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Dear Philippa

#### **R&D tax relief enquiries by ISBC Campaigns and Projects team**

Thank you to you and your colleagues for your time recently to discuss the issues set out in this letter.

We first raised the issue of R&D enquiries into claims by small and medium sized enterprises (SMEs), and our concerns about how these are being conducted, at the R&D Workshop meeting with HMRC in February. HMRC have confirmed that a team within Individual and Small Business Compliance (ISBC) that does 'volume compliance' had been tasked to undertake more R&D enquiries. This team is, we understand, one of HMRC's Campaigns and Projects teams.

At the meeting in February, we, and other attendees, cited concerns around seeming lack of basic understanding of the R&D SME regime and the level of competency of caseworkers, as well as the lack of engagement with taxpayers and their agents. HMRC acknowledged that there had been 'teething problems' with the volume compliance approach and acknowledged that a 'capability build' was still needed.

Four months later, the feedback from our members is that the way that R&D enquiries are being conducted by the ISBC team remains concerning and further problems (for example, around how penalties are being assessed and enquiries are being concluded) are emerging as cases progress. We are receiving a significant number of reports from our members about the difficulties that are being encountered in practice and they have provided numerous examples of unfairness and negative taxpayer/agent experience in their interactions with the ISBC team conducting R&D enquiries. Some of these are set out in Appendix A. Others are included below within the body of this letter.

Following us setting out our position to HMRC in June, we are pleased that HMRC have engaged with us to discuss our concerns and we are grateful for the open dialogue and HMRC's assurances that they are intending to publish their compliance action plan that sets out their approach and addresses some of the issues we have raised. We recognise that there is significant fraud and error within the system in respect of R&D tax relief claims and support HMRC with their objective of ensuring that R&D claims are not excessive. We know HMRC remain concerned about the scope for non-compliance in R&D tax reliefs and have undertaken a more detailed exercise to understand the scale and nature

of the problem. The updated rates of error and fraud relating to the R&D schemes will be published shortly as part of HMRC's Annual Report & Accounts. Non-compliance is clearly something that HMRC should take steps to address.

However, while HMRC have reported that the volume compliance approach is systematically finding problems in relation to claims for R&D tax relief, we are worried that this approach is not giving a fair reflection of what is actually happening. Even to the extent that it is identifying errors in claims, our concern is that this is at the detriment of genuine R&D tax relief claims. Indeed, in many cases we are hearing that aggressive positions are being taken by the compliance team which, along with a refusal to have conversations (in person or virtual meetings, or telephone conversations) with the competent professionals and delays in issuing formal appealable decisions, make it very difficult for genuine claimants to defend their claim. We understand that some of the 'incorrect claims' HMRC are finding are in fact valid claims that the taxpayers decide to walk away from because of the costs of defending the claim (compared to the credit due) and HMRC's approach. This approach is, therefore, driving behaviour whereby withdrawals of claims will skew any statistics to measure the error rate in R&D claims, if these are counted as cases where there was an error, particularly as early evidence suggests that many of these cases are being charged a penalty for 'careless' behaviour.

The result is a breakdown of goodwill and trust between HMRC and taxpayers and their agents and a lack of faith in the R&D tax relief regime being able to deliver for SMEs. The current approach is discouraging legitimate claims from SMEs, which is undermining the policy intentions of encouraging R&D.

Against this background, we welcome HMRC's commitment to seek to improve the compliance processes so that there is less of a collateral impact on genuine R&D claims, and that the compliance processes support the policy objective of encouraging R&D. This letter sets out the concerns that have been raised with us by our members, and the CIOT's view of the various issues discussed below. In conversations with them, HMRC have recognised these concerns and committed to responding more formally to them. We look forward to this response and to working collaboratively with HMRC towards achieving a proportionate, fair and consistent treatment of taxpayers and agents. We intend to publish this letter and the response we receive from HMRC.

### **Examples of poor behaviour**

In addition to examples of lack of care, getting the technical law wrong, poor communication and grammatical errors, there are key themes in the way in which enquiries are being conducted by the ISBC team that are particularly concerning and are unhelpful in terms of delivering the policy objectives. These are the lack of any engagement by HMRC with taxpayers or their agents via meetings/calls (in person or virtually), the apparent lack of a genuine engagement with the taxpayer's competent professionals in assessing the R&D activity and delays to the process of concluding enquiries.

Clearly, we welcome HMRC opening enquiries into R&D tax relief claims where there is a genuine concern. However, it is important that each taxpayer receives fair and consistent treatment from HMRC in respect of the conduct of their enquiry. If that happened, we, and taxpayers, could be confident that legitimate claims would be accepted by HMRC. We, and our members, want the bad claims rooted out, but as it stands, it seems that HMRC do not have the systems in place to differentiate good from bad, and the volume compliance approach does not always result in a correct outcome. In addition, the sheer number of enquiries being opened means that many genuine claimants are embroiled in a rigid and uncompromising compliance process in order to defend their R&D tax relief claim, and are reconsidering using the scheme altogether as the costs of enquiry outweigh the benefits of claiming the relief.

In our view a volume compliance approach does not work well for R&D tax relief claims, due to the complex nature of the relief and the technical consideration required in ascertaining whether or not there has been a qualifying R&D project. However, we also accept that the new volume compliance approach has been adopted as a result of the high level of fraud and error that has been identified in relation to R&D tax relief claims, and that HMRC consider that it is achieving results in terms of identifying errors and fraud. In addition, conducting enquiries in the numbers that HMRC intend seems very difficult, other than by utilising a process driven, desk-based approach along the lines of the work of the Campaigns and Projects teams without considerable additional investment in more, and more highly trained, resource within HMRC. Therefore, we understand that HMRC are minded to continue with the approach. If this is the

only option, we encourage HMRC to open up avenues to a more collaborative approach for R&D enquiries; facilitating meetings with taxpayers and their agents, where there is an arguable case that R&D has taken place. This may at least mitigate some of the most significant issues we have identified and ensure a better taxpayer experience, outcome overall and ensure that genuine claims are accepted. In particular, we would welcome routes to ensure that there is greater engagement from HMRC to understand the claims and also educate where there are genuine but not fraudulent errors. We understand that HMRC are looking at possible 'escalation' routes that could achieve this – this is something we would welcome and look forward to discussing with HMRC further.

We are also concerned by how the ISBC team are approaching the application of penalties in cases where they consider no R&D has taken place, and the general approach to the closing the enquiries, which we discuss further below.

The House of Lords Economic Affairs Finance Bill Sub-Committee report 'Research and development tax relief and expenditure credit'<sup>1</sup> published in January this year identified many of these issues. We note that the government has responded to this report<sup>2</sup>. In our view, this response does not adequately address the conclusion and recommendation in the Report about the compliance activity of HMRC.

The Report says (at paragraph 62): *'HMRC should address the criticisms witnesses made of the way its compliance activities are conducted. These included an inconsistency of approach, failing to take account of information already received from claimants when making enquiries, poorly focused questions and a reluctance to engage constructively with taxpayers and their agents.'* The government's response partially accepts this recommendation, but seems to misunderstand the reference to engagement with taxpayers and agents, which to us reads clearly as a reference to engagement during compliance activities (including for R&D enquiries, as discussed below), by citing engagement through consultation and forums such as the RDCF. Similarly, the response refers to the new requirement for additional information to be provided in order to give HMRC some 'consistency'. But the reference to 'inconsistency' in the Lords' Report is to inconsistency in treatment of taxpayers in the context of R&D tax relief enquiries, as discussed below.

We also note the points that their Lordships made around the failure by HMRC to ensure that the requirements of HMRC's Charter are consistently met in relation to the conduct of R&D enquiries by the ISBC team<sup>3</sup>. This is also something that continues to be reported to us.

Two different agents have told us that members of the ISBC team have said that HMRC's Charter does not apply to the conduct of R&D enquiries by them. We have raised this with HMRC, who have confirmed that the ISBC team is meant to be operating in accordance with HMRC's Charter. We understand that HMRC will ensure that caseworkers within the ISBC team are aware of this.

We also think that there may be some unexpected effects on HMRC's resources and efficiency from the volume compliance approach to R&D enquiries. Although there may be some easy 'wins' in terms of claims withdrawn and, indeed, some ineligible (and abusive) R&D claims being identified and challenged, our understanding is that the approach is also generating a large number of formal complaints. The approach is also likely, in due course, to lead to appeals against closure notices in respect of enquiries where the taxpayer is confident that there is R&D and/or in respect of incorrect penalty assessments. Both of these things will put pressure on HMRC's resources.

### **Engagement and lack of discussions**

A normal part of an R&D compliance check used to be a call or meeting between the HMRC caseworker and the company's technical contacts (the competent professionals). This is because the assessments made by competent

<sup>1</sup>[Research and development tax relief and expenditure credit \(parliament.uk\)](https://committees.parliament.uk/publications/38977/documents/191609/default/).

<sup>2</sup> <https://committees.parliament.uk/publications/38977/documents/191609/default/>

<sup>3</sup> Paragraph 65 - HMRC's Charter requires HMRC to ensure officers dealing with a taxpayer have right level of expertise, but our evidence suggests that this is not always the case in relation to R&D relief. Paragraph 179 – We were concerned to learn that HMRC was perceived as adopting a confrontational approach..... The Charter requirement that HMRC deal with taxpayers fairly should underpin its work.... Paragraph 180 – ... the evidence we have heard suggested that HMRC staff dealing with R&D claims are not sufficiently knowledgeable to assess what qualifies as R&D.

professionals are key to the legal framework for R&D tax relief. However, the ISBC team is routinely telling taxpayers that direct contact is not possible, even when this is requested.

Here is an extract from a letter from HMRC around why there has been no in-person engagement from HMRC in relation to an R&D enquiry that is indicative of the overall approach:

*'As HMRC is a fact and evidence organisation we are generally able to conduct our enquiries without recourse to face to face meetings, or conference calls. This is because we cannot use any unsupported opinions or information when gathering evidence or making decisions. The scope of a corporation tax enquiry is limited to establishing the facts and applying HMRC's policy to those facts. Nonetheless, I acknowledge this should have been communicated to you at the earliest opportunity, rather than being completely ignored...'*

This is a surprising statement in the context of R&D enquiries. While accepting as a basic premise the statement around establishing 'facts and evidence', it does not give a complete picture in relation to R&D: whether or not R&D has taken place is not merely a 'fact' but is an assessment of whether the activity falls within the definition of R&D set out by 'the Guidelines'<sup>4</sup>. As such, it requires a degree of understanding that can best be provided by speaking to the competent professional. In this context, the statement around 'unsupported opinions or information' is rather misinformed. The competent professional would not be providing 'unsupported opinion' but would be able to provide further clarification and explanation that would assist the caseworker in understanding the R&D activity. In addition, 'facts and evidence' are not limited to documents and written statements; in a legal context, the oral evidence given in a court or tribunal is considered as part of the 'facts and evidence' gathered.

Firstly, the approach gives rise to unwelcome inconsistency in the experience of the SME taxpayers that are subject to enquiries by the ISBC team, as opposed to enquiries conducted by the WMBC team or large business, who are still arranging calls to discuss R&D projects. Although face to face meetings are no longer the norm with WMBC and large business cases, calls continue to take place between HMRC and the company and are generally considered to be the most effective and efficient way to review the projects, discuss and agree the nature of the projects claimed, or identify any areas of disagreement.

Secondly, the approach of refusing to have any direct contact with the taxpayer or the agent is contrary to HMRC's guidance.

The CIR manual says at paragraph 80525: *'During the course of an enquiry into an R&D claim, an officer from a specialist R&D Unit will normally make arrangements to discuss the claim with the company's management and technical experts.'*

We understand that HMRC have said that CIR80525 is not relevant to these enquiries, because it is specifically a practice note for Specialist R&D units and is not, therefore, applicable to enquiries opened by other departments in HMRC, which includes ISBC, Campaigns and Projects teams. This seems inconsistent because the compliance checks are being conducted by a team within Campaigns and Projects which is focussed on R&D, and it is the part of the manuals that speak specifically to R&D enquiries, and the specific issues that arise from them, due to the necessity of understanding what is R&D and applying the Guidelines within the framework of the tax legislation. This is particularly true now that the R&D Specialists Units are no longer operating as such<sup>5</sup>. As this particular paragraph of HMRC's guidance remains published, it is not unreasonable to expect that the principles within it should be applied to all R&D enquiries that are now being conducted by teams within HMRC rather than the R&D specialist units.

In any event, HMRC manuals also refer to meetings as being useful in more general contexts.

The CIR manual says at paragraph 80550 'HMRC officers should be flexible in considering what records will be of assistance. They may well find that discussing the claim with the company, or agent, in advance of the making of

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<sup>4</sup> The BEIS guidelines were updated and replaced by those issued by the Secretary of State for the Department for Science, Innovation & Technology on 7 March 2023

<sup>5</sup> Victoria Atkins MP told the Lords that the specialists units operate as 'a national team instead of separate groups in different locations.' (paragraph 178 of the Report)

detailed evidence requests will provide a better appreciation of what records are available, and enable them to focus their enquiries in a more cost-effective way for both them and the company.'

Similarly, HMRC's enquiry manual (EM1822) notes that: *Meetings with the taxpayer are an important part of enquiry work. These can be face to face or via a telephone or video conference where these facilities are available. Meetings are often the best way to find out the facts about a business and give you and the taxpayer the opportunity to discuss the identified risks and how you have arrived at any conclusions you have already reached.*

Interestingly, where EM1822 goes on to note that '*Not all enquiries will require a meeting.*', this is in the context of meetings being '*expensive and inconvenient for the taxpayer.*' (emphasis added).

In addition to the manuals, HMRC's Litigation and Settlement Strategy also sets out how HMRC will work disputes. We note sections 9 to 15 on collaborative working, which get expanded later in the document. In particular at page 25 where there is reference to '*Wherever possible, HMRC should aim to discuss and agree the relevant facts .....*'. At page 20 the strategy emphasises the benefits of collaborative working to resolve enquiries and disputes, which it defines as including '*...discussing, sharing and testing the technical arguments to assess relative strengths and weaknesses in analysis and determine whether further facts have to be established*' and '*exploring possible alternative interpretations of the facts and relevant law that might give a different outcome from those initially proposed by HMRC and the customer*'. The way that the enquiries are being conducted by the ISBC team is the antithesis to this approach.

Finally, with regard to the manuals, we note that in its introduction to the Enquiry Manual EM0010 says that HMRC's compliance strategy has two strands:

- support those who seek to be compliant and
- come down hard on those who seek to gain an unfair advantage through non-compliance.

We suggest that the current approach is not fulfilling the first of these strands. Please can you explain why HMRC are not following their guidance in relation to meetings or other in person engagement and/or considers that it is appropriate to adopt a volume compliance approach that overrides the guidance around this for SMEs' R&D enquiries?

Please can you explain why the ISBC team are unable and/or unwilling to engage in person with taxpayers or their agents? We understand that HMRC have said that this team have not had sufficient training to allow them to either speak to or meet with any taxpayers. If true, this is difficult to reconcile with the team being considered sufficiently qualified and experienced to run an R&D enquiry. But, if this is the case, is it something that could be rectified by further training such that in the future in person engagement will be possible?

HMRC have said that training continues to be undertaken in relation to those conducting R&D enquiries and recognises that in some instances 'commercial awareness' amongst caseworkers may be low. Please can HMRC explain how this will be addressed. Is the lack of awareness something that will be addressed through any escalation routes that are put in place, so that appropriate R&D tax relief claims can be considered by specialist R&D units.

As well as resulting in an unfair and inconsistent approach between cases dealt with by the ISBC team and other R&D compliance checks, ISBC team's approach also results in an inefficient use of resources, as without direct communication between HMRC and the company, both parties must rely on written communications to explain their viewpoints. This places an additional cost burden on both sides given the additional time needed to prepare written responses. We recognise that HMRC have finite resources and that it is important that these are used in the most efficient manner taking into account the full journey from the start of a compliance check to the end, including the appeals process. To this end, we support the development of 'escalation' routes so that appropriate R&D tax relief claims can be passed to a team within HMRC that is able to conduct in person discussions, in order to facilitate a more efficient handling of the R&D tax relief claim overall.

## Due and appropriate consideration of an R&D tax relief claim

HMRC state in their R&D manual CIRD80520 *'An open-minded approach should be adopted as to whether a project, or part of a project, is relevant R&D. It is important to gather all of the facts, and listen to the company's representations before making a decision.'* It used to be expected that R&D enquiries would run for several months, or even over a year, establishing the facts. Whilst it is desirable to shorten the timescale and reach a prompt resolution where possible, this should not be because of taking insufficient time to properly consider an R&D tax relief claim, potentially resulting in an incorrect outcome.

The rapid responses by the ISBC team to detailed submissions indicate that the caseworker is not reading the detail submitted and considering it alongside information submitted previously as well as other data held by HMRC. This leads to the impression (at least) that HMRC are not being fair and objective in their assessment of whether or not R&D has taken place.

In addition, the decision that there is no R&D is often reached after only one round of questions, resulting in a decision being made before the facts have been fully established.

Also, on this point, CIRD80525 says: *'The officers handling the company's affairs will not hold themselves out to be scientific or technological experts. However where appropriate they will need to ask questions of the company's technical experts to establish their scientific or technological background and that they understand and have correctly applied the definition of qualifying R&D.'*

However, enquiries by the ISBC team have not followed this approach. We discuss above the lack of in person engagement with taxpayers and, therefore, direct contact with competent professionals. Instead, in some circumstances, the HMRC caseworker appears to be reaching an opinion that R&D has not occurred. For example, in one letter a case worker states:

*'..... should be more than a minor or routine upgrading'. It is my opinion that developing a new control panel for this existing technology is not an appreciable movement in this field and could be done by any other competent professionals.'* (emphasis added)

Here HMRC appear to have taken on the role of judging the eligibility of R&D projects themselves, rather than considering the reasonableness of assessments made by the competent professionals, which the CIRD manual<sup>6</sup> specifically warns HMRC inspectors against doing.

In the example provided above, the caseworker's opinion is presented as a conclusion, despite directly contradicting the competent professionals. The caseworker's letter concluded that the project does not meet the criteria in the Guidelines, which is disputed. Further, as a technical matter, whether or not the advance could be achieved by another competent professional is the wrong test to be applied. The Guidelines do not require a company to prove that no other competent professional could achieve the same advance – just that they faced technological uncertainty and the solution was not readily deducible. This is a technical error by the ISBC team. But over and above that (and while HMRC may refute our concerns because they are based on the same CIRD paragraph that is headed as being a practice note for Specialist R&D units), overriding the opinion of the competent professional in favour of the stated opinion of the HMRC caseworker is a marked departure from established practice.

This is a sensitive area. We recognise that HMRC must be allowed to question the company about these assessments, and it is reasonable for HMRC to expect a layman's terms explanation of the R&D. However, the ISBC team's approach appears to place little or no evidentiary weight on the judgement of the company's competent professional, instead reviewing written descriptions of the projects and making their own assessment of whether the work described represents an advance in a field of science or technology. Essentially they appear to be elevating themselves into the role of competent professionals in this regard.

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<sup>6</sup> CIRD80525 – *'The officers handling the company's affairs will not hold themselves out to be scientific or technological experts.'*

The impression of our members who have raised concerns with us about HMRC's approach is that there is a predisposition within HMRC to conclude that there is no R&D regardless of the evidence provided by the taxpayer.

This perception is strengthened by responses from the ISBC team that are critical of the taxpayer or the competent professional's expertise without apparent cause or reason. For example, it has been suggested in many cases that the company should have obtained evidence that other competent professionals outside of the business could not have solved the identified uncertainties, which is not actually a requirement – essentially saying the testimony of the company's own competent professional was insufficient, despite their credentials being provided. Other examples we have received cite statements from the ISBC team such as *'I think that a competent professional would have been able to resolve this uncertainty'*, seemingly not taking into account the R&D report that sets out many reasons why the company's competent professional (with appropriate, and often many years', experience in the industry) considers that the solution was not readily deducible. This again indicates that the ISBC team are stepping into the shoes of the competent professionals.

This issue could also be addressed by ensuring that the ISBC team are properly trained to recognise where engagement with competent professionals would be helpful and ensure that these cases are passed to another team within HMRC.

## Penalties

We understand that HMRC are routinely asking questions around behaviour with a view to considering penalties. The questions commonly being asked are set out in Appendix B. The pre-decision letters, stating HMRC's opinion that there is no R&D, often include HMRC's view as to penalties.

It is, of course, appropriate for HMRC to consider penalties. However, the conclusions being reached as to what penalties HMRC consider should be applicable, demonstrate a lack of understanding by the ISBC team as to the established law around penalties.

Below are two examples of extracts from letters where HMRC say they consider that the behaviour is careless.

### Example 1

*We consider that the behaviour was careless. This is explained below.*

*You failed to adequately consult HMRC's guidance at CIR8000, you relied upon advice given by a third party and did not contact HMRC directly, before submitting your claim to R&D tax relief. I have therefore, been unable to conclude that reasonable care was taken when you submitted your claim to R&D tax relief in your tax return.*

*The disclosure was prompted because you did not tell us about the inaccuracy before you had reason to believe we'd found out about it, or were able to find out about it.*

*For this careless inaccuracy, with prompted disclosure, the minimum penalty percentage is 15% and the maximum penalty percentage is 30%.*

### Example 2

*Having reviewed the inaccuracies and details regarding how they arose, it appears that you relied upon advice from the agent [name of agent], and you did not contact HMRC directly. You also did not thoroughly consult HMRC's Research and Development Tax Relief guidance at CIR84250, where you would have seen that the expenditure you have claimed for as a subcontractor is not qualifying expenditure, which is 'intended to prevent both parties to a contract from claiming relief for the same activities'.*

*Therefore, I believe this inaccuracy was careless as you failed to take reasonable care to prevent it occurring.*

For the avoidance of doubt, the agents that sent us these examples (and more importantly, the companies' competent professionals) disagree with HMRC's conclusion that the respective projects are not R&D.

In any event, the assessments of carelessness in these examples are, in our view, incorrect on the basis of the reasons given for a number of reasons.

Firstly, a taxpayer is entitled to obtain and then rely on advice from an agent. HMRC's Compliance Handbook manual lists, at CH81130, situations in which a taxpayer takes reasonable care (and is, therefore, not liable to an error penalty). One of these is *'acting on advice from a competent adviser which proves to be wrong despite the fact that the adviser was given a full set of accurate facts'*. This follows the decision in *Hanson v HMRC* [2012] UKFTT 314. Also, in *Carrasco & another v HMRC* [2016] UKFTT 731 the Tribunal said *'... when a person seeks appropriate professional advice from somebody who is a professed expert in the applicable discipline, it will almost always be reasonable for the person who has sought out such advice to rely upon that advice provided only that that person has selected a seemingly competent professional adviser, unless there are factors to the knowledge of the recipient of the advice which indicate to him/her that it ought not to be relied upon. In our judgement such factors would have to be reasonably obvious rather than subtle or such as might only be picked up by a fellow professional'*. This approach is followed in several other Tribunal cases considering carelessness.

Secondly, we disagree with the assertion by HMRC that adopting an approach that is different to that which is set out in HMRC's manuals is *'careless'*. The examples above say that the manuals cannot have been *'adequately'* or *'thoroughly'* consulted, as the filing position is different to that which is suggested by the manuals (specifically, CIR84250). However, if the taxpayer has taken a filing position after considering the manuals, and taking advice, and that filing position disagrees with them, that is not carelessness. This is particularly the case in an area such as subcontracting (the subject of CIR84250) where HMRC are well aware that there is strong disagreement with HMRC's view of the application of the law.

The case law goes further and says that there is no carelessness where a taxpayer has taken a considered view, even if that view is, in fact, an incorrect one<sup>7</sup>.

Thirdly, we do not accept that carelessness can arise on the basis that the company did not consult HMRC ahead of making an R&D claim. HMRC's manuals, and case law, speak of what a prudent and reasonable person in the position of the taxpayer in question would do. HMRC's manuals (at CH81120) say that: *'In HMRC's view it is reasonable to expect a person who encounters a transaction or other event with which they are not familiar to take care to find out about the correct tax treatment or to seek appropriate advice.'* Therefore, whilst it is expected that the person should find out about the correct tax treatment, this can be done in a variety of ways, including the taking of appropriate advice. It is not an expectation or requirement that a taxpayer should necessarily contact HMRC to seek advice.

More particularly, so far as we are aware, there is no obvious route by which advice can be sought from HMRC in relation to R&D tax relief prior to making a claim. In the case of Example 1 above, we understand that HMRC subsequently accepted that no application under the R&D advance assurance facility<sup>8</sup> could have been made, but suggested that the taxpayer could have called an HMRC helpline and obtained guidance. However, HMRC have not said which helpline would have been available to the taxpayer to provide guidance around R&D, and we are not aware of one.

Are you able to provide the details of the helpline that HMRC have in mind that taxpayers should contact to receive advice about what is R&D in advance of making a tax relief claim, if they wish to do so?

But in any event, while it would be helpful if advance guidance were available from HMRC in relation to R&D tax relief in the manner suggested, there is no obligation to seek advice from HMRC in order to demonstrate that reasonable care has been taken in relation to a claim.

We also find the suggestions that HMRC would have been able to take the time to speak to the taxpayer, and have a discussion around what constitutes R&D prior to the claim being made, contradictory to the approach HMRC are taking in relation to R&D enquiries, where the opportunity of in person contact is refused. Perhaps the resource that HMRC

<sup>7</sup> [Shanks v Revenue & Customs \(INCOME TAX - loss deduction - profession - partnerships\) | \[2019\] UKFTT 279 \(TC\) | First-tier Tribunal \(Tax\) | Judgment | Law | CaseMine](#) – see paragraph 56 in particular.

<sup>8</sup> Advance assurance for R&D tax relief is a voluntary scheme that can be used if a company is applying for R&D tax relief under the SME scheme [for the first time](#).



suggest is available ahead of making a claim could be deployed in providing in person engagement in relation to R&D enquiries.

While discussing the assessment of penalties, we would like to raise a point about question 5 in the list of questions set out in Appendix B. This question asks whether there are any ‘exceptional’ circumstances that should be taken into account. This suggests that the ISBC team writing these questions is unaware of the details of the statutory penalty regime. The reference should be to ‘special’ circumstances (see CH170100 and para 11 Sch 24 FA 2007). It is important that the correct terminology is used and that the law and practice around penalties is applied consistently across HMRC<sup>9</sup>. HMRC cannot reinterpret the law on penalties in discrete areas such as R&D enquiries. This approach demonstrates a lack of training and/or multi-disciplinary input into the conduct of the R&D enquiries that are being undertaken by the ISBC team.

### **Closing the enquiries**

Our members are reporting, that to a very large degree, HMRC are sending a pre-decision letter stating that they do not consider that any R&D has taken place, often with a subsequent letter setting out a view of penalties that will be assessed, but then no further action is taken by HMRC. Specifically, HMRC are not issuing closure notices of the enquiries – the trail of correspondence goes cold, leaving the companies with uncertainty. Whilst the companies could apply to the First-tier Tribunal, asking them to direct HMRC to close the enquiries in order to obtain certainty, the application and subsequent hearing is not cost free, and would take time for both HMRC and the company to deal with.

In practical terms, this means that taxpayers are unable to formally challenge the position that HMRC have apparently reached. Without a closure notice (issue of assessments, penalty assessments), the taxpayer cannot seek an HMRC statutory review or appeal to the Tribunal.

We understand that the time being taken to issue a closure notice may not be unique to enquiries in respect of R&D tax relief claims. However, it seems odd to be apparently stalling enquiries in circumstances where, from the reports we are receiving, the ISBC team are too quick in the initial stages of the conduct of the enquiry, resulting in a lack of due consideration of the claim, as discussed above.

We would welcome any explanation or insight into how HMRC deals with the closure of enquiries in order to understand the apparent change of pace. What is the process for the issuing of a closure notice? Is this part of the enquiry being passed to another section of HMRC by the ISBC team? Is any review of the enquiry being undertaken as part of the decision around whether or not to issue a closure notice?

We are also receiving examples of cases where the lack of training within the ISBC team is resulting in some incorrect assertions around enquiry and appeal processes available to taxpayers and HMRC. For example, in one case a confusing letter that says whilst the taxpayer asked for a statutory review, if the taxpayer wants the matter to go to tribunal they need to appeal before the outcome of the statutory review is received. But HMRC have not in this case issued a closure notice (which is necessary in order to trigger an appeal).

Incorrect statements around procedure are damaging to the reputation of HMRC and may confuse taxpayers.

### **Understanding HMRC’s approach to R&D enquiries**

We understand that HMRC consider that the increased volume of enquiries, which means that HMRC reach a higher number of taxpayers, resulting from the volume compliance approach by the ISBC team is useful in terms of identifying common errors. We have suggested that it would be helpful if HMRC could share the common errors they are seeing as part of an education exercise for taxpayers.

We have not seen anything from HMRC around this to date, although HMRC guidance has been published that lists sectors that are very unlikely to carry out R&D<sup>10</sup>. We are also aware of targeted compliance activity being considered

<sup>9</sup> *Edwards v HMRC* [2019] UKUT 131 (TCC) has relevant comments at 72-74

<sup>10</sup> [Research and Development \(R&D\) tax relief - GOV.UK \(www.gov.uk\)](https://www.gov.uk/research-and-development-r-d-tax-relief)

by HMRC in relation to certain sectors. We would encourage HMRC to say more about the errors that it is seeing and also to do more to encourage voluntary disclosures of incorrect R&D claims.

It is also worth noting that the accelerated compliance process, lack of opportunity for competent professionals to speak directly with caseworkers and the practice of issuing pre-decision letters without formal closure notices may be leading many taxpayers to simply give up and walk away from perfectly valid claims. To then suggest that this is evidence of 'common errors' in claims is misleading.

We understand that a significant number of enquiries are targeting companies with particular SIC codes. A targeted approach is welcome to the extent that HMRC are challenging R&D claims in sectors where there is unlikely to be any R&D including, for example, pubs and restaurants and wholesalers.

However, there are any number of reasons why a business in an area not renowned for R&D may nevertheless be undertaking legitimate R&D. For example:

- Management consultancy (usually R&D relates to development of a software platform)
- Education (again, typically ed-tech so software development)
- Wholesale (we accept that it is appropriate for HMRC to be sceptical, but companies in this sector may also have, for example, a manufacturing SIC code, which is where the R&D is)

This is why it is important that each R&D tax relief claim is given a fair hearing if subject to an enquiry and the experience of our members is that this is not happening consistently.

We would also like to understand how HMRC are classifying and quantifying the 'errors' that they are seeing.

We are aware that taxpayers are withdrawing their claims because the costs of disputing them with HMRC are too high – both financially and in terms of the administrative/time burden for the company. Similarly, HMRC have sent out pre-decision letters saying that they do not consider there to be R&D, but these enquiries have not been closed or finalised, and taxpayers may dispute them. It would be false logic to include amounts of R&D tax relief in respect of these categories of claim as 'errors'.

More generally, the number of claims being withdrawn should not be taken as a measure of success of the current volume approach to R&D enquiries. This is because in many cases this is simply a result of the cost of challenging HMRC being too high, particularly when the cost of taking a case to the Tribunal is factored in. This is particularly the case as the volume compliance approach seems to target lower value claims where any recourse to Tribunal would very clearly be uneconomical.

We suggest, based on the experiences of the many CIOT members who have contacted us, that where it is used inappropriately the volume compliance approach will result in increased work for HMRC. We understand that any indication of dissatisfaction with the conduct of enquiries by the ISBC team is promptly raised as a Tier 1 complaint by HMRC, with several of these proceeding to a Tier 2 complaint. Dealing with complaints will, of course, take up HMRC resources. It would surely be preferable for HMRC, as well as for taxpayers, if all R&D enquiries were better dealt with in the first instance, so that complaints can be kept to a minimum. This also applies to appeals.

It is also important for HMRC to recognise that, from the perspective of taxpayers and agents, HMRC are refusing R&D claims in businesses where any reasonable person would expect R&D activities to be present. Further, HMRC are doing so based on a desk-based approach and standardised responses, without understanding the business or the claim properly, seemingly contrary to all HMRC published guidance. Examples raised with us include the denial of R&D tax relief claims by businesses that have won the Queen's Award for Innovation and Oxford University spin out companies.

## **Conclusion**

As noted above, HMRC have decided to adopt a volume compliance approach to generate a high volume of enquiries into R&D tax relief claims and are seeing some benefits from this.

Taxpayers and advisers are experiencing this significant increase in uncollaborative R&D compliance activity on good as well as bad R&D tax relief claims. The result is a breakdown in trust and a perception that the R&D system is not working fairly for SMEs.

We agree that HMRC should take appropriate and proportionate actions to prevent abuse of the R&D tax credit system, but we understand that the current approach is discouraging legitimate SME claimant companies from making a claim because the likelihood of having to defend an enquiry means it is not cost effective to do so. Also, the uncertainty of challenge means that the claimants do not know when they will receive the funds and if they may subsequently have to be repaid – so the claim process does not incentivise further business or R&D investment and may therefore have a negative effect on the country's growth. The result is that the R&D tax credit system for SMEs appears not to be fulfilling the policy intentions of this and previous governments of encouraging R&D.

In our view, a volume compliance approach is not suited to R&D enquiries which, generally, require meaningful engagement between HMRC and taxpayers to ascertain whether there is an R&D project in accordance with the Guidelines. The desk-based approach of the ISBC team is likely to be counterproductive overall in some cases.

We would like to see a modification of the approach to R&D enquiries, moving back to collaborative working as set out in HMRC's manuals and other standards of engagement (for example the Litigation and Settlement Strategy). In addition, soon HMRC will have more and, hopefully, better information available to it as a result of the new compliance requirement to provide additional information in respect of R&D tax relief claims which should help it better focus on claims which are more likely to lack merit.

We appreciate HMRC's engagement with the issues raised above and look forward to your response, and to working with you further to address them.

Yours sincerely

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## The Chartered Institute of Taxation

The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

## Appendix A – Examples of lack of competency/technical knowledge/incorrect processes around enquiries

*The examples below have been provided to us by agents. We have not verified these cases or seen the full correspondence in relation to the specific enquiries referred to.*

Agent had completed and submitted an R&D report with the CT600 but this could not be found by the investigating team. The pre-decision letter contained numerous grammatical and typographical errors. It also stated that the company should have obtained evidence that other competent professionals outside of the business could not have solved the identified uncertainties, which is not a requirement – essentially saying the testimony of the company's own competent professional was insufficient, despite his credentials being provided.

An initial letter from HMRC asked for further explanations 'in a form understandable to the non-expert'. This was done, and the second letter essentially said 'you have not provided enough information, please provide more' but without elaborating on where the apparent insufficiencies were, and the second letter also contained numerous grammatical and typographical errors. The letter was very jumbled, asking for contracts and invoices in one part, and later coming back to subcontractors and asking for the same again. The pre-decision letter was issued in Word format rather than PDF and asked for email protocol authority again despite it being provided previously.

Two separate enquiries were opened simultaneously for 31/3/21 and 31/3/22, but the schedule for the 31/3/22 enquiry was a copy of the 31/3/21 schedule, still stating questions around the same date period. The pre-decision letter contained project headings which were not our clients' but clearly from another company's enquiry. The interpretation of the 'for the company alone' was also incorrect in that it suggested that if the advance was not shared wider then it would not qualify – whereas it is the technological baseline that should be measured against the wider world. HMRC also hung all their rejection of the R&D on a cursory Google search for similar products, which of course were not on the market at the time of the R&D work nearly 3 years previously (as all the ones online now had copied our client's design). They also made suggestions questioning the competency of the company's competent professional, suggesting (with a reference to CIR 81900) that 19 years' experience in the construction industry was not enough to make a person a competent professional.

HMRC had failed to check the submitted return for the R&D report and started the enquiry because they did not think there was one. A 64-8 authority had also been previously completed but lost by HMRC and a fresh one had to be done. The detailed letter asked for explanations in 'layman's terms', which we did, but the pre-decision letter then badged those explanations as insufficient. The same misinterpretation of the 'for the company alone' as the case above was also adopted here, ignoring the fact that the baseline was not the company's alone but the wider industry. Again a lack of testimony from the competent professional is cited, although this had been provided by virtue of the competent professional providing input for the letter (and this was stated).

In an enquiry into a claim by a small company (with only one employee who was on leave), a request for extra time to collate the response was denied, with a threat of a Schedule 36 notice if a full response to the information request was not received in the original timeframe. In this instance, the agent was able to contact Odette Carnell (HMRC) as a result of involvement with the R&D Workshop. Odette Carnell intervened to get the extra time allowed. Again 64-8 authority had been lost and a convoluted authority process had to be put in place at the start.

HMRC have said to an agent that a suspended penalty is inappropriate because the SMART requirements cannot be applied (see [CH83153](#)). But there have been no discussions on that and no explanation from HMRC on their conclusions. Further, the same agent has agreed suspended penalties on R&D enquiries in the last six months in other cases, indicating an inconsistent approach.

Extract from letters between HMRC and agent

[What HMRC said]

*For subcontractor payments, you mentioned the names of subcontractors. Please provide us with a brief description of their role in the R&D process. Please also provide documentation such as contracts and invoices for subcontractors included in the claim for R&D relief.*

*You are aware that subcontracted expenditure cannot be claimed unless it is directly undertaken by a charity, a higher education institute, a scientific research organisation, a health service body, an individual or partnership of individuals.*

[Response from agent]

*It is important to highlight the statement above is incorrect.*

*Whilst it is correct that under the RDEC regime, subcontractor payments are only qualifying for R&D relief if made to a qualifying body, individual, or a partnership where each member of which is an individual, we are somewhat concerned that we need to reiterate that this is a claim made under the SME regime, and therefore payments to subcontractors are qualifying expenditure.*

*This claim is made under the SME regime and point you to HMRC manuals CIRD 84200 for further reference, and CTA 2009 s 1078, 1133 – 1136.*

*In addition, as set out in HMRC's published document – 'R&D relief simple guide, making R&D easier for small companies' the table in page 22 confirms that where a contracting SME company engages with an SME subcontractor, it is the SME contracting company who are able to make the claim.*

## **Appendix B - Penalties**

### **Examples of questions being asked of taxpayers about behaviour:**

1. At the time of submitting their claim to R&D relief, did the company read and fully understand the R&D guidelines at CIR80000 within HMRC's Corporate Intangibles R&D Manual?
2. Why did the company believe that their projects would initially qualify for R&D?
3. Did the company seek any advice from a Tax Professional regarding their claim? If so, who was the specialist and what steps were taken to verify their credentials? What steps were taken by the company to check the R&D claim?
4. Have the company ever sought advice from HMRC regarding R&D? If so, when was this and what was the outcome?
5. Are there any exceptional circumstances you would like us to consider when we are determining a penalty charge?