economy and as a result, will lose out on growth and investment opportunities. The UK unlike many other OECD countries does not have incentives in place to drive up tech adoption nor policies to support a connected economy through e-invoicing. This risks SMEs falling behind their global competitors on digitisation, sustainability, and productivity levels, leaving significant obstacles to higher economic growth.

In summary our recommendations are:

- A year-long **enhanced deduction of 140% for software services for SMBs** using a similar model to Australia. This equates to an additional 40% deduction versus standard business expenditure.
- A **public consultation on modernising our VAT Invoicing and Reporting System** to enable SMBs to benefit from faster payment and HMRC to have access to real time, accurate data. This would prevent the UK falling behind other OECD countries.

If the UK is to achieve its ambition of becoming a tech superpower, it must confront this challenge. As set out in our Blueprint for Digital-led Growth, Sage believes the Government should support investment in digitalisation by offering enhanced tax reliefs for expenditure on productivity enhancing digital services. We recommend a year-long enhanced deduction of 140% on the first £50,000 of qualifying expenditure which equates to an additional 40% deduction versus standard business expenditure. This will help scale tech adoption and help SMBs overcome financial barriers to digitalisation needed to harness emerging technology, such as AI, to become more productive and grow sustainably. At a cost of around £200 million, this has the potential to unlock an additional £232 billion per annum for the British economy, position the UK in line with other OECD countries, and put us back on a competitive front foot.

As we set out in more detail below, widespread adoption of digital technology could additionally be achieved through the mandation of e-invoicing for B2B transactions which is currently rolling out across the EU.

About Sage

Sage exists to knock down barriers so everyone can thrive, starting with the millions of small and mid-sized businesses served by us, our partners and accountants. Customers trust our finance, HR and payroll software to make work and money flow. By digitising business processes and relationships with customers, suppliers and employees, banks and governments, our digital network connects SMBs, removing friction and delivering insights.

Knocking down barriers also means we use our time, digital tech and expertise to tackle digital inequality, economic inequality and the climate crisis.

Challenge: UK SMBs are under-adopters of digital technology, which is holding back growth

The UK has one of the most dynamic and entrepreneurial economies in the world where SMBs are drivers of innovation. However, the pace of tech innovation and recent advances in AI will create huge opportunities to rapidly digitise and fundamentally reduce the complexity of setting up and running a business. Making up 99.9% of British businesses[1], SMBs are central to maintaining the UK's economic standing. However, to remain competitive in the 21st century, British businesses need to transform their operating environments through digitalisation, a process that is revolutionising economies around the world. If businesses in the UK are not supported to digitalise, we will continue to fall behind our competitors on productivity gains and economic growth, and we will spend the decades ahead struggling to make up lost ground.

A long-standing obstacle to growth, the UK's stagnant productivity levels exist because we have not scaled digital adoption in line with the wider international community. To illustrate this, a 2021 report by the Enterprise Research Centre (ERC) found that 25% of SMBs in the UK do not use basic tools such as e-commerce or accounting and HR software[2]. Our Digital Britain report, published in June 2022, also showed that the UK is still underperforming when it comes to use of digital technologies by SMBs. For example, only 35% use a CRM system and only 42% use payments software.[3]

British SMBs recognise this challenge and want to invest more in digital technology. Sage research, conducted in February 2023, found that technology is seen by SMBs as a key factor in future business success, with 92% of businesses wanting to maintain or increase their levels of tech investment.[4] Over the next three years, British SMBs are in fact *more* likely to want to adopt emerging technologies than any other country.[5] However, rising overheads, inflationary pressures, and low cash balances mean that they are not in a strong position to do so. They expect only a modest increase of 13% in tech investment, lower than the European average of 18%[6].

Sage therefore believes it is critical that the Government takes decisive steps to increase digital adoption to fully unlock the potential of British SMBs and accelerate growth to the tune of £232 billion extra per annum.[7] With the Global Investment Summit fast approaching, there is a golden opportunity to ensure that the UK does not lose momentum around tech adoption, needed to drive investment. This is crucial if we are to remain competitive and in

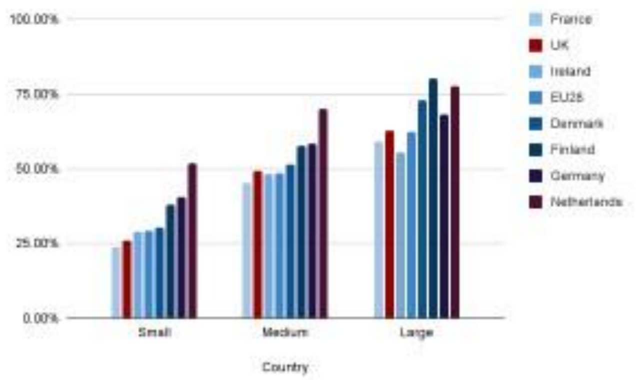
[1] https://www.sage.com/master/-/media/files/company/documents/pdf/digital-newsroom/smbs-driving-economic-recovery-report-jan-2023.pdf
[2] https://www.enterpriseresearch.ac.uk/publications/digital-readiness-digital-adoption-and-digitalisation-of-uk-smes-amidst-the-covid-19-crisis/
[3] https://www.sage.com/investors/investor-downloads/press-releases/2022/06/untapped-tech-adoption-could-boost-uk-economy-by-232-billion-annually/
[4] https://www.sage.com/en-gb/company/digital-newsroom/2023/05/05/small-business-big-opportunity/
[5] https://www.sage.com/en-gb/blog/small-business-big-opportunity-round-up-2023/
[6] https://www.sage.com/investors/investor-downloads/press-releases/2022/06/untapped-tech-adoption-could-boost-uk-economy-by-232-billion-annually/
[7] https://www.sage.com/investors/investor-downloads/press-releases/2022/06/untapped-tech-adoption-could-boost-uk-economy-by232-billion-annually/

line with other OECD countries. The digital economy is the key growth sector and will help to deliver a new generation of enterprise, tech start-ups and innovation.

UK Adoption of CRM and ERP compared with the EU

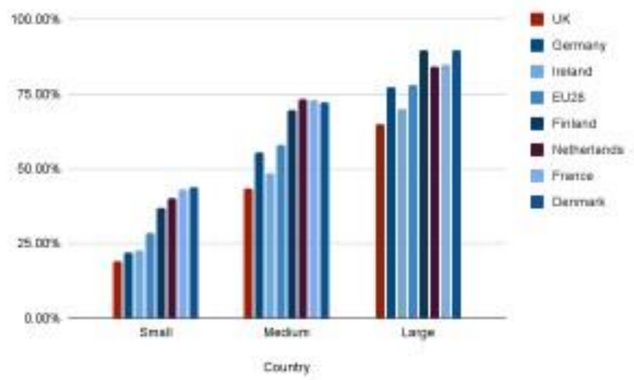
The UK is consistently below key European comparators for both ERP and CRM software. This is particularly true for ERP softwa re.

Figure 7: Businesses using CRM Software by size 2019 (%)



Source: OECD, ICT Access and Usage by Businesses, 2019

Figure 8: Businesses using ERP Software by size 2019 (%)



Source: OECD, ICT Access and Usage by Businesses, 2019

Solution: Introduce a tax incentive to increase SMB digitalisation
For SMBs to overcome the obstacles described above, the Government should introduce a tax incentive to encourage investment in digital technology. Previous and existing schemes demonstrate that the Government acknowledges the need for support, but past solutions did not lead to the desired outcomes. By working with tax experts, we have developed a practical proposal to incentivise investment in digitalisation by using the tax system.

The benefits that digitalisation will bring to productivity and growth are well-established. The Enterprise Research Centre (ERC) found that three years after adopting digital tools, productivity increased when measured via sales per employee. Customer Relationship Management (CRM) systems were found to boost growth by 18%, and Digital Accounting and e-commerce software improved sales by 11.8% and 7.5% respectively over three years[8]. Research by the OECD in 2019 also demonstrated that Enterprise Resource Planning (ERP), Cloud Computing, and CRM software led to annual productivity increases in firms with more than 10 employees[9].

Burgeoning technologies such as Generative AI have also been shown to increase productivity at work by 14%[10]. However, recently published research from Be the Business shows that while

8 https://www.enterpriseresearch.ac.uk/publications/state-small-business-britain-report-2018/
9 https://www.oecd-ilibrary.org/economics/oecd-economic-outlook-volume-2019-issue-1_5713bd7d-en
10 https://www.nber.org/papers/w31161

British companies put significant importance on management and technology adoption, we invest less than our G7 counterparts[11]. Falling behind on digital adoption means falling behind on AI deployment and prevents the Government from achieving its ambition of becoming a global leader in AI.

Previous and existing digitalisation incentive schemes, such as the Annual Investment Allowance, R&D tax credits, and the Help to Grow: Digital scheme are poorly targeted and fail to effectively incentivise digital adoption. This is because the types of spending covered did not and does not align with relevant software categories or have since been withdrawn as is the case with Help to Grow: Digital. Further, Sage believes that voucher schemes such as Help to Grow: Digital are not an effective method for incentivising digital investment in general, due to unnecessary complexities and the low level of take-up. The cancellation of Help to Grow: Digital therefore paves the way for a more flexible intervention that can have a greater impact.

In the months ahead, we believe that the Government must ensure its tax policy is designed to stimulate investment in technology, needed to maintain the UK's competitiveness.

Implementation: UK Small Business Digital Growth Allowance

Sage believes that the UK should learn from how our international partners who have successfully implemented technology investment schemes. As part of its 2022-23 budget, the Australian Government introduced the Small Business Technology Investment Boost, aimed at increasing productivity and digital uptake of SMBs[12]. Under the scheme, Australian SMBs can deduct 120% of the cost from digital adoption, capped at $100,000 and limited to 1 year. With a 25% corporation tax rate, this is effectively 5% cashback and is estimated to cost $1 billion over 3 years (~£570 million). Qualifying expenditure includes digitally enabling items like software, systems and services for computer networks, digital media, and e-commerce.

To scale digital adoption in the UK, Sage believes that the Government should emulate Australia's approach and introduce a UK Small Business Digital Growth Allowance. For a limited time only, Sage envisages this scheme providing British small and micro businesses with the opportunity to claim an additional deduction against their Corporation Tax bill for qualifying productivity-enhancing software expenditure, with a cap per company. This would be simple for both businesses and the Government to administer, as it would only require information on a business' tax return mostly completed by accountants.

To fit within a spending envelope of around £200m, Sage recommends the incentive be targeted at where it will have the greatest impact. We therefore recommend targeting such an incentive at small and micro businesses (less than or equal to €10 million turnover). This is because it is those businesses who are the greatest under-adopters of digital tools and therefore would benefit most. Ultimately, it would be for HMT to design the scheme and set the criteria, but we recommend the expenditure in scope should cover productivity-enhancing software applications, for example, CRM, E-commerce, ERP, Payroll, and Financial Management software. Sage recommends that small and micro businesses should be able to claim an enhanced deduction of 140% against their Corporation Tax bill on the first £50,000

[11] https://www.bethebusiness.com/our-thinking/be-the-business-g7-sme-productive-business-index/#:~:text=The%20G7%20Productive%20Business%20Index,in%20capabilities%20linked%20to%20productivity.
[12] https://www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-for-businesses/Small-Business-Technology-Investment-Boost-and-Small-Business-Skills-and-Training-Boost/#SmallBusinessTechnologyInvestmentBoost

of qualifying expenditure. This would be an additional 40% deduction compared to standard business expenditure. The extent of the relief will vary depending on the rate of Corporation Tax paid by the claimant. Assuming a rate of 25%, this additional 40% deduction is worth 10% of the purchase cost. We firmly believe that this type of intervention will provide a needed boost at a time when increasing growth and business productivity is vital, particularly to help reduce inflation and prevent the UK falling behind other hi-tech nations. It also has the potential to unlock £232 billion extra in GVA per annum.

Cost to HM Treasury

Over the past year, Sage has conducted in-depth research to consider the correct scope for a digital investment incentive. This has included exploring which businesses should be in scope, what expenditure should be in scope, the extent of the relief, and the corresponding estimated cost.

By working with tax experts, our cost modelling is based on the Digital Economy Survey 2021, published by the Office of National Statistics (ONS) and the International Data Corporation's (IDC) semi-annual software tracker. The ONS provides the estimated value of expenditure on purchasing software for 2021 at £25.2 billion. To ensure our estimates are up to date, we have assumed an average growth rate for the software market of 12.37%, leading to an estimated value of £28.3 billion for 2022. We have then applied the expenditure shares across software functional markets based on IDC data, which tracks software revenue across vendors and markets. IDC estimates subdivide this market into three primary markets:

- **Applications.** This includes commercial, industrial, and technical programmes and codesets for purchase. For example, CRM, ERP, and financial software (52% of total expenditure, with an estimated worth of £14.8 billion in 2022).

- **Application Development & Deployment.** This represents software used primarily by developers to build, test, and deploy software (23% of total expenditure, with an estimated worth of £6.5 billion in 2022).

- **Systems Infrastructure Software**. This includes specialised infrastructure to host and enable higher-level software (25% of total expenditure, with an estimated worth of £7 billion in 2022).

As the goal of the incentive is to increase the digitalisation of British SMBs, Sage has selected the £14.8 billion 'Applications' market as the baseline for costing the policy.

Adjusting for small and micro expenditure

Our proposed incentive is targeted towards the UK's small and micro businesses. As such, an estimate of their share of this revenue is needed. We have used data sourced from the IBIS UK Industry Report as the basis for our estimate[13]. Spending is broken down by company size for the UK and suggests that small business spending represents 15.3% of the market revenue creating an estimate of £2.26 billion.

Indicative scenarios developed by UK-based, IT-focused businesses show that an average small business with 40 employees could spend approximately £2,000-£3,000 monthly

[13] https://www.ibisworld.com/united-kingdom/market-research-reports/software-publishing-industry/

(£24,000-£36,000 annually) on software and IT services. We acknowledge that average spending across certain sectors might vary. For example, Barclays Business Barometer indicates that the most innovative UK SMBs spend up to 48% of annual revenue on technology[14]. To capture these facts in our estimates, we assume that a cap of £50,000 would maximise the ability to capture a vast majority of small business spending, excluding c. 5% of eligible small businesses' spending. The application of such a cap leads us to an eligible spend estimate of c. £2.15 billion.

We have used total small business turnover as a proxy indicator to estimate the effect of limiting the incentive to businesses subject to Corporation Tax. According to the BEIS 2022 Business population estimates for the UK and regions[15], 16.5% of small and micro businesses' turnover is derived from partnerships and sole proprietorships. Therefore, restricting the incentive in this way could reduce eligible small business spending by approximately 15-20%, leading to an estimate of eligible spend of c. £1.79 billion.

At a relief rate of 10%, £1.79 billion of expenditure would cost c. £180 million, prior to any behaviour adjustment.

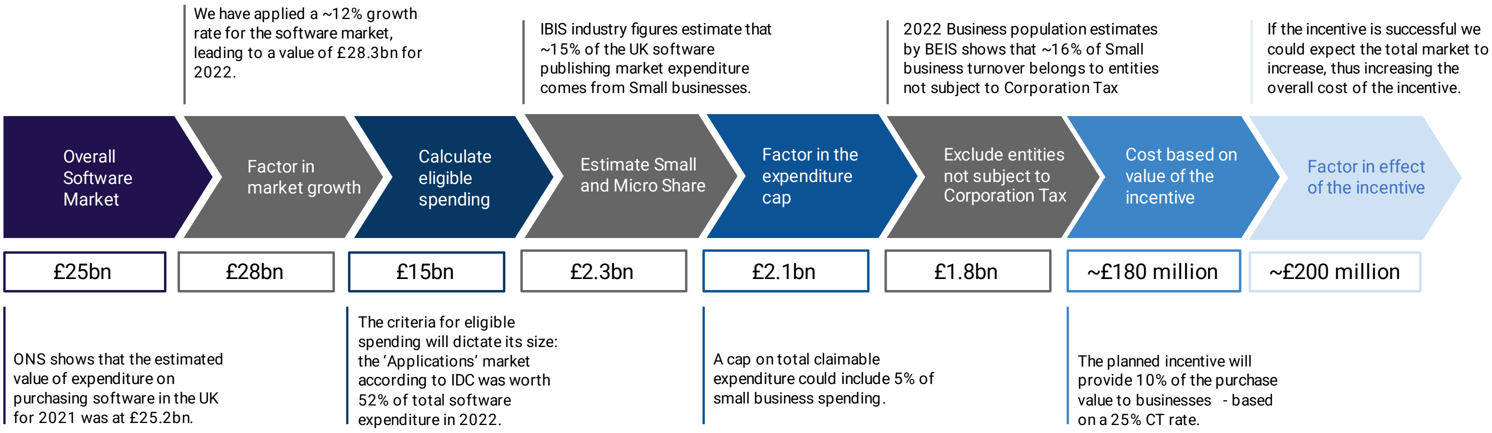
Adjusting for behaviour change

As the incentive is designed to increase spending on digitalisation, we also need to factor in an increase as a behavioural response to the incentive. As medium spending is capped, this behavioural response only needs to be factored into the calculations for small businesses. While this can be difficult to estimate, 7-15% serves as a sound guideline. Incorporating this gives us an overall cost in the region of £190-205 million for a one-off year-long tax incentive.

[14] https://home.barclays/news/press-releases/2023/08/small-businesses-could-hire-3-5-million-this-quarter/#:~:text=Ramping%20up%20innovation&text=To%20accomplish%20this%2C%20SMEs%20are,their%20annual%20revenue%20to%20technology.

[15] https://www.gov.uk/government/statistics/business-population-estimates-2022/business-population-estimates-for-the-uk-and-regions-2022-statistical-release-html#:~:text=common%20legal%20form.-,At%20the%20start%20of%202022%3A,proprietorships%20and%2095%2C000%20ordinary%20partnerships

Small Business-focused Incentive



The Small Business-focused Incentive uses revised IDC's 2022 figures, ONS data and IBIS data.

This option:
- Provides an incentive of 10% of purchase value;
- Caps eligible spend at £50,000;
- Is open to Small and Micro businesses only;
- Is offered to entities subject to Corporation Tax

Small and medium -sized enterprises as defined by the UK Government.
Note: Medium definition in accordance with the Research and Development (R&D) tax relief.

Business size	Turnover or balance sheet total	Headcount
Medium	less than or equal to €100 million or under €86 million	less than 500
Small	less than or equal to €10 million	less than 50
Micro	less than or equal to €2 million	less than 10

Risk of fraud
Due to the following factors, we anticipate that the risk of fraud with this policy is low. This proposal has much clearer and transparent boundaries than R&D tax credits. Though the purchases can be validated the challenge is the potential ambiguity of R&D claims to qualifying expenditure which can be subjective. This policy has a spending cap and is time limited and therefore there is less money to play with reducing the risk of fraud. Regular HMRC enforcement and auditing should be able to detect any signs of fraud and take appropriate action. Where there is an agent involved being an accountant filing the tax return, they have a duty of care to mitigate fraudulent claims. Finally, if the UK Government mandated e-invoicing for B2B transactions, HMRC would be able to see transactional data from both supplier and buyer and would automatically be able to spot discrepancies to identify fraud.

Conclusion: ROI for HM Treasury
At a cost of £190-205 million, Sage's proposed UK Small Business Digital Growth Allowance has the potential to unlock an additional £232 billion per annum and unshackle the productivity challenge facing UK PLC.

While it would be a one-off relief, its benefits would be felt for decades to come with increased productivity, increased investment, and increased growth[16]. It would bring the UK in line with other OECD countries, take us one step closer to becoming a tech superpower, and ensure we are on a firm footing to compete in the 21st century.

[16] https://www.sage.com/investors/investor-downloads/press-releases/2022/06/untapped-tech-adoption-could-boost-uk-economy-by-232-billion-annually/

This submission is a window into the seismic economic prize that is on offer to the UK from increased SMB digitalisation stimulated by the right government incentive. Sage encourages the Government to seize the opportunity and looks forward to working with HM Treasury.

Driving digital adoption through e-invoicing

Widespread adoption of digital technology could additionally be achieved through the mandation of e-invoicing for B2B transactions. Across the EU, US and beyond, there has been a slow but steady increase in the use of digital technology to support invoicing and tax reporting. This is driving all sectors to adopt modern financial software to record, process and report transactions and manage payments.

Only the UK, Switzerland, and Iceland in the OECD have not publicly given a date where they will support or mandate e-invoicing for B2B transactions. Sage therefore recommends HMT follow Ireland and as part of the Autumn Statement launch a Public Consultation on how we can use digital advances to modernise the UK's VAT Invoicing and Reporting System.

In the HMT and HMRC 10-year strategy published in July 2020, the UK Government set out its intention to create a tax system fit for the 21st century which acknowledged the importance of real-time information. The Government also noted that a modern tax system allows third party software suppliers to align their systems more closely with HMRC to offer taxpayers new and innovative services.

The UK's Making Tax Digital (MTD) project was announced five years before the 10-year tax strategy. Since then, MTD has now been superseded and leading tax authorities and organisations of the world, including France, Spain, Italy, Germany, Australia, South America, Japan and the EU (ViDA) have introduced or are in the process of introducing e-invoicing, supplemented where needed by Digital Reporting Requirements. By only rolling out the MTD programme and quarterly reporting, the UK risks being left behind and unable to meet its 10-year strategy objectives, particularly on real-time information. Further, without the introduction of e-invoicing, the UK risks barriers to international trade, adversely effecting UK businesses. We therefore recommend HMRC continues initially with MTD for VAT for tax reporting and introduces a phased roll out of e-invoicing for VAT registered businesses as a separate measure.

E-invoicing would also be able to compliment MTD for Income Tax Self-Assessment (ITSA) too once applied to the self-employed as they would automatically capture real-time income and expense data so it replaces the need for quarterly reporting which would only have been estimates and would have added burden onto accountants.

Benefits of e-invoicing for SMBs and Governments

Today running a small business can be complex and time consuming with a lot of manual tasks and excess admin like chasing payments and filing taxes. Over 80% of all invoices are still delivered as a PDF in email, and SMBs waste between 10-36 days each month doing invoices. E-invoicing addresses this and plays a key role in ending 500 years of inefficiency by automating this task between businesses, meaning humans are no longer relied on to complete manual processes to enable cash and goods to move across the economy.

This system saves small businesses time and money, speeds up payments, and provides them with real-time and accurate data to help access loans. There are advantages for government too as government would have real-time visibility of the state of the economy, allowing them to better spot and prevent fraud. France is set to **gain €4.5 billion in tax revenue** through e-invoicing. On the other hand, the delay to Making Tax Digital in the UK means that HMRC won't see an extra £3.9 billion in tax revenue until 2033.

E-invoicing also leads to faster access to financial products, such as loans with more favourable rates. This is because e-invoicing provides an SME with instant and more accurate data on the status of an invoice, for example, who has paid and who requires payment on the customer and supplier side, as well as Days Sales Outstanding (DSO). This information is highly valued by banks as it offers them insights on a company's cash flow, liquidity and working capital, all of which affect the creditworthiness of a business and is required by lenders. Companies that automate their Accounts Receivable processes typically have a more favourable DSO figure, as well as better cash flow. This all results in better payment terms, lower interest rates and improved access to credit.

E-invoicing also provides a transparent record of business transactions that can integrate with accounting systems. This integration streamlines financial reporting and makes it easier for lenders to understand the financial health of a business. Having a clear picture of an SMBs financial performance increases the likelihood of obtaining loans or credit facilities.