



PREVENTING ABUSE OF THE R&D TAX RELIEF FOR SMES SECOND CONSULTATION

Issued 24 August 2020

ICAEW welcomes the opportunity to comment on the Preventing abuse of the R&D tax relief for SMEs second consultation published by HMRC on 19 March 2020, a copy of which is available from this [link](#).

This response of 24 August 2020 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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EXECUTIVE SUMMARY

1. The policy objective is to reduce the number of fraudulent claims for R&D relief, specifically those exploiting the tax repayment available under the SME scheme. In principle, ICAEW supports HMRC's efforts to tackle abuse in this sector. A number of members have expressed concerns to us about the abuse of the R & D credit system and that there appear to be a number of unscrupulous advisers in this sector, most of whom do not seem to operate within any of the professional standards and behaviours that would be expected of bona fide advisers (as we have seen with the promoters of loan schemes). It is a concern that some of this activity appears to be outright fraud and we would like to emphasise that no professional adviser should be involved in such activity – if HMRC identify cases of it then it should be reported to the professional bodies under the existing gateway.
2. More generally, the PCRT bodies have recently published a **guidance note** to support members making R & D claims. The purpose is to help ensure that our members who submit R & D claims comply with our professional standards. While we believe that this is a welcome development and demonstrates the PCRT bodies' commitment to supporting high standards, the types of 'advisers' HMRC is seeking to tackle are unlikely to read or abide by it. We should also mention that there are many highly competent firms of specialist R & D advisers who do good work – we all need to work with HMRC to drive the unscrupulous out of the R & D advice market.
3. While we understand the desire to address such claims as highlighted in the consultation, we are unclear on the extent to which imposing a blanket cap will prevent those false claims. As discussed at point 6 of our representation to the 2019 consultation (published as ICAEW REP 55/19), it is still unclear how the legislation will prevent larger volumes of lower value fraudulent claims.
4. Most members thought that the threshold for which the cap will not apply is reasonable and will greatly assist in mitigating the effect on genuine R&D businesses including start-up ventures.
5. However, it is acknowledged by all that the implementation of a threshold will not prevent certain companies who are undertaking genuine R&D activity being affected by the cap. While the inclusion of additional protection for genuine businesses to not have the cap applied is welcomed, concerns were raised around some of the criteria to meet this exemption and this is explored in more detail below.
6. Feedback around alternative measures to prevent abuse involved further compliance checks/activity by HMRC and legislation around nexus (although this is accepted to be complex). It was also suggested that it might be beneficial for certain sectors to be exempt of the cap. Members did also indicate that the information collected as part of the CT600 process to support an R&D claim is very limited and does not enable HMRC to perform a proper risk assessment. Making changes to facilitate the collection of more details about the claimants and the appropriate R&D projects could be a more effective way to identify and challenge R&D evasion without penalising compliant taxpayers through a blanket cap.
7. It is also important that HMRC has the necessary powers to review any historic claims where concerns arise in an effective and as timely manner as possible. HMRC may believe that its existing powers are sufficient in this regard but should consider whether any specific further powers need to be drafted for inclusion in the new legislation.
8. We would recommend that any threshold is regularly reviewed to ensure that it is appropriate in minimising the number of genuine R&D claims prohibited by the cap. It is essential that this threshold is set at the correct level so as to maintain the spirit of the R&D legislation in supporting companies undertaking genuine advancements in science or technology.

DETAILED RESPONSES TO THE QUESTIONS POSED IN THE CONSULTATION***Question 1: Does your business subcontract to a related party or use EPWs provided by a related party? Would it be useful to be able to include the PAYE/NICs attributable to these workers in your payable credit?***

9. It was widely agreed that this is not unusual in practice and that it would be helpful to include the relevant PAYE/NICs in the calculation of the payable tax credit.

Question 2: Would it be practical to obtain information on attributable PAYE/NICs from EPW providers in order to increase the level of your cap?

10. There was feedback that this may be more complex in larger groups, although still reasonably practical to achieve. It was also noted that significant detail would only need to be obtained where the claim was marginal and therefore would not be required in every case.
11. As noted in the previous consultation it was not understood why only PAYE attributable to workers involved in R&D could be included in relation to group companies but the total PAYE&NIC bill is permitted in relation to the stand-alone claimant company. Clearly this might limit the benefit of this measure to certain businesses and in the context of challenging fraudulent claims we would question whether the restriction needs to go this far?
12. The inclusion of group PAYE and NIC liabilities will not always reduce the impact of the cap. This is because we are advised it is quite common for only a minority of employees to be engaged in R&D at the outset. Often start-ups involve key researchers being remunerated via share growth rather than salary. Few other staff are employed and most of the R&D may be carried out by specialist subcontractors. While the £20,000 threshold will assist here, it will not remove this risk entirely.
13. At present there seems to be no mechanism for ensuring that the PAYE/NICs are actually paid before the R&D credit claim is paid. Therefore R&D credit claims could be made without the corresponding PAYE/NICS be paid. This could leave the system open to abuse.

Question 3: The government welcomes views on the sorts of activities which are undertaken to manage IP, as well as the types of information and evidence of the active management of intellectual property, which genuine business would be able to provide in supporting their R&D tax relief claim.

14. There was concern that this would be difficult to evidence, particularly at the outset of a project. There was also questions around how IP would be defined in this context. There is often a significant amount of time which passes before the project creates IP in the routine sense of the word such as a patent or goodwill. The management of 'know-how' could be difficult to articulate and evidence.
15. There was also a concern that this test around the management of IP would create complexity and costs for businesses as a result of the increased compliance burden. Many affected entities would likely need to seek professional advice around this point for guidance in how to meet the requirement. Members did not feel this was an appropriate test to include and indeed a set-back given the departure from the IP condition which was abolished in 2009.
16. It is also arguable that because meaningful evidence of IP management would be difficult to obtain, especially third-party verification of such activity, the effect of this requirement in managing fraudulent claims could be minimal. It would likely hinge on internal documentation of management time and correspondence in any event.
17. This leads to the wider point made by members that while the proposal for allowing companies that meet certain "hallmarks" to make uncapped claims is very welcome, it also opens up the system to fraudulent uncapped claims being made – which is the exact issue the measures are aiming to prevent.

Question 4: Does your business subcontract work to a related party, (including using EPWs provided)?

18. We are advised that this is relatively common in practice.

Question 5: Where your business does subcontract to a related party, does this represent less than 10% of R&D expenditure? If no, please provide an indication of the percentage of your claim related party subcontracting does represent.

19. Members have suggested that the level of subcontracting to related parties can vary considerably. Groups will base decisions around where the right people are located. R&D projects tend to require specialist skills and therefore this will be the driver behind the key people working on the project as opposed to the legal entity in which they are employed. We are advised that it is not uncommon for subcontracting to exceed 10% between related parties. Where both entities are within the UK, this would not appear to generate any tax avoidance or leakage therefore it has been queried whether it is appropriate to impose the 10% test between UK based entities.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).