



## RESEARCH AND DEVELOPMENT TAX RELIEF FOR SMALL AND MEDIUM SIZED ENTITIES (DRAFT FINANCE BILL 2021)

Issued 6 January 2021

ICAEW welcomes the opportunity to respond to the **Preventing abuse of research and development tax relief for small and medium sized enterprises draft Finance Bill 2021** legislation published by HMRC on 12 November 2020.

In our view, the draft Finance Bill provisions achieve their intended outcome. We have made two recommendations: i) reduce the scope for the measure to be abused through non-payment of PAYE & NIC liabilities; and ii) clarify and simplify the intellectual property exception by the inclusion of a purpose test.

This response of 6 January 2021 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. In our view, the draft Finance Bill provisions broadly achieve the intended results. While the provisions are relatively clear and easy to read, some uncertainties remain around their application, especially determining whether the exception to the tax credit cap set out at s1058D applies.
2. We recommend that i) the PAYE & NIC liabilities should be required to be paid in order for them to count towards the multiplier referred to at s1058 (1A) (b) CTA 2009 (paras 5 to 9 below); and ii) the introduction of a purpose test in Condition A of the intellectual property exception (paras 10 to 15 below).

## THE MEASURE

3. The purpose of the measure is to reduce the number of fraudulent claims for R&D tax credits by restricting the amount of the credit with reference to the PAYE and NIC liabilities of the company carrying on the R&D activity. The rationale is that fraudulent claims are less likely to be made by companies carrying on genuine business activities through the work of employees.

## GENERAL COMMENTS

4. We continue to question the effectiveness of a blanket cap in addressing fraudulent behaviour. However, we welcome the ability at s1058 (2) CTA 2009 for the Treasury to replace elements of the cap through regulation so that it can be amended within a relatively short period of time if it is not considered to be effective in meeting its aims.

## CREDIT CAPPED BY REFERENCE TO PAYE & NIC LIABILITIES

5. We note that the tax credit cap is calculated with reference to the PAYE & NIC liabilities of the company which is defined as the amount of income tax/class 1 NICs for which the company is required to account to an officer of Revenue and Customs for the payment period under PAYE regulations.

### Our concerns

6. As set out at paragraph 13 of our previous response [ICAEW REP 55/20](#) to the consultation on this measure (submitted 24 August 2020) we note that there is no mechanism for ensuring that the PAYE/NICs are actually paid before the R&D credit claim is paid. This could therefore lead to situations where HMRC has issued tax credits without the corresponding tax on which it has been based being received. As such, this measure would appear to be a relatively blunt one when it comes to tackling fraudulent claims.

### Our recommendation

7. Most R&D tax credit claims will be made some months after the end of the payment period, by which time the deadlines for PAYE income tax & NIC liability payments would have passed. It therefore seems reasonable that the tax credit be restricted to the amount of PAYE & NIC actually paid with reference to the payment period by the date of the R&D tax credit claim. If, for whatever reason, some PAYE & NIC liabilities are paid late and therefore after the company has made its R&D tax credit claim, an amended claim could be submitted reflecting the increased PAYE & NIC paid.

### **Suggested amendment**

8. We therefore recommend that proposed s1058B(2) CTA 2009 is amended so that it reads:  
  
“Amount A is the amount of income tax the company has paid to HM Revenue and Customs for the payment period under PAYE regulations.”
9. Equivalent amendments would be made to s1058(4) in relation to NIC liabilities.

### **INTELLECTUAL PROPERTY EXCEPTION - s1058D**

10. We welcome an exception to the cap for companies that create or manage intellectual property (IP) set out in proposed s1058D. The tight definition of what constitutes relevant IP at s1058D(4) is especially welcome, as this will make it easier for companies to determine whether the exception applies to them.

### **Our concerns**

11. Determining whether relevant IP has been created by a company should be relatively straightforward, although a significant amount of time can pass before a project begins to generate IP such as patents and trademarks. Hence, early-stage companies may find this test harder to meet than more established ones.
12. It may also be difficult to ascertain whether a company is performing a significant amount of management activity in relation to relevant IP it holds, given that evidence for this may be difficult or costly to produce.
13. For these reasons, we are concerned as to how effective this exception would be in distinguishing genuine claims from fraudulent ones.

### **Our recommendation**

14. We recommend that a purpose test is included in the legislation instead which would require the R&D carried out by the company to be carried out for the purposes of creating or developing relevant IP.

### **Suggested amendment**

15. Our suggested amendment would simplify the provisions at s1058D(2) & (3) such that Condition A would then read as follows:  
  
“the company is engaged in R&D activity for the purposes of creating or developing relevant IP”  
  
(which would continue to be defined as at subsection (4)).

## 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>).