ICAEW
REPRESENTATION 73/22

RESEARCH AND DEVELOPMENT TAX RELIEF CHANGES

Issued 14 September 2022

ICAEW welcomes the opportunity to comment on the draft clause 'R&D tax relief and expenditure credit' published by HMRC on 20 July 2022, a copy of which is available from this link

For questions on this response, please contact the ICAEW Tax Faculty at taxfac@icaew.com quoting REP 73/22.

- We believe that the measures relating to non-UK related expenditure and the requirement for pre-notification of R&D tax relief claims should be amended or removed. We do not believe that these measures would have the effect of limiting the number of non-valid claims and instead would place additional administrative burdens and restrict relief available to genuine claimants.
- We believe that the pre-notification requirement set out in Part 3 should be replaced with a requirement for the claim to be certified by an authorised officer of the company.
- We believe that further details should be provided relating to the information that needs to accompany R&D tax relief claims, ideally including this in primary legislation.
- We believe that the power of HMRC to be able to remove R&D claims from returns should be restricted to prescribed circumstances ie where there has been no pre-notification of the claim or where the required information has not been provided with the claim.

This response of 14 September 2022 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the ICAEW 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. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 165,000 chartered accountant members in over 147 countries. ICAEW members work in all types of private

and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

PART 1 – EXPENDITURE ON RSEARCH AND DEVELOPMENT

THE MEASURE

1. This draft clause restricts relief for expenditure subcontracted to a party outside the UK or carried out by externally provided workers outside the UK. It ensures that relief is only available for UK or qualifying overseas expenditure. Qualifying overseas expenditure is defined as that attributable to relevant R&D undertaken outside the UK where it is wholly unreasonable for the company to carry out those activities in the UK.

OUR CONCERN

2. We welcome the inclusion of some overseas R&D activities carried out by sub-contractors and externally provided workers. However, we have concerns relating to the "wholly unreasonable" test.
3. Firstly, we consider this to be a very subjective test. Who is to say what is unreasonable and what isn't? We consider that inclusion of this clause as it stands would lead to greater uncertainty for claimants and greater costs for both companies and HMRC should cases go to the courts on this point. We believe that a more objective test should be used.
4. Secondly, we believe the test is too restrictive. Ideally, it would be a test that encourages companies to carry out its R&D activities in the UK so that the additional tax benefit of doing so outweighs any additional costs. Otherwise, the test does nothing to encourage UK R&D activity. We note at paragraph 2.25 of the R&D Report dated November 2021 that the government is not minded to include a test that allows claims for overseas activity on the basis that it is less expensive than in the UK. As a result, we have considered an alternative test that is more objective.

OUR RECOMMENDATIONS

5. We recommend including a test that would allow for overseas expenditure to be allowed provided the conditions at s1138A (2) (a) and (b) are met and that it is not necessary to prove that it would be wholly unreasonable for the company to replicate overseas conditions in the UK.
6. While this would provide for more situations than in the current proposals for claims to be made for overseas expenditure, it would still require companies to prove that the conditions necessary for the purposes of the research and development are not present in the UK. This would prove a deterrent to claiming for some companies and hence it may not be as costly to the Exchequer as it may appear.

SUGGESTED AMENDMENT

7. We suggest that proposed s1138A (2) (c) is deleted.

PART 3 – CLAIM NOTIFICATIONS

THE MEASURE

8. This draft clause introduces a requirement for any companies that have not previously made an R&D tax relief claim or have not made one in the last three years, to pre-notify HMRC of their claim within six months of the end of the accounting period to which the claim relates.

OUR CONCERN

9. We understand that the purpose of this measure is to prevent fraudulent or unscrupulous claims. We do not believe that this measure would achieve this aim, or it would do so at the expense of genuine claimants who will now effectively have only six months, rather than two years, in which to determine whether they have a genuine claim.

OUR RECOMMENDATIONS

10. We suggest that, rather than the company needing to make a pre-notification, an authorised officer of the company should be required to certify the claim as a written statement enclosed with the claim. This was one of the options mentioned in the R&D Report mentioned above but appears to have been abandoned in favour of the pre-notification requirement.
11. If HMRC does intend to proceed with this provision, we recommend that the time limit for the pre-notification is changed to take account of long periods of account.
12. Particularly when a company first starts trading, it is relatively common for it to have an accounting period that exceeds 12 months so that it can set an accounting period date that best meets its needs. For example, a company might start to trade on 1 October 2022 but find that it would like to have a 31 December year end. It would therefore have a 15-month first period of account to 31 December 2023.
13. Taking the proposed s104AA Corporation Tax Act 2009 (CTA 2009) as an example, subsection (2) states that a company is not entitled to an R&D expenditure credit under s104A CTA 2009 unless it has made a claim notification within the period of six months beginning with the last day of the claim period. The claim period is referred to in s104A (1) as the accounting period to which the claim relates. Hence, in the long period of account referred to above, the company would have two claim periods- the 12-month period to 30 September 2023 and the three-month period to 31 December 2023. Hence, notification would be needed for a claim relating to the year ended 30 September 2023 by 31 March 2024, just three months after the end of the period of account ending 31 December 2023. This is a very short amount of time after the end of the period in which to decide whether the company has a valid claim.
14. We therefore recommend that s104AA, s1045A and s1054A (which relate to different forms of R&D tax relief) are amended so that the time limit for the notification is linked to the period of account, rather than the claim period.

SUGGESTED AMENDMENT

15. We suggest that Part 3 of the draft measures is removed and replaced with a certification requirement.
16. If HMRC wishes to proceed with the inclusion of part 3, we recommend that the proposed subsection (2) of each of the new s104AA, s1045A and s1054A is amended to read as follows:

"The company is not entitled to [X relief] in relation to the claim period unless it has made a claim notification within the period of six months beginning with the last day of the period of account in which the claim period falls".

17. We have also noticed a drafting error in the proposed s1054A (1) which is at odds with the wording in both s104AA (1) and s1045A (1). We assume that it should read as follows:

"(1) This section applies where—

(a) a company has not made an R&D claim or a claim notification in relation to any accounting period before the period mentioned in section 1054(1) (the "claim period"), or
(b) a company has made an R&D claim or a claim notification in relation to an accounting period before the claim period but has not made such a claim or notification for any of the three accounting periods immediately preceding the claim period."

PART 5 – AMENDMENTS TO SCHEDULE 18 FA 1998

THE MEASURE

18. This part contains various measures reforming processes relating to R&D tax relief claims. The two areas we have comments on are:
    a) paragraph 27, requiring additional information to be provided in relation to R&D claims, and
    b) paragraph 28, relating to the power of HMRC to remove R&D claims made in error from the return.

OUR CONCERN

19. Our concern relating to the requirement to provide additional information is that this information has not been set out in the legislation and will instead be made by regulations.
20. We believe that sufficient time should be given for companies and HMRC to update their systems and processes, so they are able to capture and process the additional information required in time before the new requirement comes into force.
21. We note the changes made to the CT600L form from 6 April 2022 which meant that HMRC was unable to process some corporation tax returns for a period after this and the fact that companies had to file paper returns instead. We are concerned that similar problems will occur if these new changes are not built into HMRC systems with sufficient lead time.
22. Similarly, companies will be keen to ensure that they are keeping sufficient records to comply with the information requirements when they come into force. The earlier these requirements become known, the sooner they can plan to comply with them.
23. Our concern relating to the power of HMRC to remove R&D claims is that it is not sufficiently clear under what circumstances a claim could be considered to have been made in error.
24. Our understanding is that this measure is intended to remove claims from returns where a pre-notification has not been made or the required information has not been provided. However, this is not stated in the draft legislation, and we are concerned that this measure could be used by HMRC in wider circumstances.

OUR RECOMMENDATIONS

25. We recommend that, ideally, the legislation once included in the next Finance Bill includes details of the additional information to be provided by companies with their R&D tax relief claims and the form and manner in which this information is to be provided.
26. We also recommend that paragraph 28 is amended to make clear the circumstances in which a claim can be found to have been made in error.

SUGGESTED AMENDMENT

27. We suggest that the proposed new paragraph 83EB (1) Schedule 18 FA 1998 is amended to read as follows:

    "This paragraph applies, in relation to a claim to which this Part of this Schedule applies (the "original claim") where an officer of Revenue and Customs—
    (a) reasonably believes that a claimant company has failed to comply with any of the requirements sets out in sub-paragraph (1) (c) relating to the making of the claim (and accordingly that the claim has been made in error), and

(b) exercises the power under paragraph 16(1) to make a correction by removing the claim from the company tax return in which it is made.
(c) The requirements are those set out in paragraph 27 of this schedule and ss104AA, 1045A and 1054A CTA 2009”

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).