



Taxing Matters

Sarah Scala and Caroline Walton

Alice	Hello and welcome to Taxing Matters your one stop audio shop for all things taxed brought to you by RPC. My name is Alice Kemp and I will be your guide as we explore the sometimes hostile and ever changing landscape that is the world of tax law and tax disputes. Taxing Matters brings you a fortnightly roadmap to guide you and your business through this labyrinth. In case any of you miss any crucial information or just want some bedtime reading there is a full transcript of this and indeed every episode of Taxing Matters on our website at www.rpc.co.uk/taxingmatters . No matter what your view is on each advancement and technology planet destroying super technology or essential assistance to modern everyday life there is no arguing that research and development is important and needs to be encouraged and it is by amongst other things research and development tax relief schemes. But like any good tax relief it is open to potential abuse and the correct balance needs to be struck between encouraging genuine and legitimate projects and curbing errors and abuses. Joining me today to discuss R&D tax relief proposals for reform and what you can do to avoid ending up in sticky situations Sarah Scala head of tax dispute resolution at Claritas Tax and Caroline Walton head of innovation relief also at Claritas Tax. Sarah/Caroline welcome to Taxing Matters.
Sarah	Hi Alice thanks for having us here today.
Caroline	Thank you very much Alice.
Alice	Great so taking it from the top Caroline what is R&D relief and why is it important.
Caroline	Research and development tax relief is a corporate tax relief that can either reduce a company's tax bill or for loss making companies who don't pay any corporation tax it can provide a cash sum. The tax relief is based on the company's expenditure on research and development activity. In short it is a UK tax incentive. It is designed to encourage companies to invest in innovation and the hope is that the money saved in corporation tax will be used by a company to invest in continued innovation for example recruitment of staff to work on innovative projects or simply that the money will be put back into the business to assist with the expansion of the business and contribute to the overall growth of the economy. R&D tax relief is part of a government's growth agenda to support innovation in the UK. The UK government has an ambitious target to raise total investment in R&D development to 2.4% of UK GDP by 2027 and R&D tax reliefs have a key role in incentivising this investment by reducing the cost of innovation.
Alice	Great thank you and Sarah is there anything you think needs to be added about it is so important.
Sarah	Well it is clearly important that companies who have a genuine entitlement to the research and development reliefs are aware of that and have support in claiming them. From my point of view as a tax dispute resolution expert it is important for companies to make the right claims and that those claims are valid because HMRC have in recent years increased their focus on challenging error-ness and fraudulent claims.
Alice	Caroline in simple terms how does it work at the moment.
Caroline	Well within the UK there are two R&D tax relief schemes. There is a scheme applicable to small and medium size enterprises- that is a company having less than 500 employees and an annual turnover of less than €100m and balance sheet assets of less than €86m and that scheme is called the SME scheme and there is also another R&D scheme which is applicable to larger enterprises that fall outside the SME limits on employee numbers turnover and balance sheet assets. The scheme that is applicable to larger companies is called the Research and Development Expenditure Credit Scheme or RDEC for short. There are also rules concerning companies that may have linked or partner enterprises. It may be necessary to aggregate employee numbers turnover and balance sheet assets to determine whether a company falls within the SME limits to allow the claim to be made under the SME scheme. There can be instances where an SME is obliged to claim under the RDEC scheme for example where R&D expenditure is subsidized by a third party or where the SME is subcontracted to carry out R&D activities. There are two R&D tax free schemes in the UK. In terms of the schemes the tax definition of what R&D activity is is the same for both the SME scheme and RDEC but there are differences in the qualifying expenditure between the schemes and the schemes are

also different in terms of how the tax relief is calculated. Under the SME scheme the relief operates as an additional deduction against taxable profits for an accounting period. The additional deduction is calculated as 130% of qualifying R&D expenditure whereas under the RDEC scheme the relief operates as a taxable credit and the credit is 13% of qualifying R&D expenditure. In terms of how the benefit can be taken it can operate as a reduction in a current corporation tax liability. It can operate as a tax rebate since it is possible to go back two previous accounting periods in terms of claiming the relief so that could be money coming back from HMRC in respect of overpaid corporation tax. It can also operate as a tax credit for a loss making company if the R&D deduction creates a loss or increases losses then that can be surrendered at 14.5% of the surrenderable value. Also making a claim can create new losses which could reduce a future corporate tax liability. A claim for R&D tax relief is made through a company's tax return that is the CT600 either on the original CT600 or if you are going to claim retrospectively a tax rebate it requires an amendment to a CT600. All the amendments should be filed at HMRC together with a technical narrative explaining how the company qualifies for R&D tax relief.

Alice And how do you qualify for R&D tax relief.

Caroline In order to qualify for R&D tax relief a company must be carrying out a project that seeks to achieve an advance in the field of science or technology. It is necessary for the company to be able to state what the intended advance is and to show how through the resolution of scientific technological uncertainty the project seeks to achieve this. The activities that constitute R&D for tax purposes are those activities undertaken as part of the project which fall to be accounted for as R&D within generally accepted accounting practice and also fall within the special definition set out in the BEIS guidelines formerly the DTI. Once the advance in a field of science or technology has been articulated and the scope of the R&D project has been defined and the project activities which fall within the definition of R&D for tax purposes have been identified then tax rules set out what expenditure may be eligible for relief and the conditions that must be satisfied for the expenditure to qualify for relief. The fundamental thing is that we are looking for activities or projects where a company has sought to advance a particular field of science or technology.

Alice So what kind of errors and abuses are you and HMRC seeing at the moment.

Caroline Quite a lot - one of the key things that you see time and time again are attempts by claimants to push the boundaries in terms of what R&D activity actually is. In other words claiming for projects which don't qualify as an advance in a particular field of science or technology or where reports are prepared where the actual field or science or technology has not been correctly identified. Any claims like that would be open to an enquiry from HMRC. In addition to problems in terms of the actual R&D activity itself other common areas we see are agents who try and claim for expenditure which does not qualify - it is outside the qualifying categories for example claiming for costs in relation to staff who are not actually employees of the company and not on the payroll. Not applying the special rules for connected parties properly. Companies not recognising whether or not they are actually an SME so not looking at the proper scheme. A big one is SME's that claim under the SME scheme where actually their expenditure is subsidized by a third party or they are subcontracted to carry out R&D activity and they should in fact be claiming under RDEC. Those are some of the common problems claiming R&D tax relief under the incorrect scheme.

Alice Thank you Caroline and Sarah from your point of view in the tax dispute resolution area what kinds of things might you see or expect to see.

Sarah Well things can range between genuine errors and at the other end of the scale criminal activity so it could be the case that relief has been claimed for a project that did not exist on the more extreme end in any case any form of evasion or dishonesty will be taken very seriously by HMRC and the best advice would be not to wait for a challenge from HMRC but if a company is aware that it did not make correct claims it should engage a specialist without delay.

Alice Thank you so Caroline there have been some reforms proposed. What are they designed to do and how would they change the relief schemes you have talked about.

Caroline The concern from HMRC is just that obviously this is an attractive relief and for that reason there has been a massive increase in terms of the numbers of companies that seek to claim it year in year out. That can be shown by annual stats that are published by HMRC concerning the number of claims. For instance the most recent stats were published by HMRC in April. The estimated total number of R&D tax credit claims for the year ended March 2020 is 85,900. That is an increase of 16% from the previous year. HMRC state the increase is primarily driven by a 16% rise in the number of SME/R&D claims to 76,225. There were 9,675 RDEC claims. Quite simply with the vast number of claims that HMRC is receiving it is not possible to police every claim in the way that they might want to. Because the R&D tax relief arena is not regulated in terms of

the types of businesses that are conducting R&D tax relief claims you might have a regulated business such as a chartered tax adviser or an accountant but equally there are an awful lot of unqualified businesses which are not regulated operating in the arena as well. Unfortunately there have been problems with claims not being properly constructed projects which don't qualify as R&D or the costs not having been put together in the correct manner. This has been on HMRC's radar this problem and the government's radar for some time. In addition to concern about incorrect claims and possible abuse and fraud there has been a desire for some time or recognition that the R&D tax relief scheme in this country has been a little bit antiquated in terms of types of qualifying expenditure and not necessarily fit for purpose for modern businesses. With that in mind the government essentially wanted to overhaul the schemes and there was a large consultation into the R&D tax relief schemes in the UK which took place between March and June 2021. At Claritas I participated in the consultation we sent a paper in with our recommendations in terms of the reforms that we thought would be beneficial. A report was actually published in November 2021 with news essentially for the industry in terms of what the government intends to do. We are essentially at this point in time waiting for draft legislation. There are going to be reforms that are going to come into effect as from April 2023. Some measures are going to be introduced then there are some measures which are actually in place now. One of them is HMRC is going to allocate additional resource to R&D tax relief compliance in recognition of the sheer volume of claims and the fact that they cannot look at every single one they are now locating additional resource internally. In addition to that they are going to introduce a requirement for all claims to be made digitally in the future and they are going to require far more detail concerning the nature of a claim when the claim is made. They are going to want clear information as to the field of science or technology in which the advance has been sought and what the technical or scientific uncertainties were which I really welcome. One of the other things that is going to happen is that in future all R&D claims that are submitted to HMRC are going to need to be endorsed by a senior officer of the company that is I think massively going to help with a company having to take more responsibility for the accuracy of the claims that are submitted. There is going to be a requirement for a company to inform HMRC in advance of their intention to make a claim. In doing that there is going to be an opportunity for HMRC to actually get involved with a claim to vocalise whether or not it is likely to be accepted in advance rather than being given a claim to investigate after the event. Finally it is also going to be necessary for details of the agent who advised the company on compiling the claim for that information to be provided which at the moment does not happen so far more encouragement for a company to take responsibility and also for HMRC to really see where the fault in any errors or any inaccuracies lies you know is it with the company or is it with the agent.

Alice So Sarah what can HMRC do if you are not compliant.

Sarah The first step Alice is that HMRC would open an enquiry into a company's tax return to check the claim that has been submitted for research and development tax relief. Often HMRC then decide that they want to investigate for example the prior years tax return and will do so if they are in time to open an enquiry into that year. In addition if those enquiries lead HMRC to be able to use what we call their discovery powers they can then open enquiries and make adjustments to earlier years still so for example a case of mine that I have at the moment has HMRC wanting to close the enquiry and deny claims for four tax years. Once HMRC have made their enquiries and potentially reduced or rejected claims they then start to look at the penalties that they will seek to impose and that is where they consider the behaviour of the tax payer and what caused the errors in the claims. The reason for there needing to be an adjustment. HMRC will consider whether reasonable care was taken when the claims were made and in that case there usually is no penalty. They will consider whether errors arose because behaviour on the tax payers part was careless in that case a penalty may be charged and then as the behaviour that is determined gets more serious of course penalties can increase. Further categories of behaviour include deliberate behaviour the most severe is if a company deliberately concealed evidence when making at that stage usually fraudulent claims. There has been success on HMRC's part with criminal investigations and successfully prosecuting tax payers so in November 2020 three individuals were successfully prosecuted and sentenced to a total of 21 years in prison and a further thing to add Alice is that when HMRC conduct the enquiries into the research and development relief they may have cause to investigate wider aspects of the business.

Alice Thank you Sarah so if you are in a position where HMRC do open an enquiry what should you do.

Sarah Well the first thing to do is to check that the opening of the enquiry is valid and that HMRC are in time to do so usually they have a year from the date the return was received to enquire then the task would be to provide clear explanations considering the points that Caroline has already covered typically being to give precise details of the project undertaken to be clear on what the technological uncertainty was and the advancement that was sought. Very importantly to satisfy HMRC on why the solution that you sought to obtain was not readily available in the market place. As the enquiry progresses a company might decide that it is worth getting a second opinion from another adviser and that does not mean that there has to be any

disloyalty to an existing adviser. I currently have a new client who they are themselves the research and development business and they have asked Claritas to review the claims that they themselves made for their client, review the enquiry correspondence to date and give our view as to whether we would have done anything differently. Unfortunately in that case the HMRC officer has communicated his intention to close the case so it can be important to consider a second opinion early on when the opinion giver has got involved at an earlier enough stage to effect the strategy and assist in changing the outcome of the enquiry. If the officer has already suggested that they are going to close the enquiry and deny the claim as was the case for my client what can be done there you can request that another individual within HMRC that has not as yet been involved in those enquiries on your particular client you can request that independent person conducts a review of the case. That was the option available to my client and I was then involved in preparing the submission that would go to that new officer hopefully to get the enquiry in front of somebody that is looking at it with fresh eyes. Unfortunately it does happen quite regularly that an officer appears to have made their mind up about disallowing the claim before they have actually asked any questions so if you are faced with that type of officer you should welcome the review to be conducted by somebody else and hopefully that person will consider each piece of evidence on its own merits.

Alice

Fantastic well thank you so much for your assistance explaining R&D tax to our listeners today. Unfortunately that is all we have got time for in this weeks episode so thank you again to Sarah and Caroline for joining us from Claritas Tax. You can find Sarah and Caroline both through LinkedIn and on Claritas' website. If you have any questions for me, Sarah or Caroline or any topics you would like us to cover in a future episode please do email us on taxingmatters@rpc.co.uk we would love to hear from you.



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