

CTA Fellowship

**The UK Research and Development (R&D) tax regime – a case study on the impact of
trust on the effectiveness of tax policy**

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Chapter 1: Research Proposal and Synopsis*

The UK Research and Development (R&D) tax regime – a case study on the impact of trust on the effectiveness of tax policy: Synopsis

Tax relief for investment in R&D has been a feature of the UK tax system since 2000.

Although the regime design has evolved since, the underlying policy objective remains.

This is stated by HMRC as *“a tax relief designed to encourage greater R&D spending, leading in turn to greater investment in innovation”*¹.

Various studies have considered the effectiveness of R&D tax schemes at encouraging investment. Where a policy aims to drive behaviour, in this case investment in innovation, it must be sufficiently attractive to make it worthwhile for the business.

This could, for example, be through a scheme being very easy to access or by delivering a meaningful financial advantage. As such, the various UK R&D schemes have always been notably generous (and stayed competitive with other countries seeking to attract investors – 33 of the 38 OECD countries had similar schemes by 2022²). However, a side effect of this generosity, (combined with self-assessed reporting and HMRC’s policy of

¹ S Austin and M Rowe-Brown, HMRC, ‘Official Statistics – Background information and quality report: Research and Development Tax Credits’ (gov.uk, updated 28 September 2023) <<https://www.gov.uk/government/statistics/background-information-and-quality-report-research-and-development-tax-credits/background-information-and-quality-report-research-and-development-tax-credits>> accessed 1 January 2024

² OECD, ‘Tax incentives for R&D and innovation – OECD’ (OECD.org), <www.oecd.org/innovation/tax-incentives-rd-innovation/#:~:text=In%202022%2C%2033%20out%20of%2038%20OECD%20countries,level%2C%20up%20from%2019%20OECD%20countries%20in%202000.> accessed 2 January 2024

process first, check later), is that the UK schemes have been the target of abuse, estimated by HMRC as accounting for £1.13bn lost through error and fraud in 2020-21³ alone.

Following this, HMRC proposed some core changes: a legislative change requiring additional information to be submitted with claims (from August 2023); proposals for a new, “simpler”, merged scheme (introduced for accounting periods starting on or after 1 April 2024); and engaged in a significant increase in compliance activity through a “volume compliance” approach. They continue to consider other measures to tackle the incorrect claims including, for example, a specific R&D Disclosure Facility and a new “whistle-blower” mailbox.

This ramping up of the compliance activity has resulted in commentary across the R&D tax community, summarised in a public exchange of letters between HMRC and CIOT in 2023⁴, around lack of capability of HMRC caseworkers; lack of engagement with taxpayers and insufficient consideration of evidence; a growing perception of bias towards denying claims; and inherent unfairness in the enquiry process and decision-making by HMRC compliance officers.

³ HMRC, ‘Corporate report: HMRC’s approach to Research and Development tax reliefs’ (gov.uk, 17 July 2023) <[⁴ Letter from Ellen Milner, CIOT to Philippa Madelin, HMRC \(3 July 2023\)
Letter from Philippa Madelin, HMRC to Ellen Milner, CIOT \(29 August 2023\)
Letter from Ellen Milner, CIOT to Philippa Madelin, HMRC \(11 December 2023\)](https://www.gov.uk/government/publications/compliance-approach-to-research-and-development-tax-reliefs/hmrCs-approach-to-research-and-development-tax-reliefs#:~:text=The%20updated%20estimate%20of%20the,million)%20for%202020%20to%202021.> accessed 1 January 2024</p></div><div data-bbox=)

My research considers whether the compliance approach, and potentially by extension, the approach to the policy changes, is eroding trust in the tax administration of R&D claims. It considers whether it can be linked to a decline in the attractiveness of R&D tax relief as an incentive to invest in innovation in the UK, effectively undermining the core policy objective of what could otherwise be an effective policy.

I propose that the erosion of trust is threefold – through an earlier lack of compliance activity allowing the error and fraud to thrive; through the subsequent volume compliance approach; and, through the introduction of the new merged scheme in a way which many tax commentators feel is rushed and flawed in its design⁵.

I will carry out literature research into three areas: an overview of the history and development of the R&D regimes to date, the levels of incorrect claims, and HMRC's response; the effectiveness of R&D tax schemes as policies for driving innovation (and relevant factors in determining their effectiveness); and, what connects trust in the tax system with tax compliance. I will use this review to formulate questions for a survey of the business and agent community involved in R&D tax claims, followed by a series of in-depth interviews with specialists in the industry. The analysis of the results will be used to evidence my hypothesis that there has been an erosion of trust, which can be linked to a negative impact on the policy objectives of the UK's R&D tax regime.

⁵ Select Committee on Economic Affairs Finance Bill Sub-Committee, *Research and Development tax relief and expenditure credit* (HL 3rd Report of Session 2022-23 – published 31 January 2023 – HL Paper 137 [House of Lords - Research and development tax relief and expenditure credit - Select Committee on Economic Affairs Finance Bill Sub-Committee \(parliament.uk\)](#))

The research should help to inform the considerations of HMRC's volume compliance approach to R&D and the need to rebuild that trust if the regime is to flourish in the future. It may also provide a basis from which to consider the wider impacts of trust erosion on the UK tax system.

[To note: This Chapter reflects the position in January 2024 when the research proposal was submitted. Some of the areas have progressed since – the whistle-blower mailbox and Disclosure Facility are now effective, for example. Future chapters refer to the up to date position at the time of submission in August 2025.]*

Chapter 2: Literature review and background research

The literature review and background research focused on establishing the baselines for the research, that is, by:

- a. understanding why the question of trust and its potential impact on the effectiveness of R&D tax relief policy has arisen through considering the history, HMRC's shift in compliance approach, and changes to tax and administrative policy. This will also enable an understanding of where trust may have been affected and what impact the size and scale of the issues may have had;
- b. critiquing the effectiveness of R&D tax relief as a way of driving investment in R&D (if the conclusion is that the relief is ineffective per se then the question as to whether compliance and policy approaches have undermined the policy becomes irrelevant); and
- c. understanding the importance of trust in tax compliance and effective tax policy, and how to identify it. This part of the literature review was used to identify hallmarks which could be used to measure a shift in trust in the research survey.

2.1 Literature review and background research: History and developments in R&D tax relief

UK R&D relief – the history of the policy changes

Historically, the UK government focused its investment in R&D and innovation primarily on funding of research and education, including universities⁶. However in April 2000, the UK introduced an R&D tax credit for Small and Medium-sized Enterprises (SMEs) in response to evidence from the US that linked investment in innovative R&D activities to growth and prosperity, especially in the case of smaller firms; compounded by the UK having the lowest industry-funded business enterprise investment in R&D compared to GDP in the G5⁷.

On introduction, the scheme operated by increasing the relief for qualifying R&D expenditure from 100 to 150% (which equated to a 30% saving on the costs of R&D, with a 24% saving if they were loss makers).

In 2002, the relief was extended to large companies, followed by many more changes since. These included changes to the rates of relief as well as a replacement of the

⁶ HM Treasury, Stability and Steady growth for Britain: Pre Budget Report (November 1999), pp 34-37
<<https://assets.publishing.service.gov.uk/media/5a747ea6e5274a7f99028a0c/cm4479.pdf>> accessed 6 September 2024

⁷ Rachel Griffith, Institute for Fiscal Studies, *Briefing Note: How important is business R&D for economic growth and should the government subsidise it?* (ifs.org.uk, October 2000) <https://ifs.org.uk/sites/default/files/output_url_files/bn12.pdf> accessed 6 September 2024

large company scheme with an “above the line” credit, the Research and Development Expenditure Credit (RDEC), for large companies in 2013.

At the Spring Budget in March 2021, the then government announced a review into R&D relief to ensure that *“the UK remains a competitive location for cutting edge research, that the reliefs continue to be fit for purpose and that taxpayer money is effectively targeted”*⁸. Questions were being asked as to the whether the more generous relief available for SMEs (which at that point was a 130% additional deduction giving 230% total relief for qualifying R&D expenditure or, for loss makers, a payable credit worth 14.5% of the surrenderable loss) was good policy⁹. HMRC’s research¹⁰ suggested that the RDEC scheme (which only gave an additional 13% relief of the qualifying spend above the normal 100% expenditure) was a more effective incentive to investment, and so better value for money, and undermined the argument for greater relief for SMEs.

⁸ HM Treasury, *Budget 2021: Protection the jobs and livelihoods of the British people* p70 (gov.uk, March 2021)
<https://assets.publishing.service.gov.uk/media/60411da7e90e077dcdd752ce/BUDGET_2021_-_web.pdf> accessed 1 October 2024

⁹ HM Treasury, *R&D Tax Reliefs: Consultation* (gov.uk March 2021)
<https://assets.publishing.service.gov.uk/media/603cc357d3bf7f03985e12b5/Condoc_-_RD_review_.pdf> accessed 1 October 2024

¹⁰ HMRC, *Evaluation of the research and development expenditure credit (RDEC)*
<https://assets.publishing.service.gov.uk/media/5faad42ed3bf7f767a564f65/Evaluation_report_-_R_D_RDEC.pdf> accessed 22 January 2025

By this point large amounts of abuse of the scheme had been identified¹¹, and the government had put the policy and its administration under review. HM Treasury reported back in the autumn of that year that it would expand the definition of qualifying R&D activities to include data and cloud costs; refocus the reliefs on UK activities; and introduce measures to tackle the compliance problems¹².

The expansion of qualifying activities to include data and cloud computing costs followed advocacy from the UK technology sector¹³ and R&D specialists, who saw the previous definition as not reflecting modern innovation and as an area of uncertainty and lack of clarity¹⁴. While some changes were welcome, the scale of change added uncertainty to the regimes.

¹¹ HMRC, *Annual Report and Accounts 2020 to 2021* (ordered by House of Commons to be printed 4 November 2021)
<https://assets.publishing.service.gov.uk/media/619e0a29d3bf7f05539de453/HMRC_Annual_Report_and_Accounts_2020_to_2021_Print_.pdf> accessed 24 September 2024

¹² HM Treasury, *R&D Tax Reliefs Report* (gov.uk November 2021)
<https://assets.publishing.service.gov.uk/media/61a60db7e90e0704423dbfb8/RD_Tax_Reliefs.pdf> accessed 1 October 2024

¹³ Julian David OBE, CEO, techUK, *Cloud Computing and Data costs to be covered under expanded R&D tax credit* (techuk.org, 27 October 2021)
<<https://www.techuk.org/resource/cloud-computing-and-data-costs-to-be-covered-under-expanded-r-d-tax-credit.html>> accessed 24 September 2024

¹⁴ HM Treasury, *The scope of qualifying expenditures for R&D Tax Credits: 2020 consultation – summary of responses* (gov.uk, March 2021)
<https://assets.publishing.service.gov.uk/media/6037e891e90e070554d5573e/The_scope_of_qualifying_expenditures_for_R_D_Tax_Credits_summary_of_responses_consultation_.pdf> accessed 1 October 2024

The position was still not settled when the then government confirmed in March 2022¹⁵ that it would be extending its review, including narrowing the gap between the SME and RDEC rates by increasing RDEC and decreasing the SME rate to “rebalance” the regimes and start the journey towards a likely single, unified scheme based on RDEC. Pure mathematics was also added to the expansion of qualifying activity. At the same time, HMRC started ramping up its compliance activities to address the high levels of error and fraud in response to pressure from the NAO, PAC and others.

The uncertainty continued even after draft legislation for a merged scheme, which was eventually brought in for accounting periods beginning on or after 1 April 2024, was published in July 2023, following a commitment to do so in the 2023 Spring Budget.

Agents and industry alike were surprised¹⁶ that alongside the Spring Budget commitment for draft legislation, there was also a new scheme for loss-making “R&D intensive” SMEs from 1 April 2023¹⁷.

¹⁵ HM Treasury, *Spring Statement 2022* pp 41-42 (gov.uk, March 2022) <https://assets.publishing.service.gov.uk/media/623b313ed3bf7f6ac2de7557/Spring_Statement_2022_Print.pdf> accessed 22 January 2025

¹⁶ House of Lords Economic Affairs committee, *Research and development tax relief, HMRC data requirement, promoters of tax avoidance and sentencing for tax fraud* (HL 2nd Report of Session 2023-24 – published 1 February 2024) <<https://committees.parliament.uk/publications/43082/documents/214705/default/>> accessed 4 October 2024

¹⁷ HM Treasury, *Policy Paper: Spring Budget 2023 Media factsheet: cutting & simplifying tax for business to invest and grow* (gov.uk, published 15 March 2023) <<https://www.gov.uk/government/publications/spring-budget-2023-factsheet-cutting-simplifying-tax-for-businesses-to-invest-and-grow/spring-budget-2023-media>>

It was not until the Autumn Statement in 2023 that some areas were given clarity – the government confirmed that the SME scheme and RDEC would be merged on the basis of the RDEC scheme, starting for accounting periods beginning on or after 1 April 2024¹⁸. However, this still left the SME intensive regime in existence so much of the reaction focused on the simplification not being a true simplification as there were in effect still two schemes and for SMEs on the border between the two, this could mean uncertainty as to which scheme they would fall into.

The House of Lords Economic Affairs Committee Finance Bill Sub-Committee¹⁹ sought evidence from expert witnesses in November 2023 and identified general support for the objective of simplification through the merger of the regime. This simplification objective was in addition to the originally stated objectives of the review: competitiveness; fitness for purpose of the reliefs; and tackling non-compliance.

[factsheet-cutting-simplifying-tax-for-businesses-to-invest-and-grow](#)> accessed 22 January 2025

¹⁸ HM Treasury, *Technical note on changes to research and development tax reliefs at Autumn Statement 2023* (gov.uk, published 22 November 2023) <<https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform/technical-note-on-changes-to-research-and-development-tax-reliefs-at-autumn-statement-2023>> accessed 23 May 2025

¹⁹ House of Lords Economic Affairs committee, *Research and development tax relief, HMRC data requirement, promoters of tax avoidance and sentencing for tax fraud* (HL 2nd Report of Session 2023-24 – published 1 February 2024) <<https://committees.parliament.uk/publications/43082/documents/214705/default/>> accessed 4 October 2024

There were observations from business representatives that the lengthy period of review and reform and its “piecemeal” nature created further uncertainty. One business, Forrest Brown Ltd, told the Committee that the approach had *“led to uncertainties that have undermined the effectiveness of the incentive as a driver of R&D”*. As well as uncertainty, the witnesses raised concerns with the approach as being disruptive and with regards to the merger, “rushed”. “Stability” and “reliability” were considered important for an effective regime. The uncertainty was amplified by the surprises in the government’s approach (for example, the additional relief for SMEs with intensive R&D), with long gaps between confirmed next steps and a lack of consultation.

CIOT also observed that the impact of the changes was likely to result in fewer SME claims (given its reduced generosity) but that there was a lack of transparency as to whether the objective was to refocus the incentive towards benefiting larger companies.

There was a significant amount of industry commentary on the changes, which highlighted the feeling of uncertainty, lack of consultation and questioning of the decision-making. Some areas continued to leave the potential for confusion or disagreement between businesses and HMRC. One example was the issue of sub-contractors and subsidised expenditure. While the technical detail is not relevant to this research, CIOT commented that the approach was *“permitting a situation of uncertainty to continue”* showing that this was a further area where there was a lack of confidence in the government’s actions. This was compounded by HMRC later losing on the issue at Tribunal but not accepting any late amendments to reinstate claims of

those who proceeded in accordance with their strong direction (when agents raised strong concerns at the time). This has resulted in some agents (who had responsibly advised their clients of HMRC's position and the risks of taking an alternative interpretation) being angry that their clients have ended up in a disadvantaged position compared to those who did the opposite of what HMRC was telling them to do, raising a significant question of fairness.

The literature in relation to policy changes over the life of the UK's R&D scheme, and in particular the more recent changes since the government announced its review in 2021, is rich with government publications mapping out the changes and detailed reviews as part of their scrutiny, combined with significant commentary from agents, businesses and representative bodies.

In addition to the high volume of changes shown by the literature, it is notable how often the words used by commentators about the approach revolve around a lack of certainty, clarity and coherence, which this research explores as potential hallmarks of a lack of trust in the system.

With regards to the effectiveness of the regime, the number of changes and the continuing questions being asked suggest that there is at least some evidence that the regimes are not as effective as the government would like, and that there may have been a shift from the original intention of supporting SMEs to the government seeing the incentives for large businesses as better value for money and having greater effect.

This section of the literature review and background research has specifically focused on the development of policy although it should be noted that there are two important

links with the research into HMRC's approach to compliance (which is explored further below):

1. The government's review also included the introduction of policy changes aimed at tackling non-compliance, which were more administrative in nature, for example, the introduction of an additional information form (AIF) for any claims made on or after 8 August 2023. These will be explored further in the section of this paper which considers HMRC's approach to compliance.
2. It is noticeable that the themes – for example, certainty, transparency, and competence/confidence in the decisions – which run through the commentary on the government's approach to the policy changes may also be seen in the concerns raised as to HMRC's approach to compliance, and are indicators to explore as to their importance for overall trust and confidence in the system.

2.2 Literature review and background research: HMRC's compliance approach

Pivotal to this research is HMRC's approach to compliance in relation to R&D claims.

Historically, to encourage use of the schemes HMRC sought to "simplify the claims process"²⁰ and claims were actioned on a "process now, check later" basis, which resulted in limited compliance activity. This system has been credited as making the system a target for abuse. Abuse took the form of wide interpretations of what was qualifying R&D (and setting an arguably unrealistic expectation of what was, or would pass as, qualifying) and presented an opportunity for less scrupulous agents charging high fees to exploit the system through poor quality, excessive and non-qualifying claims, and in some cases misleading claimants. The problem was not new - agents were raising concerns the mid-2010s²¹. Concerns and the issue of professional standards in R&D were first discussed at the HMRC R&D Consultative Committee (RDCC), predecessor to HMRC's R&D Compliance Forum (RDCF), a regular meeting for agents and HMRC, in October 2016²².

²⁰ HMRC, *R&D Consultative Committee meeting minutes Wednesday 17 May 2006* (gov.uk, archived 6 June 2013, no publication date) <<https://webarchive.nationalarchives.gov.uk/ukgwa/20130606044141/http://www.hmrc.gov.uk//consultations/rdcc.htm>> accessed 23 May 2025

²¹ David O'Keefe, *Dubious R&D claims brew hidden problems* (Accountingweb.co.uk, 9 October 2020) <<https://www.accountingweb.co.uk/tax/business-tax/dubious-rd-claims-brew-hidden-problems>> accessed 23 May 2025

²² HMRC, *R&D Consultative Committee meeting minutes Monday 10 October 2016* (gov.uk, archived 10 June 2017, no publication date) <<https://webarchive.nationalarchives.gov.uk/ukgwa/20170610061916/https://www.gov.uk/government/groups/research-development-consultative-committee#meeting-minutes>> accessed 23 May 2025

The NAO took the step of qualifying HMRC's accounts from 2015/16 (and each year since). In 2021/22, HMRC carried out a random enquiry programme (MREP) of 500 small business claims to explore the "size and scope" of non-compliance²³. Drawing on the MREP and a refined computational methodology, error and fraud attributable to R&D tax relief was estimated at around £1.13 billion, significantly uplifting an earlier estimate of £336 million, and suggesting some level of non-compliance in 50% of claims, ranging from technical misinterpretation and varying degrees of overstating of claims to full disallowance due to a lack of qualifying R&D.

The Public Accounts Committee (PAC) urged HMRC to gain a "*better understanding of the nature and error and fraud in R&D tax reliefs*"²⁴ following the National Audit Office (NAO) qualifying HMRC's accounts in 2020-21. Amongst other actions, HMRC ramped up its compliance coverage. Alongside a special Anti-Abuse Unit set up in July 2022 to work complex cases, HMRC set up a team in its Individuals and Small Business Compliance (ISBC) directorate to increase coverage of R&D cases. This included bringing in 400 new compliance staff to work enquiries, leading to one in every five

²³ HMRC, 'Corporate report: HMRC's approach to Research and Development tax reliefs' (gov.uk, 17 July 2023)

<[²⁴ Public Accounts Committee, *HMRC Performance in 2020-21* \(HC 37th Report of Session 2021-22 – ordered to be printed on 2 February 2022\)](https://www.gov.uk/government/publications/compliance-approach-to-research-and-development-tax-reliefs/hmrcs-approach-to-research-and-development-tax-reliefs#:~:text=The%20updated%20estimate%20of%20the,million)%20for%202020%20to%202021.> accessed 1 January 2024</p></div><div data-bbox=)

<<https://committees.parliament.uk/publications/8862/documents/89198/default/>> accessed 23 May 2025

claims being subject to a check.²⁵ The objective of this team was to test the simpler claims through a “volume compliance” approach.

This scaling up of compliance activity took place at pace and has become subject of much commentary from the R&D community of claimants, agents, representative bodies and commentators.

There was universal acknowledgement that action needed to be taken to tackle the error and fraud. However, a number of issues surfaced (broadly summarised by CIOT in their exchange of letters with HMRC). Many felt that HMRC were failing to meet their own Compliance Professional Standards²⁶. These included, for example:

- Poor quality of correspondence including cutting and pasting from other letters; errors and misrepresentations of the requirements of R&D; incorrect statutory references
- Slow responses from HMRC and an inability to discuss issues leading to lengthy enquiries
- Dismissal of the views of competent professionals and failures to read the information provided

²⁵ HMRC, *Approach to Research and Development tax reliefs 2023 to 2024* (published 30 October 2024) <<https://www.gov.uk/government/publications/hmracs-approach-to-research-and-development-tax-reliefs-2023-to-2024/approach-to-research-and-development-tax-reliefs-2023-to-2024>> accessed 1 January 2025

²⁶ HMRC, *Professional Standards for Compliance* (published 27 July 2023) <<https://www.gov.uk/government/publications/professional-standards-for-hmracs-compliance-work/hmrc-professional-standards-for-compliance>> accessed 10 January 2025

- Decisions based on poor Google searches
- A perception of default and prejudiced rejections of claims, and some closure notices not being received

CIOT highlighted collateral damage in their letters to HMRC; they were seeing examples of valid claims being caught up in enquiries and receiving reports of agents and claimants in despair.²⁷ Another outcome which emerged was a backlog of statutory review appeals with HMRC's Solicitors' Office (SOLS) and Alternative Dispute Resolution (ADR) cases, and numerous complaints being made to HMRC.

Recognising they did not have the information necessary to perform basic checks on claims, HMRC undertook some administrative policy changes including introducing a disclosure facility, the need for claims to be accompanied by an AIF, and a requirement for first time claims (or those where there was no previous claim within the last three years) to be pre-notified to HMRC. They are also building an Expert Advisory Panel, to provide expertise on R&D in specialist sectors, with recruitment over the spring of 2025 but with the outcome still awaited as of August 2025.

HMRC also published new Guidelines for Compliance²⁸ to assist people comply with R&D tax relief rules and setting out their expectations.

²⁷ Letter from Ellen Milner, CIOT to Philippa Madelin, HMRC (3 July 2023)
Letter from Philippa Madelin, HMRC to Ellen Milner, CIOT (29 August 2023)
Letter from Ellen Milner, CIOT to Philippa Madelin, HMRC (11 December 2023)

²⁸ HMRC, *Help to see if your work qualifies as Research and Development for tax purposes – GfC3* (published 31 October 2023, updated 23 January 2025)
<<https://www.gov.uk/government/publications/help-to-see-if-your-work-qualifies-as-research-and-development-for-tax-purposes-gfc3>> accessed 23 May 2025

The level of change, well-published difficulties with volume compliance and HMRC's attempts to provide further guidance and upskill staff, while tackling the large swathes of error and fraud illustrate the challenges of R&D compliance in the last three years. It is clear that all of these issues could have an impact on trust, something which the research will explore further.

2.2.1 Data on numbers of and value of claims

As noted in the synopsis, it is important to understand the scale of R&D relief and hence the scales of the issues faced by HMRC both in terms of amounts of error and fraud and the number of claims they have to deal with. HMRC collates a lot of data on R&D claims, initially due in part to the need to be able to show how it was managing a notifiable State Aid in some parts of the regime²⁹.

HMRC's data showed increasing costs of the regime and increased numbers of claims. Between 2015/16 and 2020/21 claims increased from 43,665 claims totalling £4 billion to 89,300 claims totalling £6.6 billion but conclusions as to what was driving the increase are difficult to definitively assess. An increase in claims could be an indicator that the regime was a target for erroneous claims and abuse. However, the objective of the policy is to increase expenditure on qualifying R&D so its success would also show an increase in the number of claims and amounts paid out. Further, the fast-paced growth and innovation of areas like digital technology and during the Covid 19 pandemic may have led to increased R&D activity, impacting the statistics.

These conflicting possibilities make the data harder to interpret (without deeper research outside the scope of this report), as to whether and why the number of claims or the amounts paid out were overinflated – but given the facts suggest they were all

²⁹ HMRC, *Approach to Research and Development tax reliefs 2023 to 2024* (published 30 October 2024) <<https://www.gov.uk/government/publications/hmracs-approach-to-research-and-development-tax-reliefs-2023-to-2024/approach-to-research-and-development-tax-reliefs-2023-to-2024>> accessed 1 January 2025

influential to some extent, it is logical to conclude that the increase is probably attributable to a range of factors.

The data also shows the sheer scale of the challenge facing HMRC. It is simply not feasible to check 90,000 claims without a huge investment of resource. It is understandable, if little comfort to those subject to enquiries, that 400 new recruits will have, at least initially, lacked the skills to apply the highly complex and subjective R&D rules (something CIOT in their letters to HMRC cited as being a reason for R&D not being well-suited to the volume compliance approach). These factors suggest that not only were HMRC going to struggle to ensure consistency and the right outcome across the population, they were also starting from a position of low competency, both of which the literature have indicated are important for trust.

HMRC have also publicised data relating to the impact of their compliance interventions, which is explored as part of the section 2.3.1 below.

2.3 Literature review and background research: Are/were the UK R&D tax relief schemes effective?

In considering whether or not an erosion of trust in the system and/or HMRC's approach to R&D tax relief compliance has undermined the policy objectives of UK R&D tax policy, it is important to understand not only what those objectives are, but also whether the R&D tax scheme would otherwise encourage investment in qualifying R&D (that is, is the scheme effective in and of itself?).

If the scheme was/is intrinsically ineffective as such an incentive, then the question of whether a decrease in trust resulting from HMRC's compliance approach erodes the scheme's effectiveness is a moot one.

The literature review therefore considers sources which could indicate the role of R&D tax policy in the UK's strategic approach to R&D (as well as whether this has shifted with a change of government in 2024). Evidence of the objectives of the UK government in power at the times the policy was set or changed, which is key to assessing effectiveness, is considered alongside academic and government literature.

A number of relevant articles, reports, consultations and studies evaluate effectiveness of R&D schemes and enable a critique of the more economically focused modelling, to assess whether further research outside of the literature is required to answer this question of effectiveness, including what factors (other than the volume compliance approach) may have influenced the schemes' ongoing effectiveness.

For the purposes of this research, the UK R&D schemes will be accepted as meeting the definition of "effective" if it is shown that they do in fact increase investment in

qualifying R&D. Ideally the return through investment in qualifying R&D would outstrip the government investment in the scheme – so there is a positive or optimal return on the investment – but this more in depth assessment of the value or level of return versus investment, including of indirect effects is outside the scope of this research. Where the literature considers levels of effectiveness, and valid policy questions arise, these may be flagged during the research as areas that warrant further consideration or caution when being used for analysis purposes.

In short, quantifying the level of effectiveness is outside the scope: the question for this research is simply whether the schemes can be taken as effective in order to benchmark and enable an assessment as to whether there is a shift from this position.

2.3.1: What does the literature say about the effectiveness of R&D tax relief schemes at driving investment and whether the UK had/has an effective scheme?

More broadly than tax, R&D is important to the UK's economy and is an area of considerable public investment. In 2023, the UK was ranked 4th in the Global Innovation Index³⁰, which measures the performance of national economies' innovation ecosystems. This suggests that the UK is world leading for R&D but does not shed much light on the extent to which this success comes from tax versus other policy measures.

³⁰ World Intellectual Property Organization, *Global Innovation Index 2023, Innovation in the face of uncertainty* (2023)

In July 2020, the then Conservative UK government published their UK Research and Development Roadmap³¹ highlighting their aims of attracting investment in R&D in the UK. The roadmap included considerable public funding commitments and an ambition to increase investment in R&D to 2.4% of GDP by 2027. The roadmap identified businesses as being the biggest investors in R&D – and identified the tax system as a key influencer in business decisions whether to invest. The level of business impact was demonstrated by the ONS³² quantifying the UK spend on R&D at £70.2 billion in 2022, and of this, £49.9bn (71%) came from business.

Following their election in July 2024, the current Labour government reinforced its manifesto commitment to supporting R&D at its first Budget in October 2024, announcing investments of £20.4bn in UK R&D³³. At the same time, the government published a corporate tax roadmap³⁴, which included a number of R&D commitments

³¹ HM Government, *UK Research and Development Roadmap* (July 2020)

³² Office for National Statistics, *Gross domestic expenditure on research and development, UK: 2022* (8 August 2024) <<https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/bulletins/ukgrossdomesticexpenditureonresearchanddevelopment/2022#data-on-gross-domestic-expenditure-on-research-and-development>> accessed 24 May 2025

³³ Department for Science, Innovation and Technology, *News Story: Government backs UK R&D with record £20.4bn investment in Autumn Budget* (published 31 October 2024) <<https://www.gov.uk/government/news/government-backs-uk-rd-with-record-204-billion-investment-at-autumn-budget>> accessed 23 May 2025

³⁴ HM Treasury, *Corporate Tax Roadmap* (October 2024) <https://assets.publishing.service.gov.uk/media/6721199c4da1c0d41942a8bd/Corporate_Tax_Roadmap.pdf> accessed 22 January 2025

(including maintaining the rates of relief for the R&D schemes), and in May 2025, followed up these commitments with new ten-year budgets for R&D funding³⁵, showing their intention to maintain support for R&D, including through tax relief.

This continued investment by successive governments in R&D, both within and outside the sphere of taxation, indicates an ongoing conviction that the incentives are effective at delivering growth (albeit without a clear basis for this set out in those documents, which were more focused on governmental direction, ambitions and commitments).

In 2021, the then government launched a review of R&D tax reliefs, signalling what it saw as the key policy objectives: *“R&D tax reliefs have a key role in incentivising...investment [in R&D] by reducing costs of innovation”*³⁶. It went on to highlight the need for ensuring the regime was well-targeted and competitive, with a focus on private sector R&D investment. There is nothing to suggest that the current government has shifted from this position given they are continuing with the implementation of the outcomes of that review.

However, not all commentators are convinced by the approach. At the CIOT-IFS debate on the corporate tax roadmap on 4 September 2024, Helen Miller, then Deputy

³⁵ Department for Science, Innovation and Technology, *Press release: Government to set new ten-year budgets for R&D funding* (published 19 May 2025) <<https://www.gov.uk/government/news/government-to-set-new-ten-year-budgets-for-rd-funding>> accessed 23 May 2025

³⁶ HM Treasury, HMRC, *R&D Tax Reliefs Consultation* (March 2021) <[https://assets.publishing.service.gov.uk/media/603cc357d3bf7f03985e12b5/Condoc - RD review .pdf](https://assets.publishing.service.gov.uk/media/603cc357d3bf7f03985e12b5/Condoc_-_RD_review_.pdf)> accessed 13 June 2024

Director at the IFS, advocated for a clear vision as to what the government is trying to achieve through the corporate tax system – whether its ambition is, for example, for a broader base-lower rate or narrower base-higher rate tax system. This vision would dictate the government’s approach to reliefs. Similarly, CIOT wrote to the Exchequer Secretary to the Treasury about the corporate tax roadmap on 11 September 2024.³⁷ They stressed the need to take a full strategic look at tax reliefs (not just R&D) and what the government was seeking to achieve with them – considering the tax system and other policy levers as well as the wider growth agenda – and establish from that whether broad reform of corporate tax relief in general was required. None of these points specifically answers the question as to the effectiveness of the UK R&D schemes, but they do support a conclusion that the schemes could be improved while also recognising them as useful fiscal levers.

Exploration of the effectiveness of R&D incentives is also apparent in the academic studies, of which there are a number. Broadly, these show that there are two approaches to R&D schemes – grants and tax credits – both of which seek to encourage investment by reducing the user cost of capital of investing in R&D (in other words, the government objective of reducing costs of innovation). The general conclusion across the academic research is that schemes do incentivise additional investment in R&D, with a good rate of return. This suggests that the simple answer to the question posed by this research is that they are effective, albeit the different

³⁷ Letter from Ellen Milner, CIOT to the Exchequer Secretary to the Treasury (11 September 2024)

studies show that the stated policy intent and hence the definitions of “effectiveness” are not uniform.

In some studies, for example, HMRC’s Evaluation of the Research and Development Expenditure Credit (RDEC) in 2020³⁸, one of the policy objectives is described as addressing a market failure caused by businesses failing to invest enough in R&D activities to maximise the social benefits, which often exceed the private returns to investors themselves. The tax reliefs therefore work to reduce the cost and risk to the business of investing in R&D, which supports overcoming the market failure. This goes beyond simply a reduction of cost to also considering the indirect effects of the policy.

A more commonly seen expression of a measure of effectiveness focuses on the increase in investment in R&D for the each £1 of tax foregone, based on the concept of R&D tax reliefs reducing the user cost of R&D for businesses who carry out qualifying activities. This was a feature of HMRC’s 2020 RDEC evaluation, and separately in its 2019 evaluation of the SME scheme³⁹. These studies computed what is termed an “additionality ratio” – that is, the expected amount of R&D expenditure for each £1 of tax foregone through the relief.

³⁸ HMRC, *Evaluation of the research and development expenditure credit (RDEC)* (October 2020)
<https://assets.publishing.service.gov.uk/media/5faad42ed3bf7f767a564f65/Evaluation_report_-_R_D_RDEC.pdf> accessed 22 January 2025

³⁹ HMRC, *Evaluation of research and development tax relief for small and medium-sized enterprises* (September 2019)
<https://assets.publishing.service.gov.uk/media/5fae77c18fa8f55debcc5fd4/HMRC_Research_Report_598_R-and-D_tax_relief_for_SMEs.pdf> accessed 22 January 2025

Over time there have been various ranges computed with the 2020 statistics being the latest available - the study concluded an additionality range of 2.4-2.7 for RDEC (although it should be noted this only took into account new expenditure by those already claiming the relief and did not account for any wider economic benefits derived from the investment). The latest available SME range, computed in 2019 and referred to in HM Treasury's policy consultation as a driver for the full review of the scheme was that for every £1 foregone, there would a stimulus of between £0.75 and £1.28 in qualifying R&D expenditure. Therefore, it is not certain that on the face of it the rate of return exceeded the investment. However, the evaluation also highlighted a number of indirect effects, including a trend for increased turnover for the businesses investing in R&D (with a potential negative impact on other businesses in the sector but a positive regional "spillover" effect when considering only businesses in the same proximity), so the position is more complex than just the additionality ratio of direct effects.

What these evaluations do suggest is that the expected return was lower for the SME regime than the RDEC, although HMRC also highlighted research by Nelson, 1959, and Arrow, 1962, which indicates that it is also important to consider the social benefits in the context of market failure (that is, that private levels of R&D expenditure are likely to be less than the amounts desirable for society as a whole) so using R&D tax relief to encourage the narrowing of the gap between the desired amount and unstimulated private investment has a societal benefit, which may be more considerable for SMEs.

Overall whilst the additionality ratio for SMEs raises a question as to the level of effectiveness of that regime, these evaluations do support the idea that R&D tax relief is an incentive to investment in R&D.

Other studies have settled on different additionality ratios in their findings, for example, Fernando Galindo-Rueda, Matej Bajgar, Chiara Criscuolo, and Silvia Appelt in 2020⁴⁰ concluded an average of around 1.4 units of investment per unit of relief, and a general consensus that the relief will have a not insignificant impact on businesses deciding to invest in R&D, so if a solid level of investment is a key measure of effectiveness then the conclusion is consistent, and it certainly meets the test of increasing investment. They also considered the design of support for R&D and noted that in the OECD, R&D is mostly incentivised through tax systems rather than grants and concluded that different considerations are required for small and large businesses.

Some commentators have also identified the importance of considering the difference of requirements for “high-tech” and “low-tech” businesses as well as those of different sizes, suggesting that the target of the relief could impact its effectiveness. However, for the purposes of this study, there is no suggestion that the schemes did not deliver a positive return across different sizes of business and different sectors albeit perhaps at different levels of effectiveness.

Much of the literature focuses on economic concepts like the additionality ratios and how changes to the rates of relief can impact the return. It is not clear if, and if so how,

⁴⁰ Galindo-Rueda, Bajgar, Criscuolo and Appelt, *OECD Science Technology and Industry Policy Papers, The effects of R&D tax incentives and their role in the innovation policy mix* (oecd.org.uk, published September 2020)

<https://www.oecd.org/content/dam/oecd/en/publications/reports/2020/09/the-effects-of-r-d-tax-incentives-and-their-role-in-the-innovation-policy-mix_b7f9884d/65234003-en.pdf> accessed 22 January 2025

models account for erroneous or abusive claims in reaching conclusions on rates of return. This would require stripping out any return for expenditure on reliefs identified as invalid claims, as well as the amounts of any invalid claims recovered by HMRC as they would no longer be costs of the policy. High levels of error and fraud could quickly reduce the additionality ratio. Therefore, the question as to whether the schemes are effective also needs to consider the levels of error and fraud that have been identified in the system.

In October 2024, HMRC published a report on its approach to R&D tax reliefs⁴¹. In this report (and also in its 2024 Annual Report and Accounts⁴²) HMRC set out updated estimates for the amount of error and fraud in the years from 2020-21 to 2023-2024:

2020-2021: 16.7% - £1.13 bn (£1.04bn from SMEs and £90m from RDEC) – of total expenditure £6.6bn

2021-2022: 17.6% - £1.34bn (£1.2bn from SMEs and £134m from RDEC) – of total expenditure: £7.4bn

2022-2023: 13.3% - £1.05bn (£1.0bn from SMEs and £48m from RDEC) – of total expenditure: £7.5bn

⁴¹ HMRC, *Approach to Research and Development tax reliefs 2023 to 2024* (published 30 October 2024) <<https://www.gov.uk/government/publications/hmracs-approach-to-research-and-development-tax-reliefs-2023-to-2024/approach-to-research-and-development-tax-reliefs-2023-to-2024>> accessed 1 January 2025

⁴² HMRC, *Annual Report and Accounts 2023 to 2024* (ordered by House of Commons to be printed on 30 July 2024)

2023-2024: 7.8% - £601m (£476m from SMEs and £125m from RDEC) - of total expenditure: £7.7bn

These figures suggest that since 2022 and the introduction of volume compliance and other policy measures, in the absence of other effects, the schemes should have given a better return on investment as the amount of money paid out has increased but there has been a reduction of fraud and error in the system of more than 50%.

(To note, HMRC published revised figures in their 2024-25 Annual Report and Accounts⁴³ on 17 July 2025. A shift to accruals basis of accounting makes direct comparison with the 2023-2024 Annual Report and Accounts used for this analysis difficult. However, the revised figures display similar trends and do not shift the analysis so the figures above have not been updated at the end of this research project.)

However, there are a number of factors which make drawing a conclusion from either sets of statistics difficult. Firstly, there is a question as to whether HMRC's error and fraud statistics reflect genuine claims that have been withdrawn because of the difficult and costly enquiry process, something this research explores further. If genuine claims are being caught by the compliance approach, not only will this skew HMRC's statistics but also suggests that the rate of return on R&D tax relief may not have been eroded by error and fraud to the extent estimated by HMRC. It is not possible to critically examine these numbers, as they are available only to HMRC at the necessary

⁴³ HMRC, *Annual Report and Accounts 2024 to 2025* (ordered by House of Commons to be printed on 17 July 2025)

granularity. However, this can be examined to a certain extent by asking claimants (or their agents) whether they are, and the circumstances in which they (or their clients) are, giving up on enquiries despite not agreeing that their claims are invalid. In such cases, HMRC will record a tax adjustment in their favour and so it is likely that these will be included in future statistics showing that an HMRC intervention has resulted in an increase in tax. This is likely recorded as due to error or fraud, (which of these will depend on HMRC's grounds for selecting or settling the claim), rather than due to the claimant choosing not to defend the claim for whatever reason.

Secondly, and presenting an argument which would have the opposite effect to the first, a report by Tax Policy Associates in 2024⁴⁴ concludes that the levels of error and fraud may be significantly understated by HMRC. Tax Policy Associates suggest there could have been closer to £10bn lost since 2000. They attribute this in part to insufficient consideration of the levels of error and fraud in the system since the introduction of the modern relief in 2000.

Their reasoning is a high level of scepticism as to the quality and regulation of the tax services market, especially with regards to R&D claims which have been historically easy to abuse, with minimal policing by HMRC. They also note surprise with regards to HMRC's sectoral analysis, pointing to many "valid" R&D claims being allocated to "suspicious" sectors, such as wholesale and retail, where qualifying R&D seems

⁴⁴ Tax Policy Associates, *The £10bn R&D tax relief scandal: the evidence and the blame* (30 September 2024) <<https://taxpolicy.org.uk/2024/09/30/the-uk-has-lost-up-to-10bn-in-the-rd-tax-relief-scandal-how-did-hmrc-and-the-treasury-miss-it/>> accessed 13 January 2025

unlikely. The idea that there have been high levels of error and fraud for a considerable period of time is not without support from other commentators – CIOT reference raising the issues prior to volume compliance in their July 2023 letter to HMRC, and the trade press archives show articles⁴⁵ dating back to the mid-late 2010s, raising concerns that clients were being targeted by “R&D consultants” seeking to make (likely questionable) claims on their behalf. They highlighted the ease with which a claim could be made and the process now, check later approach of HMRC (with very few actual checks taking place).

If Tax Policy Associates’ estimates are more accurate than HMRC’s, then arguably the question of the UK R&D schemes’ basic effectiveness becomes more in dispute. There will be a tipping point where the number of valid claims versus invalid claims becomes skewed so far in the direction of the invalid that even if some genuine investment is incentivised the level is so low that it is hard to sustain a conclusion of effectiveness. However, it is not only difficult to assess whether the numbers in the study would move sufficiently close to this tipping point but also, while a credible analysis, the report is also a hypothesised theory, the testing of which is outside the scope of this research. As such it cannot be taken as conclusive proof that on balance outweighs the other literature as to the likely effectiveness of R&D tax incentives leading to an uplift in qualifying R&D expenditure. It is also possible that the level of effectiveness over time has been commonly overestimated (as opposed to reaching that tipping point to

⁴⁵ Kevin McC, *R&D Claims – Are we missing a trick?* (Accountingweb.co.uk, 26th January 2018) <<https://www.accountingweb.co.uk/any-answers/rd-claims-are-we-missing-a-trick>> accessed 23 May 2025

be regarded as ineffective), albeit that as the rates of error and fraud increased this is likely to have reduced the overall return. It is not possible to draw a firm conclusion on this from the literature.

Taking these points together, it seems likely that there has been some shift in the level of return generated by the HMRC's increasing levels of compliance but that neither this nor the levels of erroneous or fraudulent claims have been accurately captured in academic literature to date.

Similarly, while some of the research considers the wider economic effects (or "spillovers") in evaluating effectiveness, there is no evidence that the models have considered the true costs of accessing the relief, which will impact the effective rate of relief of the claim for the claimant. This means that if costs of accessing and defending claims – which could be, for example, from systems, the need to pay for advisers, data gathering and staff time – increase (potentially due to the increased likelihood of an enquiry given HMRC now check one in five claims) then the value of the tax relief received in return is eroded. This is a displacement of costs from government to claimant businesses so the true costs to the economy of the regime are higher than that estimated for each £1 additional investment in qualifying R&D. The research will consider further how claimants have reacted in their investment decisions following the introduction of volume compliance, and test whether these are considerations that have played a part in any shift.

The policy design itself is also relevant to the schemes' effectiveness, which again other than some consideration of the differences between sizes of business and sectors, has

received minimal attention in the academic literature and economic modelling. Arguably, the act of carrying out a formal review of R&D tax reliefs over 2021-23, culminating in a change of the policy to merge the SME and RDEC schemes (subject to some exceptions) and introducing a raft of new requirements, indicates that HM Treasury felt that improvements could be made. In launching a review of the single scheme consultation in January 2023⁴⁶ they highlighted the then Chancellor's intent to *"reform the R&D tax reliefs to ensure taxpayers' money is spent as effectively as possible"*. Whilst this would seem to support a conclusion that the schemes were not as effective as they could be, on its own it does not surpass the high bar needed to conclude that the previous schemes were wholly ineffective. The new merged scheme came into force for accounting periods beginning on or after 1 April 2024 so it will take some time before this can be evaluated and compared with previous schemes. But some of the other policy changes, for example, the requirement for claimants to submit an AIF with their claims, came into use in August 2023, had a quicker lead in time and so the emerging impacts can be explored with participants in this research. In conclusion, the literature broadly supports the notion that R&D schemes are effective at incentivising investment in R&D by the private sector by reducing the user cost of capital. By extension the UK R&D schemes have been evaluated as delivering in this way, albeit that there are questions over the level of that effectiveness. It is

⁴⁶ HM Treasury, *R&D Tax Reliefs Review: Consultation on a single scheme* (January 2023) https://assets.publishing.service.gov.uk/media/63c51fc08fa8f572a9a36f33/20230113_R_D_Consultation.pdf accessed 22 January 2025

therefore reasonable to assume for the purposes of this research that the UK R&D schemes can be treated as effective and as such, their effectiveness may be impacted by an erosion of trust.

2.4 Literature review and background research: The role of trust in the Tax

Administration System – identifying the hallmarks of trust

2.4.1 What does the literature say about the role of trust in the tax administration system, what trust looks like, and how it is linked to HMRC's current volume compliance approach to R&D tax relief?

Traditional economic theory focused more on compliance through rational and logical decision-making; for example, assessing risk and deterrents against the possibility of gains through non-compliance (one of the most notable pieces of research here being Allingham and Sandmo's 1972⁴⁷ paper on income tax evasion).

However, the development of behavioural economics has somewhat displaced purely traditional economic models over time with research demonstrating factors other than pure logic influencing taxpayer behaviour, including heuristic shortcuts in decision-making. These have led governments, including in the UK, to consider a much wider range of behavioural drivers through various initiatives like the now independent, but previously Cabinet Office run, "Behavioural Insights Team", which was set up in 2010. Their work centred around "nudges" to drive behaviour, and for HMRC, understanding what led to tax compliance was the key. Nudge techniques have proved useful in driving behaviours and are now commonly used in tax compliance. For R&D these have included HMRC's use of One-to-Many letters sent to claimants, whom HMRC believe operate in sectors (such as care homes and retail) unlikely to be carrying out qualifying

⁴⁷ Allingham, Sandmo, *Income tax evasion: a theoretical analysis*, Journal of Public Economics Volume 1, Issues 3-4, November 1972, pages 323-338

R&D, advising them to check/withdraw their claims. For overall compliance however, the concept of trust is also seen as a fundamental component and behavioural driver.

This embodiment of the importance of trust in the UK's approach to tax administration can also be seen in HMRC's 2020 report titled "*Building a trusted, modern tax administration system*"⁴⁸. This strategic policy paper is based on a principle that trust is essential for the tax administration's effective functioning. The report states an expectation by the government that HMRC will "*maintain and build trust in the tax administration system*". In doing this, it references fairness, care, consistency, plus the need for HMRC to be operating in line with internal assurance and governance as well as statutory safeguards.

Further, HMRC demonstrated its recognition of the need for trust through its commitment to services for those who need additional support, and by setting up its Customer Experience Committee, which includes independent members to improve challenge, accountability and transparency. HMRC has also published its Charter⁴⁹ (which sets out its commitment to: getting things right, making them easy, being responsive, and treating people fairly), and its linked Compliance Professional

⁴⁸ HMRC, *Building a trusted, modern tax administration system* (published 21 July 2020) <<https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system>> accessed 22 January 2025

⁴⁹ HMRC, *The HMRC Charter* (updated 30 July 2024) <<https://www.gov.uk/government/publications/hmrc-charter/the-hmrc-charter>> accessed 23 May 2025

Standards⁵⁰ (which comprises four standards taxpayers should expect from HMRC in its compliance work: getting things right; being aware of their customers' situation; being responsive – communicating with customers; treating them fairly). HMRC ties both the Charter and the Compliance Professional Standards to trust, describing the latter as playing “a vital role in helping us to become a trusted and modern tax department and reinforce...commitment to the HMRC Charter”. HMRC’s 2020 report also stresses that it is important in establishing trust that taxpayers witness the successful tackling of undesirable behaviours, for example, tax avoidance.

While this statement of commitment to being trusted is important, it is likely that this last point is critical - if HMRC’s actions do not follow through in the eyes of taxpayers then trust will be hard to maintain or establish. This is pivotal to this research in considering whether HMRC are (or were) in fact trusted, despite their stated intent.

It is now commonly accepted that trust (or lack of) in a tax administration can influence taxpayer behaviour and compliance, and the UK is not alone in shifting its focus onto trust as core to a “healthy” or effective tax administration. The EU has also considered the issue and includes it in a tool developed for EU tax administrations to consider their effectiveness⁵¹.

⁵⁰ HMRC, *Professional Standards for Compliance* (published 27 July 2023) <<https://www.gov.uk/government/publications/professional-standards-for-hmrcs-compliance-work/hmrc-professional-standards-for-compliance>> accessed 10 January 2025

⁵¹ EU Tax Administrative Diagnostic Assessment Tool <https://www.tadat.org/>

A considerable number of academic researchers have also looked at the components that are required for trust and some specifically in relation to tax compliance, although it is notable that the focus of most of the research is on tax evasion and avoidance (and to some extent avoiding error and mistake).

There is very little consideration of trust in the context of the broader question as to whether trust in a compliance approach could also impact whether or not taxpayers are disincentivised from claiming reliefs to which they are entitled due to an erosion of trust in the tax administration – by extension negatively impacting the effectiveness of such reliefs, and the success of growth-focused policies at driving investment.

However, it is possible to see a number of themes in the consideration of what factors impact trust and whether organisations are trusted, which will provide a foundation for testing whether there has been a shift of trust for the purposes of this research. This can be drawn from HMRC's statements as to its ambitions on a trusted tax administration, as well as wider research and commentaries.

In 2011, Michie, Stralen and West⁵² looked at trust through a tax compliance lens and identified capability, motivation and opportunity as all playing a part in what they term the COM-B model.

Breaking this down, the model identifies the need for:

⁵² Michie, Stralen and West, *The behaviour change wheel: A new method for characterising and designing behaviour change interventions* (Published 23 April 2011) *Implementation Sci* 6, 42 (2011) <<https://doi.org/10.1186/1748-5908-6-42>> accessed 13 June 2024

- Capability, that is, compliant taxpayers having the skills and access to the information they need through access to support and with minimal costs/burdens.
- Motivation, that is, the risk of penalty and getting caught outweighing potential advantage or avoidance; social norms and societal expectations as well as social contracts (perhaps the value of what you get back in return or the risk of reputational damage associated with avoidance); trust and fairness supporting the notion the system is itself built on a positive platform
- Opportunity, that is, whether the legislative framework makes compliance actually possible; having the systems to support it; and an environment which drives compliance or non-compliance

Others have observed that trust in a tax administration system is a two-way concept as between taxpayers and the government; in the case of this research with the UK's tax authority, HMRC.

There is a broadly accepted principle that there is a correlation between tax compliance and citizens' belief that the system seeks to be fair and even-handed. This includes concepts of the tax system being possible (and preferably easy) to comply with; certainty for taxpayers as to their position; getting a fair hearing and chance to present arguments in dispute; proportionate consequences; transparency of decision-making, including consistency and competence within the tax administration system; and a feeling of non-discriminatory treatment.

Similarly, some commentators have observed that to trust a system, taxpayers themselves need to feel trusted – so innocent until proven guilty and starting from a position that the majority of taxpayers, whether it be due to the desire to contribute to society or for fear of repercussion, are honest and aim to operate within the rules.

KPMG captured some of this sentiment in its 2020 guide to organisational trust “*Trustworthy by design*”⁵³, where it highlighted three characteristics of a trustworthy organisation: ability; humanity; and integrity. Within these characteristics the guide highlights the need for competence and reliability as well as benevolence (at its minimum doing no harm), honesty, fairness, taking responsibility, operating within the law and living the expressed values.

The latter part of this supports the hypothesis that while HMRC may make a public commitment to the principles of trust it must also demonstrate them.

Slightly earlier in 2020, the Institute of Chartered Accountants Scotland published an article entitled “*Do you trust HMRC?*”⁵⁴ questioning how “confidence” in HMRC could be enhanced. Focusing on transparency and robust commitments by HMRC to their Charter as being key to trust, ICAS shows the weight it assigns to these hallmarks and

⁵³ KPMG, *White paper: Trustworthy by design: a practical guide to organisational trust* (November 2020)
<<https://assets.kpmg.com/content/dam/kpmg/nl/pdf/2020/services/trustworthy-by-design-organisational-trust-guide-final-09-11.pdf>> accessed 12 June 2024

⁵⁴ Susan Cattell, ICAS, *Do you trust HMRC?* (2020)
<<https://www.icas.com/landing/tax/do-you-trust-hmrc>> accessed 12 June 2024

that this is also an issue of importance to tax professionals and their professional bodies.

Moving specifically to HMRC's approach to R&D compliance, there have been a number of reports citing the importance of trust. The House of Lords Economic Affairs Committee Finance Bill Sub-Committee⁵⁵ referenced the potential impact on trust by HMRC's approach to R&D tax relief compliance – both from the perspective of abuse not being seen to be tackled sooner and through the subsequent volume compliance approach, which has raised numerous questions over fairness, consistency, and competence.

Looking across these reports and letters, it is reasonable to conclude that trust is playing a role in how taxpayers are acting in the context of R&D reliefs given the breadth and commonality of the issues being raised. The National Audit Office and the House of Lords Economic Affairs Committee Finance Bill Sub-Committee sought evidence from witnesses both from within in and outside of government.

There has also been considerable public commentary on the issues. Some of the most cited of these are CIOT's public letters to HMRC. In their 3 July 2023 letter⁵⁶, CIOT makes the case that HMRC needs to "*rebuild trust*" and highlights the importance of

⁵⁵ Select Committee on Economic Affairs Finance Bill Sub-Committee, *Research and Development tax relief and expenditure credit* (HL 3rd Report of Session 2022-23 – published 31 January 2023 – HL Paper 137 <[House of Lords - Research and development tax relief and expenditure credit - Select Committee on Economic Affairs Finance Bill Sub-Committee \(parliament.uk\)](#)>

⁵⁶ Letter from Ellen Milner, CIOT to Philippa Madelin, HMRC (3 July 2023)

taxpayers feeling they are going to be able to have a fair hearing from a competent caseworker to deliver the correct result in a timely manner.

Some of the statements across the reports and letters are based on purely sample or anecdotal evidence (albeit in some cases in a material volume), so cannot be treated as representing the full range of experiences. Further, exchanges between CIOT and HMRC operational staff have acknowledged that there is a whole range of behaviour, some of which is only visible to HMRC (and often encompassing the really poor, and at times criminal, behaviour that has driven up the error and fraud estimates) and so the examples cited by non-HMRC commentators should be carefully considered as to the extent to which they capture a systemic picture of trust versus a particular sample group.

Another consideration is whether there may be inherent evidential bias within commentary by both those within and outside of government: those negatively impacted may be more likely to engage on the issues (and arguably those who are involved in fraud less likely to be sharing their experiences or being concerned about being able to trust HMRC). Similarly, those having a positive experience or witnessing positive experiences are gaining a benefit and so unlikely to feel the need to raise the issue in a public forum. Government comments, despite showing a degree of openness through acknowledging not meeting their professional standards, will be made through a lens of defending and justifying their actions.

On the other side of the equation, it is also possible that HMRC's view of the full (including the worst) range of behaviours, combined with pressure to deliver a

reduction in error and fraud, may see caseworkers display bias towards taxpayers claiming R&D by seemingly starting from a position of denying claims. This is counter to a commonly referenced feature of trust, that is, of innocence until proven guilty (counter to HMRC's own Charter and commitment to building trust through fairness and consistency, as well as raising questions as to the competence of caseworkers, whom agents and claimants feel are incorrectly and arbitrarily rejecting valid claims).

There is some evidence of a perception in the R&D agent community of this behaviour by HMRC, set out in CIOT's public letters to HMRC⁵⁷. Considering the academic literature, the perceived practice may also touch on a further component of trust – reciprocity – a displayed lack of trust in taxpayers could itself impact how much taxpayers feel they can trust HMRC. There is a question as to whether the perception itself is enough to erode trust, even if in practice HMRC's actions are not to treat taxpayers in a discriminatory fashion.

HMRC acknowledged in their letter to CIOT of 29 August 2023 that their actions had "fallen short" of their professional standards and Charter commitments. One area was in relation to evidence relating to lack of competence and poor-quality work, suggesting that this is a feature that may have contributed to a shift in trust since the introduction of volume compliance.

One of the features identified by KPMG in its model of a trusted organisation was for it to operate within the law. Arguably this is even more important when an organisation

⁵⁷ Letter from Ellen Milner, CIOT to Philippa Madelin, HMRC (3 July 2023)
Letter from Philippa Madelin, HMRC to Ellen Milner, CIOT (29 August 2023)
Letter from Ellen Milner, CIOT to Philippa Madelin, HMRC (11 December 2023)

is a public body and there is a natural imbalance of power. CIOT and others challenged HMRC on what they saw as a potential abuse of power by HMRC in some R&D compliance checks, which gives a perception of HMRC pushing the boundary of the law⁵⁸. Regardless of whether the practice was strictly within the rules, the perception of HMRC treading a fine line with the law is not supportive of building trust based on KPMG's model. In the cases in point, HMRC used an existing power (under Paragraph 16 of Schedule 19 Finance Act 1998) to correct corporation tax returns to remove R&D relief claims without opening an enquiry. While it may have been possible to construct a case that this was within the scope of the quite widely drafted legislation, it was certainly counter to HMRC's own published guidance and broadened the power's previous use and understood scope, as well as appearing to be an attempt to circumvent the usual enquiry rules (and their in-built taxpayer safeguards). On challenge, HMRC did review the usage and explained that they wished to use it in obvious fraud cases. However, this raised further fairness concerns as to whether the usage in these "worst" cases actually meant that a penalty could not be charged in the same way as under a normal enquiry (and so putting "obvious fraudsters" in a better position than someone whose behaviour did not amount to this). This example highlights behaviour by HMRC which could have had a negative impact on trust, including how in trying to correct one problem which was eroding trust (that is, the

⁵⁸ CIOT, *R&D compliance activity and new compliance measures* (23 November 2023) <<https://www.tax.org.uk/r-d-compliance-activity-and-new-compliance-measures>> accessed 25 May 2025

fraudulent behaviour) HMRC's actions, in breaching their Charter commitments and pushing the boundaries of their powers further contributed to eroding trust.

The difficulties with accessing a full view of the positive and negative experiences, and a full range of experiences, is important to keep in mind throughout the research – including in collecting data and in any conclusions drawn. However, the volume of commentary is likely indicative that even if the scale is not accurately quantifiable, there is a significantly strong feeling to ask the question as to the role of trust and it may be that conclusions can be considered for a particular subset of the R&D community, which if linked to a decrease in investment in genuine R&D should be of concern to policy makers.

The various sources of literature – both on the role of trust in tax compliance and the publications relating to HMRC's current approach to R&D tax relief compliance – point to a number of themes that are linked to trust. These can be summarised (in no particular order) as follows:

1. Fairness (even treatment without bias, opportunity for a fair hearing)
2. Competence (skills to reach the right answer)
3. Instils confidence (that the right outcome will be reached)
4. Proportionality (that actions and consequences will be balanced)
5. Consistency (that similar and appropriate outcomes will be reached across the population)
6. Reciprocity of trust (that to be trusted, HMRC must also trust)
7. Participation (in decision-making)

8. Balance of power (effective processes, safeguards and appropriate use of powers)
9. Responsive (addressing problems in a timely manner)

2.5 Using the themes from the literature review and background research to address the hypothesis of this research

The literature is comprehensive and consistent in support of identifying the key hallmarks of trust. It is reasonable to conclude that trusted tax administrations and tax policymakers would demonstrate these hallmarks, and that these would be visible to those dealing with them.

The articles and letters published around the current R&D tax relief compliance approach provide multiple examples of areas which could indicate that HMRC are not consistently behaving in a way that positively demonstrates these themes (or indeed meeting their own published Charter and Compliance Professional Standards).

Supporting this is HMRC's acknowledgement that they had "*fallen short*"⁵⁹ in their letter to CIOT in 2023. In conclusion, these themes, or "hallmarks" of trust provide a reliable proxy for assessing the existence of trust, that is, whether claimants and agents see these behaviours from HMRC and as such trust them in their handling of R&D tax relief compliance, and whether that has changed since the introduction of the volume compliance approach. Similarly, the number and unpredictability of the policy changes can be considered against the same measures to establish whether the process has been a contributor in potentially eroding trust.

⁵⁹ Letter from Philippa Madelin, HMRC to Ellen Milner, CIOT (29 August 2023)

The research survey therefore uses the identified hallmarks to test whether there has been a shift in trust in HMRC since the introduction of volume compliance.

The testing of the hypothesis requires not only establishing the presence (or erosion) of trust but also consideration as to how this impacts investment in qualifying R&D.

While the consequence for investment is referenced in some of the literature, and some commentators have written articles raising concerns, there is little published from which to draw conclusions. This is an area which requires wider exploration through the research survey, deeper interviews, and analysis of the data in the round to assess whether there has been, or if there is a risk of, a reduction in investment and whether this is wholly or in part causally linked to a change in levels of trust in HMRC.

Chapter 3: Research survey and interviews with practitioners and claimants

3.1 Research Survey

The survey design drew insights from the literature review and background research to identify areas to test the hypothesis of whether the policy objectives of R&D relief are being eroded by a lack of trust stemming from HMRC's compliance approach.

These were broken down into three pillars:

1. Whether R&D relief can be said to be effective, and if not, whether this is amplified by the compliance approach
2. The level of trust that those using the R&D regime (agents and taxpayers) had in the system before and after the identification of error and fraud in the system and HMRC's subsequent compliance approach
3. How the approaches to compliance and policy have themselves impacted that level of trust and what behaviour has this driven (that is, the impact on R&D investment decisions)

3.1.1 How participants were reached

The survey was open from 19 December 2024 for one month and potential respondents were limited to claimants (current/past/prospective) of, and agents involved with, R&D tax relief.

Using contacts gathered through my professional work on R&D for CIOT, Linked In was identified as the best way to publicise the survey to these groups, with a recognition that this would have more direct contact with agents than claimants.

The survey was therefore published on Linked In (with re-postings half-way through and shortly before closure) and Facebook, as well as through the CIOT newsletter to members. Readers of the posts were invited to share the survey with their own networks to extend reach.

Key commentators, practitioners and agents with wide R&D networks were also contacted directly for support with raising awareness of the survey and encouraging completion. This resulted in further publication of the survey to members of the R&D Community (an R&D training company) and to some wider networks. At least two medium-sized firms shared the survey with their staff and R&D clients. A number of personal contacts operating in the R&D industry were also contacted for support with either raising awareness or participation.

Recognising the need to promote completion by claimants (as opposed to agents), an individual who had been the subject of a media article in the summer of 2023 was approached via Linked In – he agreed to participate and volunteered to share the survey with a claimant support group and a business founders' group, creating a small catalyst effect with claimant responses.

This widespread approach resulted in a broad demographic of participants. There were 56 responses submitted, of which 39 identified solely as agents who deal with R&D tax relief claims; 14 who identified solely as R&D tax relief claimants (or past/prospective claimants); and three who identified as falling within both categories.

3.2 Demographic of participants (numbers, size, sectors, and R&D tax relief experience)

Claimant participants

Sixteen claimants (including three who also identified as agents) identified as SMEs and operated across the following sectors:

Electronic engineering; Community; Information Technology services (other); Professional, scientific and technical activities (not elsewhere classified); Cultural education; Construction; Technology; Pharmaceuticals; Technology development, health and care; Automotive; Car mileage tracking; Software; Cyber and tax/National Insurance advisors; Software; Cybersecurity – technology; Technology in fleet management; Financial Services; Marine engineering and technical services.

One claimant identified as Large and operated in the publishing sector.

Claimant participant experience of compliance checks since the introduction of volume compliance:

Eight claimants indicated direct experience of a compliance check by HMRC since 2022 and the introduction of volume compliance.

Seven had no direct experience of such a compliance check.

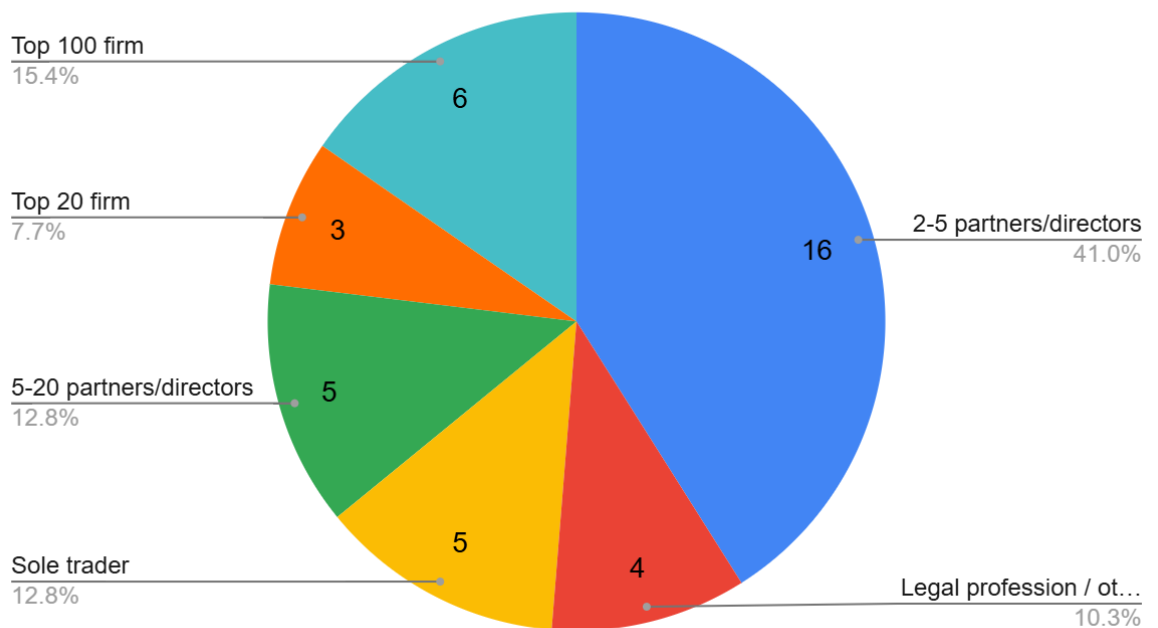
Two identified as agents who had been subject to compliance checks.

Agent participants

Thirty-nine participants identified solely as agents involved in R&D tax relief, and a further three identified as being both an agent and claimant.

Agent participants came from a wide range of types of firms as indicated by the following pie chart, with the sole traders and two-five partner/director firms (the smallest end of the market) accounting for 53.8% of the participants.

Type of agent firm (including those who identified as agents and claimants)



3.2.1 Assessing the validity of the population

Fifty-six participants are too few to be considered statistically valid. While some claimants make multiple claims, and R&D agents deal with multiple claims and

claimants, overall in 2022-23 alone there were 65,690 UK R&D tax relief claims so the sample set witnessed by the participants will be just a small percentage of this.

However, the number of responses is large enough to give an indication of trends, and the range of size of firms and types of claimant sectors is broad enough to consider that responses will include a degree of diversity (while not being fully representative of the populations). These trends should enable reasonable conclusions to be drawn that are sufficiently reliable to inform policy makers, at least to the extent that they can identify and carry out further relevant research.

The sample set is likely to be particularly representative of groups actively engaged or impacted by the volume compliance approach – more than 50% of claimants have been subject to an enquiry. It is also reasonable to assume that the sample set lacks representation from claimants with deliberately overstated claims (although some claimants may have been victims of inappropriate targeting by agents) or agents promoting fraudulent or incorrect practices. At the other end of the spectrum, those who have had an easy experience are less likely to have felt the need to engage in the survey.

The analysis includes a critical consideration of the potential for bias and a lack of broad representation of the R&D claimant and agent populations. The results may be considered more reliable and applicable to certain subsets of the R&D population.

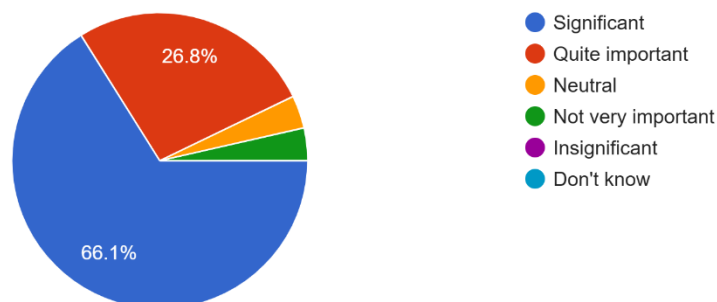
3.3 Survey Analysis: Trust in HMRC

3.3.1 Importance of Trust

As illustrated in the pie chart below, 92.9% of participants indicated that trust in HMRC's administration of the UK R&D scheme was a key consideration (either quite important or significant) in deciding whether or not to invest in qualifying R&D in the UK. This shows a very strong link between trust in HMRC and R&D investment decisions.

Do you consider that trust in HMRC's administration of the UK R&D scheme is a key consideration for investors in qualifying R&D?

56 responses



Participants were further asked to explain their response to show how they saw trust as featuring in decisions, enabling an analysis of what features of trust provided a link with investment – and support an assessment as to whether a decrease (or increase) in trust could impact a policy designed to incentivise investment.

Four participants' comments summarised the majority:

1. *Trust in HMRC's administration of the UK R&D scheme is crucial for encouraging investment. It provides businesses with confidence in the fairness, consistency, and*

predictability of the claim process. Without this trust, businesses may perceive the scheme as risky or unreliable, or unfair/unjust (i.e. biased towards Large Companies, for example) - potentially deterring participation, particularly among smaller companies or first-time claimants.

- 2. It is a key consideration as an inability to trust HMRC's administration of the scheme results in a lack of confidence surrounding the certainty of investors being able to make an R&D tax claim on the R&D that they are investing in. If there is no certainty of an R&D tax claim in advance of investing in R&D, then the investment into that R&D may not happen.*
- 3. If investors cannot be confident of an R&D tax credit being received, this in turn requires additional investment beyond what was originally considered. It would then be considered reasonable to assume that investors would be less likely to invest if there is a higher possibility of additional investment being required.*
- 4. The decision to invest in R&D is significantly affected by a) the knowledge that some of that original investment will be returned in the form of a successful R&D claim and b) the actual payment of a claim will support future R&D. Therefore, advising investors (potential claimants) that scheme administration is now problematic has occasionally been the sole reason why some have not proceeded with a) an R&D claim and thus b) further investment in R&D.*

Others expanded on the need for certainty highlighting the need to be able to rely on the relief for forecasting investment projects, both where they (or in the case of agents, their clients) are investing themselves and when producing plans to attract external

investors. One participant noted that without certainty, forecasts are simply “*wishful thinking*”; another observed the importance of claims being checked early to gain essential certainty so that they could confidently reinvest it without the risk that the money later be clawed back (when they no longer have it/access to it).

For some, without the government’s support, the R&D project would not be affordable or feasible, so certainty that the money received as an R&D tax credit will be theirs to keep is critical, particularly at the smaller business end. Similarly, there needed to be trust that any compliance activity would not end up costing more than the potential benefit of the relief itself – again linking back to certainty, minimising risk and the potential benefits outweighing the risk. Many do not have the resources to support defending claims so need to trust that checks are fair and correct.

Trust in HMRC as a key consideration for investment was also noted by some as an important comparator when deciding whether to invest in the UK or elsewhere – a country which provides the hallmarks of trust, for example, predictability, certainty, consistency and fair (not arbitrary) treatment was going to be favoured to invest in over one that did not. Further comments related to attracting overseas investors where certainty and predictability were critical to the attractiveness of the investment. The high elasticity of these type of investments mean they can just (or nearly) as easily be made outside of the UK.

One participant appeared to link trust in the tax administration more to the policy itself – noting that without trust in HMRC’s administration, the relief could not be relied upon in decision-making so became a “*nice to have*” rather than incentivising

investment or being relevant for strategic planning. This suggests that for this participant, while trust in HMRC was not an active consideration in investing itself, the absence of it was, which, consequently, meant that the tax relief itself equally becomes a non-consideration (and rendered ineffective).

The survey clearly indicates that participants attach considerable value to the importance of trust in HMRC in investment decisions. This was reflected in both the percentage of participants rating trust in HMRC in such decisions as significant or quite important, and analysis of their supporting commentary. The commentary also includes numerous references to the hallmarks of trust identified in the literature in response to this question, showing how these are important in investment decisions.

3.3.2 Assessment of any shift in trust in HMRC before and after the introduction of volume compliance for R&D

A fundamental question for this research is establishing whether there has been an erosion of trust in HMRC. To assess this, the survey used “hallmarks of trust” from the literature against which to benchmark participants’ levels of trust at two points in time – both before volume compliance and since its introduction – and to provide a proxy for measuring any shift.

The survey asked participants to indicate whether, in their opinion, HMRC demonstrated the hallmarks needed to generate trust when handling R&D enquiries.

Table 1 below sets out a comparison of the results for pre- and since the introduction of volume compliance. The percentages relate to the percentage of participants who gave that response; the non-percentage numbers indicate the number of participants

who gave that response. Responses of “highly likely” and “more often than not” were combined to assess the percentage of positive responses and “less often than not” and “rarely” were combined to assess the percentage of negative responses.

Table 1

<u>Hallmarks of Trust</u>	<u>Pre-volume compliance</u>	<u>Since volume compliance</u>	<u>Movement</u>
Fairness (even treatment, without bias, opportunity for a fair hearing)	76.8% +ve: 17 Highly likely / 26 More often than not 11 Neutral 1.8% -ve: 1 Less often than not 1 Don't know	0% +ve 6 Neutral 87.5% -ve: 14 Less often than not / 35 Rarely 1 Don't know	76.8% +ve to 87.5% -ve
Competence (skills to reach the right answer)	69.6% +ve: 10 Highly likely / 29 More often than not 7 Neutral 12.5% -ve: 5 Less often than not / 2 Rarely 3 Don't know	0% +ve 3 Neutral 92.9% -ve: 11 Less often than not / 41 Rarely 1 Don't know	69.6% +ve to 92.9% -ve
Instils confidence (that the right outcome will be reached)	66.1% +ve: 12 Highly likely / 25 More often than not 10 Neutral 12.5% -ve: 6 Less often than not / 1 Rarely 2 Don't know	1.8% +ve: 1 More often than not 2 Neutral 92.9% -ve: 12 Less often than not / 40 Rarely 1 Don't know	66.1% +ve to 92.9% -ve
Proportionality (that actions and consequences will be balanced)	67.9% +ve: 14 Highly likely / 24 more often than not 11 Neutral 8.9% -ve: 4 Less often than not / 1 Rarely 2 Don't know	3.6% +ve: 2 More often than not 5 Neutral 85.7% -ve: 18 Less often than not / 30 Rarely 1 Don't know	67.9% +ve to 85.7% -ve

Consistency (that similar and appropriate outcomes will be reached across the population)	64.3% +ve: 13 Highly likely / 23 More often than not 10 Neutral 14.3% -ve: 4 Less often than not / 4 Rarely 2 Don't know	3.6% +ve: 2 More often than not 3 Neutral 87.5% -ve: 11 Less often than not / 38 Rarely 2 Don't Know	64.3% +ve to 87.5% -ve
Reciprocity of trust (that to be trusted HMRC must also trust)	71.4% +ve: 15 Highly likely / 25 More often than not 8 Neutral 8.9% -ve: 3 Less often than not / 2 Rarely 3 Don't know	1.8% +ve: 1 More often than not 5 Neutral 85.7% -ve: 11 Less often than not / 37 Rarely 2 Don't Know	71.4% +ve to 85.7% -ve
Participation (in decision-making on issues)	51.8% +ve: 11 Highly likely / 18 More often than not 14 Neutral 14.3% -ve: 6 Less often than not / 2 Rarely 5 Don't know	5.4% +ve: 3 More often than not 4 Neutral 83.9% -ve: 9 Less often than not / 38 Rarely 2 Don't Know	51.8% +ve to 83.9% -ve
Balance of power (effective processes, safeguards and appropriate use of powers)	55.4% +ve: 31 Highly likely / 20 More often than not 8 neutral 21.4% -ve: 6 Less often than not / 6 Rarely 5 Don't know	3.6% +ve: 2 More often than not 5 Neutral 83.9% -ve: 10 Less often than not / 37 Rarely 2 Don't Know	55.4% +ve to 83.9% -ve
Responsive (addressing problems in a timely manner)	51.8% +ve: 9 Highly likely / 20 More often than not 11 neutral 23.2% -ve: 4 Less often than not / 9 Rarely 3 Don't know	3.6% +ve: 2 More often than not 5 Neutral 83.9% -ve: 9 Less often than not / 38 Rarely 2 Don't Know	51.8% +ve to 83.9% -ve

There is a clear shift from a more than 50% positive demonstration (and less than 25% negative demonstration) across all of the identified hallmarks of trust by HMRC prior to volume compliance. Before the introduction of volume compliance, the highest positive demonstration was of the hallmark of Fairness at 76.8% and only 1.8% negative. After the introduction of volume compliance, this shifted to more than 80% negative demonstration across all of the hallmarks and a less than 5% positive demonstration of any of the hallmarks.

This indicates not only that there were high levels of trust in HMRC's handling of R&D tax reliefs prior to 2022 but that within this population the highest number of participants recording a positive demonstration of any of the hallmarks post 2022 was three (in relation to Participation). Fairness and Competence went from the most positive responses (76.8% and 69.6%) to nil positive responses after the introduction of volume compliance.

As noted in the analysis of the demographic of participants, there is likely to be some bias within the participant population due to them most likely being people who have strong, negative feelings about the subject, commonly those who have been heavily impacted. However, the strength of answer is compelling and certainly shows a significant erosion of trust, at least within this population.

The survey also explored factors that may have impacted trust in HMRC in relation to R&D prior to 2022 and what had driven any shift in participants' perceptions of trust since the introduction of volume compliance.

3.3.3 Factors impacting trust in HMRC in relation to R&D's handling of tax relief claims prior to 2022: Confidence in HMRC refusing/enquiring into valid claims prior to 2022

The literature review concluded that maintaining trust would likely require HMRC to be seen to be effectively policing abuse. As far back as mid-2010s (if not earlier, although the evidence prior to this is anecdotal and records have proven difficult to find), there was recognition both within and outside of HMRC that the UK R&D scheme was being abused, evidencing that the concerns around error and fraud were not a new issue and also that action by HMRC to tackle the issue was not quickly taken.⁶⁰

To test whether the lack of compliance activity by HMRC was likely to have had a strong influence on trust levels prior to volume compliance, participants were asked whether prior to 2022 they were aware of levels of error and fraud relating to R&D tax relief and whether they trusted that HMRC would tackle incorrect or fraudulent claims at that time.

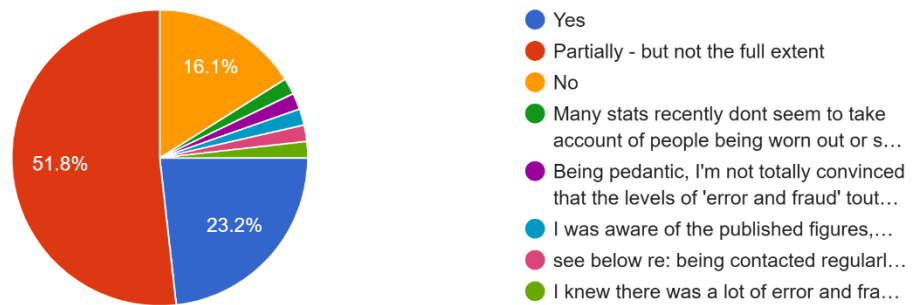
The results demonstrated quite a spread in levels of awareness of the error and fraud prior to 2022, and similarly in levels of trust in HMRC's response to the problem. This suggests that while some participants' opinions were likely influenced by this (55.5% indicated that they did not trust that HMRC would tackle incorrect or fraudulent

⁶⁰ HMRC, *R&D Consultative Committee meeting minutes Monday 10 October 2016* (gov.uk, archived 10 June 2017, no publication date) <<https://webarchive.nationalarchives.gov.uk/ukgwa/20170610061916/https://www.gov.uk/government/groups/research-development-consultative-committee#meeting-minutes>> accessed 23 May 2025

claims), others were less likely. The spread of awareness is shown in the first pie chart below, and the level of trust in the second.

Were you aware of the levels of error and fraud present in the regime prior to 2022?

56 responses



Prior to 2022 and the introduction of volume compliance, did you trust that HMRC would identify and tackle incorrect or fraudulent claims?

56 responses



Notably, the survey also indicated that a significant majority (75%) of participants believed that HMRC's approach to compliance during this period contributed to the high levels of error and fraud.

Commenting on this point, participants who were aware of the issues considered that "known bad actors" were able to continue pushing "dubious claims" unchallenged.

There was felt to be very little scrutiny of claims. Evidence given in support was the lack of a need for a written report (one participant welcomed the policy change to requiring the submission of the AIF with a claim) and the fact that fewer than 5% of claims were checked (this compares to the current rate of one in five).

They considered that these factors led, in some cases, to the overinflation of claims and encouraged “cowboy” firms into the market. One claimant shared that they received numerous direct marketing emails and calls from R&D “sales agents”, who seemed to have formed an industry of encouraging claims. Another pointed to HMRC’s statistics showing 175 Health and Social Work claims in 2014-2015, which jumped to 1,745 in 2020-21, illustrating the targeting of that sector (not a sector where you would expect to find much qualifying R&D activity).

Participants observed problems with the “process now, check later” feature of the claims system. They indicated that they believed bad actors used this to convince unsuspecting claimants that receipt of funds indicated an approved (and so legitimate) claim. Despite seeing high profile marketing of their practices by these bad actors, participants did not feel HMRC had responded to tackle the practice until recently – a number commented on the recent, high-profile case of HMRC’s intervention against Green Jellyfish and how long this firm had been allowed to continue to act after its poor behaviour had become highly publicised.

There was a perception that this did show that trust in HMRC to tackle bad claims was important for compliance because they had seen some claimants “give claims a go” after they had seen friends receive money for claims (despite their gut feeling that they

were not actually carrying out R&D). The firms pushing them to claim relied on the fact that they did not trust HMRC to administer the regime properly and so were likely to get away with it.

The survey also illustrated distrust of HMRC's error and fraud statistics more broadly – a feeling, as supported by the literature, that HMRC's statistics do not take into account businesses (of whom they indicate there are many), who have simply withdrawn genuine claims because they do not have the will or resources to defend them, so are counted by HMRC in their statistic as corrections of invalid claims.

Survey commentary indicating an erosion of trust since the introduction of volume compliance:

Participants provided comments on what they saw as having driven an erosion of trust in HMRC in relation to their volume compliance. There were a number of common themes and links to the question around impact on investment, as well as risks to, and the effectiveness of, the UK R&D tax relief schemes.

A number commented on the impact of international competition. Examples were provided of SMEs choosing to move out of the UK due to the "poor behaviour" of HMRC compliance staff. This included those with existing non-UK business and multiple global R&D hubs, who could easily shift their R&D and are in some cases doing so, due to how they perceive they have been treated badly by HMRC. A question posed by one participant was why businesses would choose to do business in the UK if there were cost-savings to be had abroad.

A perception of HMRC acting in “*bad faith*” in its volume compliance approach (by which they are likely referring to previous comments on the arbitrary rejection of claims and the challenges claimants have had to prove genuine claims) is indicative of a lack of trust – and attributed consequences are consideration of, and decisions to, move R&D overseas. Ireland was cited as an example of somewhere perceived as a more “*reasonable jurisdiction*”. The comments also highlighted a perception that the UK has become anti-entrepreneurial and simply pro-big business. HMRC’s statistics referred to in the literature review that show an increase in claim values despite a decrease in the volume of claims would align with this, and it again raises the IFS and CIOT’s questions as to what the government’s strategic vision and goals are for R&D (and reliefs more broadly).

Related points were that the credibility of the scheme has been damaged and this is deterring genuine claimants, and the previously well-respected tax administration was now considered a “*strongly negative*” reason for investing in the UK.

Several participants linked HMRC’s compliance approach with having eroded certainty – which has impacted cashflow considerations in investment decision-making and shifts the viability of carrying out R&D (either because there is too much internal risk of losing the cash from the tax relief or because there is not enough certainty leaving too much exposure for external investors). As one participant put it “*wise investors do not rely on wishful thinking*”.

A number shared that distrust was leading to companies being deterred from claiming.

A reason put forward was that trust is being lost due to the feeling that “*HMRC’s*

prevailing assumption seems to be no-one should be claiming for R&D as nothing should qualify (everything should be readily deductible)". With this, perception that an enquiry from HMRC is going to lead to a significant resource and time cost is deterring people from defending existing claims and from making future ones (not least because the claims are not large enough to warrant the hassle). There is further distrust evidenced by emotive comments that HMRC considers such cases as "*victories*" and that HMRC are carrying out "*witch-hunts*".

Uncertainty and increased risk were the feature of multiple comments – uncertainty as to the potential outcome from putting in a claim was given as a reason for a reduction in willingness to invest.

Fairness was also referenced in the context of the process now, check later approach. It was put that where a claimant had the claim "accepted" (that is, paid out) by HMRC, this gave rise to an expectation that this had been reviewed and agreed by HMRC. They felt HMRC would ask questions if they had any, so if they did not then this could be relied on as the claim being accepted. Subsequently under the volume compliance approach, enquiries selected on the basis of a sector (using their SIC code) were then rejected by HMRC staff who did not appear to understand the project (calling competence into question) and without a collaborative dialogue to reach a positive outcome. The volume compliance is being perceived as unfair and claimants are hesitating on making claims, not because there is doubt in their minds as to them qualifying, but because they do not expect HMRC to treat their claim fairly. The impact goes beyond claiming, into decision-making to invest in R&D because without the certainty they will receive the relief, the project is too much to commit to – they no

long feel the support is there. One participant noted having seen some companies go out of business because of HMRC's hampering their R&D activities and also reported connected mental health problems of the business owners.

One participant commented: *"If clients don't believe that HMRC are policing the claim process fairly they are less likely to make a claim even if it does in fact meet the criteria to qualify. They don't have the resources to 'fight' an 'unfair' enquiry."*

HMRC staff behaviour in meetings and toward people involved in enquiries was another point raised as impacting trust – from basic courtesies such as HMRC staff refusing to put on cameras during meetings, which made the claimant feel intimidated, and feeling like they were being treated as fraudulent. They noted this contrasted with interactions with Innovate UK and UKRI, by whom they felt supported.

The strength of feeling is also apparent in one participant's comment: *"I believe MD's, owners, founders, investors would rather remain remote and not take the risks now inevitable if making an R&D tax relief claim. Inconsistency of approach and implementation, unjustified FIS letters, protracted enquiry timescales, lack of engagement and failure to face the very public, who pay their wages and engage in open dialogue. Nothing short of disgraceful and I have had this feedback from virtually every client I speak to."*

One participant did disagree as to the potential impact: their view was that genuine claimants undertaking genuine innovative activities would invest in R&D regardless of HMRC scrutiny and would be willing to defend their claims. They commented that the *"lay of the land"* was well understood by businesses and that *"a lot of HMRC's*

caseworkers launching these campaign enquiries have very little to no understanding of the technicalities of the qualifying activities, the UK tax system or how businesses work in real life”.

However, despite most participants identifying shortcomings by HMRC in their approach to R&D, the conclusions on the impacts were not universal. One participant noted that while the issues do call into question the effectiveness of the schemes themselves at driving investment, in their experience the R&D activities would be *“carried out regardless”*. It is possible that the tightness of cashflow/reliance on R&D and ability to absorb the costs (or other factors around the nature of particular R&D or types of business) may influence the outcome of investment decisions.

3.3.4 Summary of analysis on trust

The results indicate a clear shift between the position before and after the introduction of volume compliance. This is supported by the comments which show clear examples where the hallmarks of trust were lacking.

3.3.5 Trust as a feature in how policy changes have been made

Participants were also asked about how they saw the hallmarks of trust demonstrated by HMRC and HM Treasury through recent R&D policy changes. This was to test the observations from the literature review and background research, which highlighted concerns about the changes being *“piecemeal”*, *“rushed”* and poorly consulted on. The graph and Table 2 below shows how much participants felt HM Treasury and HMRC demonstrated the hallmarks of trust during the recent policy developments. Responses of *“significant”* and *“quite a lot”* were combined to assess the percentage of positive

responses and “not a lot” and “insignificant” were combined to assess the percentage of negative responses.

How much did HMRC and HM Treasury demonstrate the following traits through the recent policy changes to R&D relief (eg merging of the schemes and introduction of the Additional Information Form)?

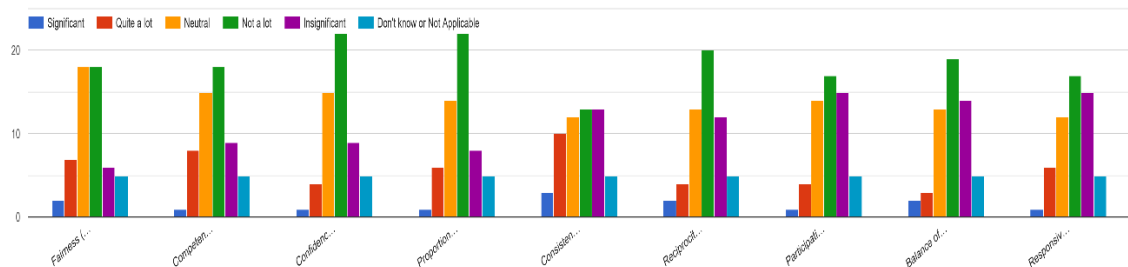


Table 2

Hallmarks of Trust	
Fairness (even treatment, without bias, opportunity for a fair hearing)	16.1% +ve: 2 Significant; 7 Quite a lot 18 Neutral 42.9% -ve: 18 Not a lot; 6 Insignificant 5 Don't know or Not applicable
Competence (skills to reach the right answer)	16.1% +ve: 1 Significant; 8 Quite a lot 15 Neutral 48.2% -ve: 18 Not a lot; 9 Insignificant 5 Don't know or Not applicable
Instils confidence (that the right outcome will be reached)	8.9% +ve: 1 Significant; 4 Quite a lot 15 Neutral 55.4% -ve: 22 Not a lot; 9 Insignificant 5 Don't know or Not applicable
Proportionality (that actions and consequences will be balanced)	12.5% +ve: 1 Significant; 6 Quite a lot 14 Neutral 53.6% -ve: 22 Not a lot; 8 Insignificant 5 Don't know or Not applicable

Consistency (that similar and appropriate outcomes will be reached across the population)	23.2% +ve: 3 Significant; 10 Quite a lot 12 Neutral 46.4% -ve: 13 Not a lot; 13 Insignificant 5 Don't know or Not applicable
Reciprocity of trust (that to be trusted HMRC must also trust)	10.7% +ve: 2 Significant; 4 Quite a lot 13 Neutral 57.1% -ve: 20 Not a lot; 12 Insignificant 5 Don't know or Not applicable
Participation (in decision-making on issues)	8.9% +ve: 1 Significant; 4 Quite a lot 14 Neutral 57.1% -ve: 17 Not a lot; 15 Insignificant 5 Don't know or Not applicable
Balance of power (effective processes, safeguards and appropriate use of powers)	8.9% +ve: 2 Significant; 3 Quite a lot 13 Neutral 41.1% -ve: 19 Not a lot; 4 Insignificant 5 Don't know or Not applicable
Responsive (addressing problems in a timely manner)	12.5% +ve: 1 Significant; 6 Quite a lot 12 Neutral 39.2% -ve: 17 Not a lot; 15 Insignificant 5 Don't know or Not applicable

The results indicated a less than 25% positive demonstration across all of the hallmarks. One noticeably negative result was the hallmark of Participation, which was 57.1% negative (with 17 participants thinking this had not been demonstrated a lot and 15 participants saying the demonstration had been insignificant). This would correlate with concerns identified in the literature that consultation had been lacking. The

majority also responded negatively in relation to Reciprocity of trust, Confidence instilling (that the right outcome will be reached) and Proportionality.

These results, combined with the literature, support a conclusion that the lack of trust extends beyond HMRC's compliance approach into the wider handling of R&D tax relief. The survey does not provide a measure as to whether trust in relation to policy is influenced or amplified by the identified erosion before and after the introduction of volume compliance, but it may be worth policy makers considering whether building trust back into the process of how policy is designed and delivered might support building trust more broadly (and the recent consultation on Advanced Assurance for R&D may be telling⁶¹). Further, if the recent policy changes are seen as effective when they bed in, this may also support the rebuilding of trust. This is explored further in the interview part of this research.

3.4 Survey analysis: testing conclusion from literature that R&D schemes are effective

The literature review and background research concluded that the UK R&D scheme did provide an incentive to investment in qualifying R&D. However, there were also notable observations relating to the difficulties with quantifying how effective the schemes were (which the literature review noted was outside of scope). In addition,

⁶¹ HMRC, *Open Consultation: R&D tax relief advance clearances* (published 26 March 2025) <<https://www.gov.uk/government/consultations/research-and-development-tax-relief-advance-clearances/rd-tax-relief-advance-clearances>> accessed Friday 23 May 2025

since the introduction of volume compliance, CIOT and others have questioned whether that effectiveness has been eroded.

The conclusions of the literature review were supported by the survey. Fifty-five of the 56 survey participants responded to a question asking whether pre-2022 (that is, prior to volume compliance) the UK R&D relief scheme encouraged or enabled them (or their clients) to invest in qualifying R&D activity.

76.4% (42) participants answered “Yes – key factor in decisions to invest or increase investment in qualifying R&D”.

20.0% (11) participants also answered positively but believe they or clients would have invested the same amount regardless.

Two participants answered that the question was not applicable and none answered that the schemes were not a factor.

Taking the two positive responses together shows a clear historical link between the schemes and positive investment decisions (96.4%) albeit that 20% of the participants indicated that the same amount would have been invested regardless.

3.5 Survey analysis: impact on investment in qualifying R&D

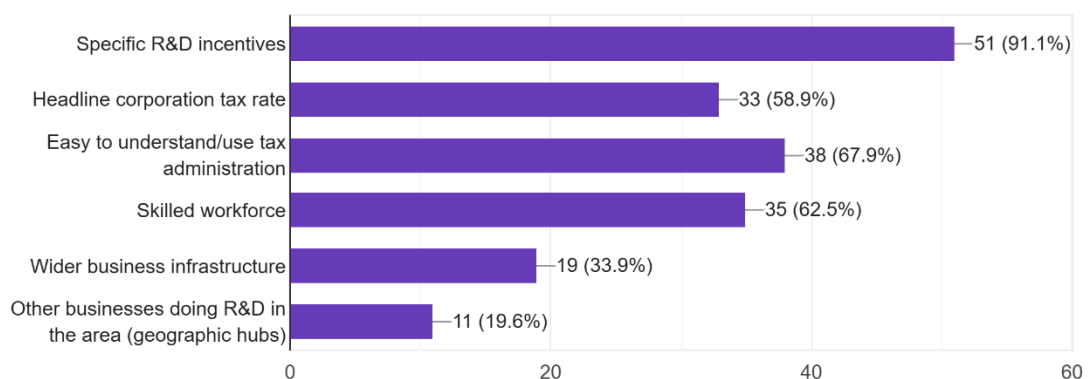
3.5.1 Factors which impact investment decisions relating to R&D activities

Participants in the survey were asked to indicate which of the following they considered were the key features of a tax system affecting decisions to invest in qualifying R&D:

1. Specific R&D incentives
2. Headline corporation tax rate
3. Easy to understand/use tax administration
4. Skilled workforce
5. Wider business infrastructure
6. Other businesses doing R&D in the area (geographic hubs)

All 56 participants responded, with the following results:

What are the key features of a tax system which affect decisions to invest? Select all that apply.
56 responses



This indicates that while at least eleven participants considered all these features of a tax system were key to investment, specific R&D reliefs were considered as a key

feature by a significant majority (91.1% of participants). The significance of the majority may be slightly overinflated by the tendency of tax agents (so the majority of respondents) to overweight the importance of tax in decision-making (a potential bias also relevant to the ranking of the features below). However the strength of the response suggests that even taking into account that the result might be skewed, the reliefs are still a considerable incentive. By extension, this suggests that if these specific reliefs become less of an incentive, then this will have a negative effect on investment decisions.

Participants were also asked to rank the key features in their order of importance.

Thirty-one participants had Specific R&D incentives ranked as the most (20 participants) or second most (11 participants) important feature affecting decisions to invest.

This compared to the corporation tax headline rate, which was ranked by 11 participants as the most important and by 17 participants as the second most important; a skilled workforce, which was ranked by 14 participants as the most important and eight participants as the second most important; and an easy to understand/use tax administration, which was ranked by five participants as the most important and 12 participants as the second most important.

There was a clear gap in ranking to the other two features: wider business infrastructure and other businesses doing R&D in the area (geographic hubs). However, these were also considered by some participants as the most important feature, indicating that they are still relevant considerations in investment decisions, evidence

further supported by 11 and 19 participants respectively marking them as key features of a tax system that affect decisions to invest.

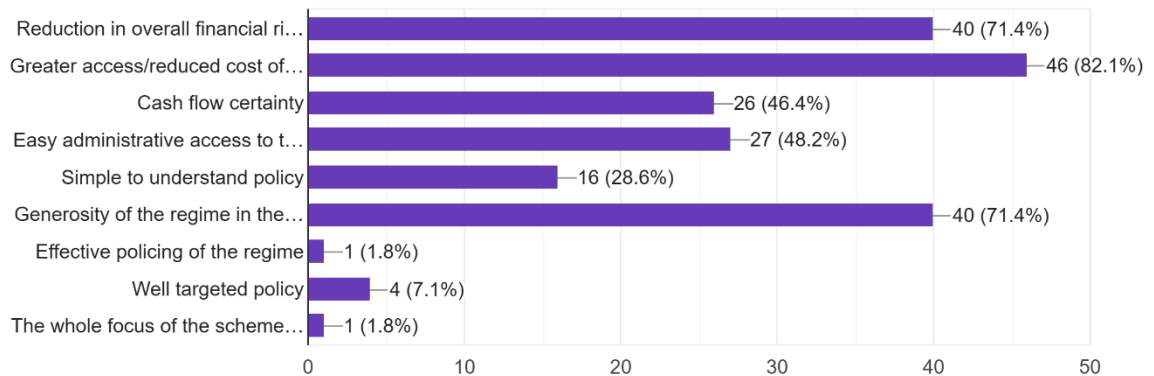
The survey also asked participants which of the following they considered key features of the UK R&D scheme that encouraged investment:

1. Reduction in overall financial risk of investing
2. Greater access/reduced cost of cash/capital for use in investment
3. Cash flow certainty
4. Easy administrative access to the relief
5. Simple to understand policy
6. Generosity of the regime in the amount claimable
7. Effective policing of the regime
8. Well targeted policy
9. The whole focus of the scheme was to promote innovation and economic growth

The results were as follows:

What do you think were the key features of the UK R&D scheme that encouraged investment? Select all that apply.

56 responses



This shows the top three features as:

1. Greater access/reduced cost of cash/capital for used in the investment – 46 participants (82.1%)

=2. Generosity of the regime in the amount claimable – 40 participants (71.4%)

=2. Reduction in overall financial risk of investing – 40 participants (71.4%)

Also significant, was that 27 participants (48.2%) thought that easy administrative access to the relief was a key feature that encouraged investment.

Very few (only four participants/7.1%) considered that the policy was well targeted to encourage investment.

Participants were invited to note any other key features of the UK R&D schemes.

Responses included the need for the UK regimes to be globally competitive. A number of participants raised the importance of certainty and predictability plus the need for

confidence in HMRC's consistency in administering the relief. Further asks for certainty came via comments that the policy should not undergo frequent changes or reductions in generosity. Advance assurances were noted as important for "*upfront certainty*" before significant costs were incurred (although one participant noted that despite advance assurance in one case, they were still subject to an enquiry). A couple of responses also referred to issues relating to information – both in terms of knowledge of other firms in the sector receiving reliefs and the importance of guidance, including up to date examples as to what constitutes R&D.

These responses show a wide variety of features of the UK R&D scheme that participants in the survey considered important. A number of these tie in with the hallmarks of trust – for example, those relating to certainty and confidence in consistent administration by HMRC.

3.5.2 Testing the impact of volume compliance on investment in qualifying R&D

When asked about the impact of volume compliance on decisions to invest in new or qualifying R&D, only eight participants indicated that they thought that they or (some of) their clients were claiming and investing as previously. (Recognising that agents have multiple clients with multiple circumstances, participants were invited to indicate all of the behaviours they had seen to a material degree.)

There were 88 indications of volume compliance having a negative impact on investment decisions, broken down as follows:

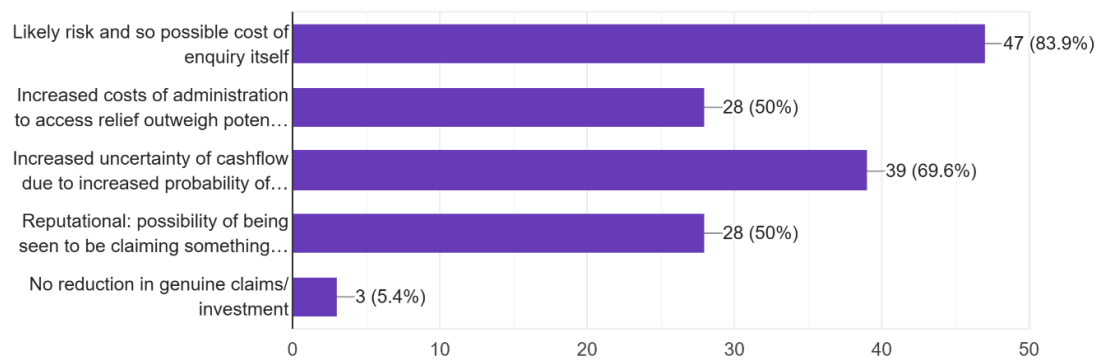
Twenty-nine participants (51.8%) – reported incidences of not claiming R&D reliefs, that has led to decisions not to invest/invest as much

Fifteen participants (26.8%) – reported incidences of making R&D relief claims, but reducing claims and investment to reduce risk of enquiry

Forty-four participants (78.6%) – reported incidences of genuine claims being rejected leading to reduced investment going forward

If you think there has been a reduction in genuine claims/investment since 2022, what do you think were the key factors in those decisions? Select all that apply.

56 responses



This supports a conclusion that volume compliance has had a material impact on investment decisions. Some caution is needed for potential inherent bias in the minds of those who responded – as noted above those who chose to participate are more likely to have had a negative experience, so the results are unlikely to be fully representative of the R&D population. However, the wide demographic of the participants suggests that the answers are more than isolated incidents.

Participants were invited to consider which of the following they believe were key factors leading to a reduction of claims/investment.

1. Likely risk and so possible cost of enquiry itself – 47 participants (83.9%)

2. Increased uncertainty of cashflow due to increased probably of having to pay back claim – 39 participants (69.6%)
3. Increased costs of administration to access relief outweigh potential benefits (eg AIF) – 28 participants (50.0%)
4. Reputational – possibility of being seen to be claiming something not entitled to or under enquiry by HMRC – 28 participants (50.0%)
5. No reduction in genuine claims/investment – 3 participants (5.4%)

Three participants did not believe there has been a reduction in genuine claims or investment in qualifying R&D. However, this was a considerable minority. Nearly 84% of participants believed that the likely risk, and possibly cost of, an enquiry was a key factor. Increased uncertainty of cashflow due to increased probability of having to pay back the claim (noted by 69.6% of participants); increased costs of administration to access the relief outweighing the potential benefits (50% of participants); and potential reputational damage - from the possibility of being seen to be claiming something they are not entitled to or of being seen to be under enquiry by HMRC – (also 50% of participants), were seen as key factors by a significant number of participants.

Participants were invited to explain their view with regards to how HMRC's volume compliance approach to R&D impacted new or increased qualifying R&D investment decisions.

These answers were analysed for links with the hallmarks of trust. As shown above, the survey has demonstrated a decrease in trust in HMRC between before and after the introduction of volume compliance. The evidence also suggests a negative impact on

investment decisions (supported by HMRC statistics that show while the value of R&D claims has increased, the number of claims has decreased).

Survey comments illustrating impacts on both trust and investment

Participants' comments can be grouped into a number of themes:

1. Time taken to receive/get certainty over claims

One participant gave an example of having two claims rejected three times before they were eventually accepted. This created too much uncertainty, and the result was the company making staff redundant and taking a decision not to make future claims.

Others noted that certainty could be improved by approving claims in advance prior to payment (it may be that advanced assurance proposals assist with this). Further, some observed a reduction in the value of some claims and some not being made at all because of the lack of certainty over whether they would receive or have to pay the money back. This led to participants concluding that they would expect to see a knock-on effect to amount of R&D investment due to reduction in capital.

Some comments related to uncertainty driven by the time lag between a claim being paid out (and so money used by the investing firm) and the possibility of HMRC enquiry, potentially years later. This was linked to firms seeing it as too risky to open themselves up to potentially having to repay after the money had already been spent.

Similarly, one agent noted that an erosion of trust and increased uncertainty has reduced confidence. *"Feedback from clients indicates that some, particularly SMEs with*

historic claims typically under say £20k per year, have stated they will not claim again due to the perceived risks and the potential for genuine claims to be rejected."

2. Costs and other impacts of HMRC's approach to compliance checks

There was an observed loss of trust in the schemes due to a lack of opportunity to discuss claims under enquiry with HMRC and what participants saw as HMRC's aggressive approach in compliance checks. Comments suggested that the effort of defending claims was outweighing the benefits of relief. In some cases, this resulted in valid claims being pulled, giving rise to less scope for future investment, or withdrawn due to considerable time taken for the compliance check and the amount of resource required to defend a claim.

One participant noted that the amount of work required to justify even small claims reduced desire to continue with using the schemes. Further, some claimants can no longer afford to invest in R&D without support from the relief (and they can also no longer afford the specialist advice needed) so they are reducing their investments.

Anger, frustration and reduced claims were a noted outcome where solid claims with R&D hallmarks (for example, one involved Innovate UK grant funded projects, which involved patented technologies led by industry experts), were being rejected despite being seemingly obvious R&D.

A number of comments gave clear examples related to the hallmarks of trust, for example, lack of basic competence shown in correspondence from HMRC which contained errors, and unfairness and imbalance of power where the same caseworkers who sent very delayed, erroneous responses challenged agents' competence and set

them impractical deadlines. There was a common perception of ineffective resourcing and expertise in HMRC to investigate and correctly determine claims for valid R&D, combined with observations of incorrect quoting of guidelines/using them out of context (and a disregard of them when proven wrong).

An entrepreneur commented that their enthusiasm for innovating was dampened by the suggestion from HMRC that their R&D activities were not worthwhile R&D.

There was expression of a disconnect between indicators of R&D activity such as the granting of patents and what HMRC accept as qualifying R&D – and a disproportionate burden of proof required by claimants under enquiry (often rejected by a “template” response from HMRC).

Similarly, one agent noted a feeling of blanket rejection of claims and disregard for competent professional opinions despite detailed (and often repeated) requests for information. They felt their only avenue was appealing to the First Tier Tribunal but this was too costly and took too long: *“HMRC are “winning” their cases not because they are right, but because they [the claimant] are being bullied.”*

A key concern was a lack of appreciation by HMRC of how much money is spent on defending claims. Some went further and believed HMRC purposely took advantage of the fact that SMEs generally do not have the resources to defend their claims (so it is easier to push them to withdraw, as they cannot afford to fight HMRC’s rejection of the claims). This again illustrates where trust has broken down.

3. *Overseas options for R&D investment becoming more attractive than the UK*

A key question for business is deciding where to carry out their R&D and participants suggested the UK may be becoming less attractive compared to some other jurisdictions. Examples were given both of investors/claimants stating their intentions to explore options for moving elsewhere but having not yet followed through, and of a firm who had planned UK based R&D but the risk of the costs associated with the administration, time and effort of the claim, and its potential rejection along with consequentially reduced amounts, has meant it is cheaper and easier to outsource abroad.

One participant stated that they were seeing claimant firms still making claims as before, but for reduced amounts of UK investment due to better competing international alternatives. Another stated that they had seen instances of companies leaving the UK due to the handling of compliance checks (leading to costs and length of time outweighing benefits) to invest elsewhere.

4. Impact on relationship between agent and client

The agent market itself is also impacted, with R&D agents having to reconsider their business models. Some have experienced a detrimental impact on their relationship with clients, where they have struggled to engage with HMRC on compliance checks. Agents have found it difficult to explain the time and costs needed to pursue an enquiry. Participants noted that it could be difficult for small claimant companies to get representation and support because it was not cost effective for agents to support some SMEs due to the length and volume of work needed for long enquiries (which were too costly for the companies to pay for).

One participant agent noted that this had got to a point where they had changed career as a result.

5. *Impact on claims*

The comments showed a number of examples of the enquiry process leading to companies deciding not to submit claims. For one firm, a lengthy compliance check into a claim for the previous year resulted in a claim for the following year being put on hold; for another, fear and the risk of a long dispute with HMRC has resulted in them not submitting claims for the last two years; and a third participant noted that fear of claiming was removing the ability to incorporate R&D claims into future plans, resulting in reduced longer term investment.

While noting they could not directly link what they had seen to levels of investment, one participant stated that it is clear that there has been a reduction in claims (value and number) by genuine claimants due to fear of a compliance check because *“It’s just not worth it.”*

A number of comments related to a shift in decision-making to not making claims due to risk of compliance checks, but with the result that they have less funding for R&D activities and there were several references to a significant shift in the risk versus reward of claiming, with the incentive no longer outweighing the risk.

6. *Impact on R&D activities and investment (in addition to above examples)*

One participant noted that time taken (for example, by the company's competent professional) defending claims has left less time available for doing the core job of R&D work itself, which has a detrimental impact on the R&D.

There was also an observation that R&D claims previously made some firms more appealing to investors, something which in the participant's experience is no longer the case due to the uncertainty of receiving/keeping the funding. This has also led to cash flow problems with a number of startups (including the participant's investment companies). Two other participants supported this observation, giving examples of staff being laid off to manage cashflow while they did the work to successfully defend claims. Examples were given of investors telling companies not to rely on funding from the UK R&D schemes, and to remove it from their plans. This is a problem for claimants where R&D incentives are being removed from budgeting and reducing development runways, which are used to attract investors.

One participant noted a decision to shift business models from internal R&D projects to consulting because they could not continue with the previous business model due to the costs and risk of lengthy compliance checks. They also refocused onto non-R&D bottom-line profitable activities with a corresponding reduction in investment in R&D.

Participants also noted a lack of understanding by HMRC as to the commercial impact of delays on funding, which can "kill start-ups and other R&D companies".

7. Positive impacts of volume compliance:

Criticism of HMRC's approach was not universal and there was broad support for seeing HMRC's activities reduce fraudulent claims and the volume of firms chasing

inappropriate R&D claims. (Although one participant did note that they still see boutiques contacting clients and pushing them into making invalid R&D claims, suggesting that the bad practices have not been eradicated.)

Further, counter to the majority of comments, one participant noted that the majority remain unaffected and will continue to invest and claim as they have done before.

3.6 Interviews with claimants and experts

Starting during, and then following on from, the research survey, 14 in depth (45-60 minute) interviews were conducted, comprising interviews with two claimants, 11 agents/advisers and a business representative body.

Representatives from HMRC and HMT were invited to participate but, while indicating an interest in seeing the outputs of the research, did not feel able to participate.

However, there is considerable published literature setting out the views of government. This has been explored in the literature review and background research alongside insights from direct professional interactions with HMRC and HMT and experiences shared by other parties throughout the research process.

Participant selection

Having become aware of the research, some participants directly requested a discussion to present their thoughts. Others were contacted following the completion of the survey from a list of those whom had indicated they would be willing to participate further to ensure a wide range of views – including from R&D agents spanning small to large in size.

The interviews

Participants were invited to talk about their experiences and views, both before and after the introduction of volume compliance, and encouraged to give real examples. They were asked to consider the impact of what they had seen on claims and investment.

The interviews were analysed for common themes and looked at for evidence of the link between any impacts on claims and investment and trust, using the hallmarks of trust identified in the literature review and background research, and used in the survey.

The examples provided during the interviews were in most cases anecdotal personal experiences of the participants in their capacity as claimants and agents but, subject to the limits of the population demographic noted across the research, it is reasonable to conclude that the examples were not isolated or outlier cases given the wide demographic. It is not possible to extrapolate the instances to quantify the frequency or to validate the representation of the sample, but they do provide an indicative evidence base, which would be valuable for policy makers (both tax and administrative/operational) to consider in policy evaluation and decision-making and from which to draw broader conclusions in conjunction with the other sections of this research.

Analysis of interviews

The following themes came up throughout the interviews:

- 1. Shift from expectation of what to expect from an enquiry to feeling of unknown*
- 2. Shift from working to get to the right outcome to “them and us” and lack of ability to speak to HMRC (during compliance checks and at RDCF meetings)*
- 3. Competence of HMRC caseworkers: Lack of training, poor quality correspondence, lottery*
- 4. Rejections of claims being seen as HMRC’s goal and foregone conclusion*

5. *All agents being seen as “bad” or “evil”*
6. *Fees and increased insurance premiums – impacts on decisions to defend claims and agent business models*
7. *Length of compliance checks, SOLS reviews and ADR*
8. *Impacts on claims: reduced incentives*
9. *Impacts on investment: examples of people being laid off; tax relief put in bank accounts; attractive opportunities outside of the UK*
10. *Policy changes: rushed process but positive reaction to AIFs and merged schemes*

It was clear from the interviews with agents who had been working on R&D claims both pre- and post the introduction of volume compliance, that there had been a shift on what to expect from a compliance check. One interviewee described the feeling that they got historically when an enquiry letter arrived as *“ok, well we’ll get this sorted and we can reassure the client”* [about what would happen and the strength of the claim]. Since volume compliance was introduced interviewees felt that it was difficult to predict the end result or how the enquiry process would play out. More than one interviewee described it as a *“lottery”* and another saw the enquiry experience having become *“mechanical”* with nothing being read or reviewed leading to *“computer says no”* type replies following a presumption by HMRC of rejection from the outset.

An example was given to illustrate the feeling of being in a lottery: the interviewee’s firm took a case to a Tier 2 complaint at HMRC, resulting in the case being moved to the Wealthy and Mid-sized Business Compliance (WMBC) team from ISBC after an MP with a job at the Department of Science and Technology (DSIT) intervened. After three months, including a videocall with the agent and a few further questions, WMBC issued

a letter stating that subject to a couple of points, the claim was agreed. A week later, the client received a 45-page letter from ISBC rejecting the claim. HMRC apologised and rectified the position but this cemented a perception of a lack of competence, consistency and fairness.

The interviewee was also concerned as to the thousands of claims being subjected to enquiries and how this made it very difficult for the 400 newly recruited caseworkers, who were not seen as having the necessary training, skills or experience, to handle them. Other common observations included a perception that HMRC saw all agents as “bad” or “evil” (albeit that one interviewee noted this may have shifted back a bit more positively more recently) and were trying to manipulate claims. They felt this gave rise to the development of an “us and them” culture, compounded by the inability to have a two-way dialogue, including at the RDCF, which had shifted from a discussion forum to HMRC giving an information download.

A number of those interviewed commented that caseworkers in ISBC were starting from a position of the claims being invalid. One interviewee referenced a conversation with a senior leader in HMRC who indicated that the risk processes were intended to identify the risky claims before they were sent to ISBC caseworkers. It is logical to conclude that inexperienced caseworkers receiving pre-screened cases could develop a mindset of seeing success where rejections led to a reduction in fraud and error statistics. This could easily present as bias in enquiries. Those experiencing the pre-judgment of their position are likely to lose trust in HMRC caseworkers if they behave in this way, given the importance of fairness (even-handed treatment without bias) and reciprocity in establishing and maintaining trust. If caseworkers are displaying (or

claimants and agents are perceiving) pre-judgment in enquiries and indicating a lack of trust in agents, then this indicates that conditions exist to support the survey findings that there has been an erosion of trust. Some interviewees also noted a lack of accountability stemming from caseworkers being faceless and unnamed on letters. They were able to hide “*with bravado and confidence and little oversight*” because the decisions could not be publicly attributed to them.

One interviewee described the shift in trust as “*stark*”: HMRC’s R&D teams had previously been on a “*pedestal for wanting to do the right thing*”, compared with the position since volume compliance where it is no longer possible to get a conversation with a person and written communications frequently contained errors. Another stressed that the tax services industry recognised that HMRC had a job to do and needed to check claims – and that the benefit of learning something, even where the adjustment went against them and their client, had been lost with volume compliance.

This was mirrored by the majority of interviewees, who gave examples that supported their survey responses showing a lack of trust in HMRC’s competence. Examples were given of a range of errors from incorrect company names, the wrong accounting period dates and the inclusion in standard letter responses of yellow highlighted sections where the caseworker should have selected an option. These indicated a lack of basic proof-reading and checks before letters were issued. One interviewee had dealt with ten enquiries, nine of which had contained factual errors in correspondence. They observed that this undermined confidence that the right result would be reached and that cases were being given due care and attention. Another noted the imbalance of power and a lack of appreciation of the time and costs and challenge presented by

information requests. An example was given of an information request with an inflexible 28-day deadline relating to five or six projects. Just the organisation of pulling together the information took two weeks, and the time investment removed key people in the company (for example, requests often required significant competent professional time) from doing the core work of the business.

Interviewees recognised the need for HMRC to act, albeit that a number commented on HMRC's role in failing to police the system properly historically as contributing to its abuse. Systemic targeting of the regime by organised crime gangs between 2016 and 2022 was highlighted, as was the failure to act by HMRC sooner, and its subsequent strong response. This lack of action and then sudden shift the other way has undermined confidence – it has eroded trust that HMRC will ensure the right outcomes are reached. One claimant interviewed noted that they are still routinely approached by “advisers” hustling for business.

There was a further observation that HMRC had been promising to upskill its workforce for over two years but that in the meantime, collateral damage continued and appeared to be accepted by the government department. However, sympathy was also expressed towards HMRC that getting the balance right and training large numbers of people quickly, all while large numbers of claims continued to be made, was a very difficult task. A contrast was also given between a potential imbalance between newly recruited staff at HMRC with specialist agents who had decades of experience. As well as questions of confidence, there was also a concern that the more experienced staff in HMRC were not available to support with getting to the right answer. One claimant noted a lack of trust in HMRC due to what they saw as no effort made to understand

what the R&D claimant business did and why they were making the “appreciable improvements” needed by the R&D tax rules, with the caseworker getting immovably wedded to the idea that the product already existed despite explanations to the contrary. The company felt they were being dismissed without due process with a lack of understanding or care as to the impact on the claimant if they had had to pay back £180k.

On the wider process, there was a clear distrust of getting a fair outcome from an appeal for a statutory review by HMRC’s SOLS, which was described as a “*rubberstamp*” of caseworker decisions. One interviewee noted that HMRC’s 2023-2024 Annual Reports and Accounts⁶² showed that across all types of case about 30% of internal reviews were upheld at the statutory review stage, yet for R&D cases 85% were upheld⁶³. The interviewee felt this difference was hard to explain because it did not make sense to go for review if the HMRC position was so obviously correct. Other interviewees suggested that going for a statutory review was now viewed simply as a step to get to ADR (which was viewed much more positively, with some noting it was the first opportunity during a volume compliance check to properly and directly discuss

⁶² HMRC, *HMRC’s Annual Report and Accounts 2023-2024: Our Accountability* (published 30 July 2024) <<https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2023-to-2024/hmrcs-annual-report-and-accounts-2023-to-2024-our-accountability> (accessed 25 May 2025)

⁶³ HMRC, *Approach to Research and Development tax reliefs 2023 to 2024* (published 30 October 2024) <https://www.gov.uk/government/publications/hmrcs-approach-to-research-and-development-tax-reliefs-2023-to-2024/approach-to-research-and-development-tax-reliefs-2023-to-2024> accessed 1 January 2025

facts and explain the R&D, usually leading to a sensible resolution). One interviewee noted that even where the claim was being rejected (for good reason), the chance to be heard [at ADR] was important. It could be drawn from this that lack of trust in HMRC is not universal across the different parts of the department – with there being an avenue, currently seen by many as ADR, to get to the right result, and with particular criticism levied towards teams in ISBC compared to WMBC. However, the fact that it is so difficult to get to ADR, supported by the costs of doing so making it prohibitive for some, may explain a perception of the process being inconsistent, unfair and there being an imbalance of power.

Impacts - fees and agent business models

Several interviewees noted the impact of compliance checks on their fees, business models and costs for clients.

They shared that there are several different fee models, some of which are contingent based on the success of a claim versus some which are fixed. Where fees are contingent, some or all of the costs of defending a claim are at the agent's expense. This raises a number of important questions in relation to agent and client behaviour but also potential consequences for HMRC data and statistics.

The interviewees provided examples to support a conclusion that some valid and genuine claims are not being defended, and also that HMRC's approach to compliance itself is contributing to this. In some models, contingent fees covered enquiry work up to the point of closure notices. There was an observation that many cases are not enabling a full exchange of facts and analysis during the caseworker stage so there is a

higher-than-normal tendency for statutory review requests after a closure notice is issued (and likely ADR after this). It is therefore reasonable to conclude that in particular for the smaller firms (for whom interviewees identified costs as particularly disproportionate to the size of claims) decisions not to proceed are likely to have been influenced not just by belief in the strength and validity of the claim, but also on the need to pay agent fees for support with a statutory review and ADR.

One interviewee felt that their business model was shifting from one of advice to managing tax risk so rather than supporting clients with maximising (legitimate) relief, they were educating them on the risks of compliance checks. Some noted a shift commercially from supporting with claims to more compliance work.

Another noted a concern that smaller claimants were getting priced out of the advice market because of the amount of work now required to prepare and sign off claims. The work required has resulted in a doubling of fees on average, and more where another agent has prepared the claim prior to sign off (given the need for so much additional checking). An example was provided of a well-publicised R&D claim that the interviewee and others believed should have been obvious R&D for HMRC, and in the interviewee's opinion was on the cautious side in terms of quantum. Defending the claim (which was upheld) had cost the company £50k in fees, which was disproportionate to the size of the claim and may have led to it being withdrawn if the company had not wanted to preserve the ability to make future claims. This was funding the company could have invested in R&D and did not take into account the value of the director and other staff's time involved, which were also real costs to the company.

Another factor noted relating to costs was the increase in agents' insurance premiums due to the numbers of compliance checks, with a knock-on effect on fees and commercial viability for companies to use an agent. Small claims under enquiry are often just pulled and the circa £2k fee refunded because it is not cost effective to defend the claim.

Impacts on claims

The interviews supported to some extent HMRC's data that claims are still being made, albeit in reduced numbers, with agents confirming that they are still gaining new clients. However, there was also an observation of a mood change in claimants towards more negative pre-conceptions of what the process might look like than previously and some deciding not to claim again.

Other interviewees described a new degree of nervousness in making claims with increased prudence on the costs to include in claims and with an increase in questioning about the likelihood of enquiries. It is not possible to test this anecdotal evidence for whether the shift is meaning claims are more accurate (that is, the behaviour HMRC want to drive) or that eligible firms are not claiming the full costs the policy intends them to be able to relieve. A swing towards the latter would suggest that the compliance approach is deterring genuine claimants from fully accessing the relief counter to the policy. This was expressed by one interviewee as having an impact on those who were using R&D funding as working capital for their next projects so a trend may emerge here which is noticeable in the future, and in some cases, they are seeing

a shift towards activities other than R&D, because they now consider the latter too risky.

A number of examples highlighted that the costs of enquiry led to claims being withdrawn (with taxpayers conceding to HMRC's position) and this has put them off making future claims. Again, it is not possible to assess the legitimacy of the claims from the examples, or how this has affected investment, but if they are legitimate, this similarly suggests that the costs of compliance and treatment by HMRC are distorting claim decisions. On the premise that the schemes are effective in driving investment, this indicates that this is likely to have a negative overall effect on the policy intent.

Another example was given by an agent who was dealing with six company enquiries. The clients had indicated (despite the claims in the agent's view being genuine R&D) that they would not be using the schemes in future because of what they saw as *"dismissive and aggressive bullying behaviour"* from HMRC, which they *"did not expect from a government department"*. The strong words illustrate the strength of feeling, which suggests a failing of trust in line with the KPMG's 2020 guide to organisational trust (as referenced in the literature review), which requires that for an organisation to be trusted, it needs not only a statement of commitment to its principles of trust, but also to demonstrate their application. Similar conclusions could be drawn from examples of HMRC's Charter not being met but with seemingly no recourse or accountability. An example given was an HMRC caseworker's child interrupting a call, requiring it to be rescheduled but there then needing to be a complete reset due to the caseworker not having recorded a note of the previous conversation, resulting in more time and costs for the claimant.

The interviews highlighted a perceived greater impact on smaller claimants, because the high risk of compliance checks with related costs is likely disproportionate to the value of potential claims. One interviewee had seen between ten and 15 potential claims relating to *“activities which 9 out of 10 people would agree were qualifying R&D”* where the companies would not bother claiming for a £20k claim. This seems like a direct link to the effectiveness of the policy – in the interviewee’s opinion companies doing these types of activities with these types of claim were the target of the policy but no longer being supported.

Impacts on business and investment

Examples were provided that indicate that business and investment decisions are being impacted in ways that are likely counter to the policy objective of encouraging qualifying R&D activities in the UK. This analysis looks at these through the lens of the hallmarks of trust to see how they featured in these decisions.

Example 1: An interviewee gave an example of a client who was dependent on their R&D claim to make the work viable. The length of the enquiry contributed to the 24-25 person innovation team being reduced to three or four people. Further, the client is deterred from making future claims because of the process (as well as no longer having the resource to do the R&D work due to the reduction in the team). The compliance check was eventually resolved in the company’s favour – verifying that the activities were qualifying R&D. This is a clear example of where the compliance check process has impacted funding and the business has suffered, resulting in it no longer pursuing qualifying R&D. The attribution to the impact of the length of enquiry is likely indicative

of a failing on a number of the hallmarks of trust from responsiveness (given the time taken) to balance of power (the company's inability to pushback against the process) and proportionality and fairness, given the serious consequences for the company's (legitimate) activities due to the enquiry.

Example 2: one company under enquiry came very close to having to cease trading and instead has paused all of its UK R&D activities until the outcome is known. They have been waiting for a statutory review for six months. This is clearly not only an example of lack of timely responsiveness by HMRC but one that has led to such uncertainty that it has had a direct impact on the company's activities.

Example 3: The interviews highlighted nervousness, in particular in SMEs, to spend the money received due to the chance they may have to pay it back later. In at least one case, the client had put the money into a bank account, where they intended to leave it until the enquiry window closed and they could get the certainty needed. Clearly this is not how the policy intended the money to be used and highlights the importance of certainty.

Example 4: the considerations for larger corporates are different from those for SMEs because they are not under the same funding constraints, so have more agility. Some interviewees reported companies exploring options for investing in R&D overseas instead of in the UK, because it was easy to do with existing infrastructure and the UK is no longer as attractive. It is not possible to say where on the tipping point large corporates are in seeing the UK as less attractive than elsewhere as a place to carry out R&D but it is indicative of the UK compliance approach being seen as a negative

influence on the decision-making process on where to carry out R&D, and could be seen to be undermining the attractiveness of the UK.

An example was given where a client with its main customer base in the US was being offered state credits to do their R&D work there, so there is also a factor of overseas jurisdictions targeting firms to move their R&D.

Example 5: One claimant highlighted that the impact was often wider than just a financial one for claimants as the stress and potential consequences and the difficult process had impacted severely on mental health. While very challenging for the individual (and trust that HMRC would provide an appropriate duty of care had been severely eroded), it is also possible to see a link between the detriment of a difficult enquiry process on an individual as being fatal to the policy objectives. In this case the individual had to scale back activities. The business model included hiring disadvantaged people (those with disabilities and ex-criminal offenders, for example) so there is a wider knock-on effect to economic wellbeing and growth.

Example 6: one claimant, who was an entrepreneur, noted the impact of the indirect costs of defending their claim. They estimated that in defending a £180k claim they had lost about £100k worth of staff time due to the numbers, and seniority, of the people needed to be involved with the defence of the claim. The process had required their finance team and leaders throughout the business to work on letters and briefings. This had undermined their confidence in the UK as a place to invest and do business (they also thought a more strategic approach was needed for investors and entrepreneurs – not just in tax).

Comments on the tax policy development

Only one view was expressed directly in relation to tax policy. The interviewee felt that there had been a lack of collaboration in the policy changes, and while the position had shifted somewhat back to a dialogue with stakeholders, rejections of small claims en masse had been used to illustrate problems with the SME regime and to justify pushing through the merged scheme, with minimal consultation. Their perception that not enough was done to understand how many of the small firms simply could not afford to defend their claims when they got caught in compliance checks, and raised questions about HMRC's statistics as it is impossible to tell the levels of valid versus invalid claims.

This clearly illustrates a scepticism of the policy process. However, a number of interviewees also referred positively to some of the changes. They noted that the AIF was useful, that the merged scheme was simpler to explain, and looking forward, a number responded positively about the potential for expanding advanced assurance options for R&D, which the government is currently consulting on.

Recommendation and suggestions

Some interviewees gave thoughts on things that would help rebuild trust. One interviewee noted that more transparency from HMRC as to the breakdown between error and fraud would be helpful. This idea was supported by the Sussex Chamber of Commerce and the finding of their member survey⁶⁴.

⁶⁴ Sussex Chamber of Commerce, *Chamber R&D Tax Relief Report Reveals Systemic Issues Hurting Small Businesses* (27 March 2024)

Others saw the AIF as a positive step forward, both in terms of ensuring HMRC had the information they needed to review and check claims but also as it presented a barrier where there was no substance to a claim, making it harder for bad actors.

One interviewee observed that previously billions of pounds were handed out with little checking or provision of information, which had clearly contributed to the abuse of the system. In their view genuine claimants would accept the upfront burden of a more robust process in exchange for certainty.

This led to an endorsement for the advance clearance consultation, which was seen by a number as potentially very valuable. There was some caution expressed that it needed to be well-implemented, give real certainty in a timely fashion, and that this would require skilled and sufficient resource at HMRC.

A repeated suggestion was the need to reset HMRC's approach to competent professionals. Interviewees felt that currently, despite HMRC senior staff indicating that it was not the correct approach, caseworkers sought to discredit competent professionals by challenging their professional opinion (often based on ill-informed Google searches) as to whether something was an advance or qualifying R&D. Some interviewees suggested that a better approach would be to test whether the competent professional understood what constitutes R&D for tax purposes, and whether the competent professional was capable of providing the judgement needed. The interviewees mentioned the need to respect the professional expertise of a

<<https://www.suffolkchamber.co.uk/latest-news/chamber-rd-tax-relief-report-reveals-systemic-issues-hurting-small-businesses/>> accessed 13 January 2024

credible competent professional and trust their view – this was an indicator of the need for reciprocity, and they saw it as damaging where competent professionals were accused of lying.

Generally, interviewees indicated that it was going to take years to restore trust, with a demonstration of consistency and actions over time. This included the need to find a way for discussions to be had with HMRC again, both on cases and at the RDCF, so that concerns could be heard and aired, and solutions reached.

Chapter 4: Conclusions

Through the literature review and background research, survey and interviews this research has tested whether there has been an erosion of trust which has had an impact on the UK R&D tax relief policy and its objective of incentivising investment in qualifying R&D.

This has been through:

1. Establishing whether the R&D scheme is/was in itself effective
2. Considering the importance of trust and what trust looks like
3. Assessing whether there has been a shift in trust
4. How R&D acts as an incentive to investment (and if this has changed)

The questions have been explored in detail in the analysis above so this conclusion does not revisit each in detail but pulls out the overall conclusions that can be drawn.

Effectiveness

The conclusion from the literature review was that for the purposes of this research, it was reasonable to conclude that the R&D scheme was effective per se, that is that it encouraged investment in R&D. This was further supported by the survey results with 91.1% of participants indicating that R&D was a key incentive to investment decisions. Therefore it was possible to say that any shift in investment decisions (and potentially by extension, claims to R&D relief) were indicative of a shift in effectiveness.

Trust

The literature review and background research demonstrated the importance of trust across compliance and engagement with tax systems, as well as showing the focus attributed to it by HMRC. The analysis enabled a number of key hallmarks of trust to be identified. These were used to test whether trust has existed both before and after the introduction of volume compliance and how visible the hallmarks were in the R&D tax policy making process.

The survey showed a clear erosion of trust between pre- and post- the introduction of volume compliance. Across the hallmarks there was a shift from >50% positive (or >75% positive or neutral) indicators of trust prior to 2022, dropping to more than 80% negative after the introduction of volume compliance. This was backed up by a number of evidentiary examples of where HMRC behaviours had changed participants' perceptions.

The interviews enabled a deeper analysis, which showed that historically HMRC R&D teams were viewed positively so a deeply negative feeling is a significant shift. There were also numerous examples given to support the views given.

Throughout the research, it has been noted that the sample set is likely to have predominantly included those who have stronger views or have been more negatively impacted. However the strength and breadth of evidence provided presents a compelling case that at least in some parts of the R&D population, trust has undergone significant damage.

This was further supported through the consideration of policy where visibility of the hallmark of participation in particular received a very low score and could be indicative of the perceived lack of consultation. This evidence of low trust is supported by the commentary in the literature as to the piecemeal approach to policy making and the long gaps between each new policy announcement and decision giving rise to considerable uncertainty.

The survey also explored the question as to HMRC's historic light touch policing of the regime and its impact on trust. The survey showed a mixed awareness of the levels of error and fraud prior to 2022, but it was notable that throughout the research commentators observed that HMRC had played a role in driving the error and fraud – both with its historic minimal compliance and the scheme's operation as process now, check later. The survey indicated that 75% of participants considered HMRC had contributed to the levels of error and fraud.

The combination of these areas throughout the research leads to the conclusion that trust has been eroded and not just in the area of volume compliance, although it is not possible to tell if this compounded participants perceptions in the other areas.

Impact on policy objectives of R&D tax relief

The survey indicated a clear link between trust and investors, with 92.9% of responses indicating that trust is significant or quite important to investors.

This suggests that any erosion of trust would have a correlative effect on investment.

Further, the research has shown the importance of the tax relief in making investment in R&D affordable. The survey and interviews gave numerous examples which indicated

that people are considering investing less (or at least making both fewer claims and claims for lesser amounts, which is likely to have a knock-on effect to the amounts invested).

What was also clear was that in the examples given both in the interviews and the survey, was that in the descriptions of why decisions were being made (for example to consider investing in R&D overseas rather than the UK), the hallmarks of trust were prominent. For example, it was notable that these decisions were tied for example to certainty, fairness or instilling confidence.

The research is purely qualitative in this regard, but it is reasonable to conclude that at least within the participants of the research there is a belief that investment in R&D in the UK is now less likely and that this is connected to an erosion of trust, which has featured highly in relation to volume compliance but also stems from the policy approach and the historic policing of the regimes.

It is also reasonable to conclude that the participants, given their broad range of backgrounds, are likely representative of at least those who are subject to or working on R&D cases subject to enquiry checks.

As noted early on in relation to the sample set, the evidence is not a statistically valid sample, but the results are strong in their conclusions, backed up by considerable numbers of illustrative real-life examples, which should at least alert policy makers and administrative decision-makers to the challenges and impacts in this area of tax.

There is also recognition that any rebuilding of trust is likely to require visible action and take considerable time. Actions such as providing opportunities to engage directly

with HMRC, and have a two-way dialogue with them, be it during enquiries or more generally, is needed to restore that feeling of mutual trust and reciprocity. Also, further evaluation of the effectiveness following the introduction of the new merged scheme and additional administration requirements like the AIF will be essential to assess whether the regime remains fit for purpose – not least because the impacts of a number of the examples relating to investment decisions and future claims are not yet likely to have filtered through, and if these come to fruition and are proven indicative there could be serious ramifications for the future of UK R&D.

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Chapter 6: Ethics statement and disclosures

My current professional role includes being privy to some confidential conversations with government on R&D policy and compliance. Any information received on this basis has been disregarded for the purposes of this research unless also publicly available.

I was also signatory in my professional capacity to some of the letters referenced in the research. These represent CIOT's position rather than my personal opinion (albeit that the two things may align). The materials have been viewed objectively throughout the research, with any potential for conflict and bias taken into account.

Participants were notified at the start of the survey and interviews that the research was primarily personal research, as opposed to being carried out in my professional role at CIOT. They were advised that it might also help inform CIOT work.

Data was collected through Google Forms and interview write ups. It has been stored securely and anonymised and comments kept non-attributable in this report to preserve confidentiality.