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Draft Finance Bill 2023-24

House of Lords Economic Affairs Committee Finance Bill Sub-Committee - Call for Evidence

Response by the Chartered Institute of Taxation

1 Executive Summary

1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.

Dealing with promoters of tax avoidance and increasing the maximum prison term for tax fraud

1.2 The CIOT strongly supports the raising of standards in the tax advice market and driving out those people who continue to promote tax avoidance schemes. However, this needs to be done in a way that has due process with adequate safeguards and appropriate governance. In our view the proposed new criminal offence fails this test because an important constitutional line is being crossed, namely that (in principle at least) something can potentially be a crime on HMRC's say-so, given that a decision to issue a stop notice will rest entirely with HMRC with no external oversight. The lack of external scrutiny prior to the issue of the stop notice presents a risk that a notice could be incorrectly issued and / or inappropriately targeted with significant consequences for the promoter concerned. We have therefore suggested to HMRC that they should have to make an *ex-parte* application to the Upper Tribunal (Tax and Chancery Chamber) for 'judicial' approval before a criminal stop notice can be issued.

1.3 How effective the criminal offence for promoters will be will largely depend on how realistic promoters believe the prospect of a criminal conviction is. There may be a higher deterrent effect on promoters based in the UK than those overseas. We agree with HMRC that prosecution should be reserved for the most serious cases where HMRC need to send a strong deterrent message or where civil investigations are ineffective. The power to seek disqualification of directors of promoter companies may not be effective in deterring the promotion of tax avoidance if the directors are unaware of the role they are playing and so similarly unaware that these proposals may apply to them; for example, if they are 'stooge' directors. People are being recruited via social media to act as directors to front umbrella companies, paying people through disguised

remuneration. The level of culpability of the director concerned should be considered when deciding whether to proceed with disqualification. Like the criminal offence, its effectiveness will also depend on directors' awareness of the risks of disqualification, which in turn will depend on how much HMRC publicise the new rules.

1.4 We do not have the expertise to offer specific comment on whether doubling of the maximum prison term for tax fraud will help deter tax fraud, over and above general comments such as the importance of raising awareness of such consequences and reinforcing the likelihood of being convicted of such an offence. The approach to prosecution should be in line with HMRC's published criminal investigation policy.

R&D reforms: a potential merged R&D scheme and additional relief for R&D-intensive SMEs

1.5 If the government decide to merge the research and development (R&D) schemes, they should slow down the timetable. An implementation date of April 2024 is over ambitious; it will present practical difficulties for HMRC and taxpayers and will result in unintended consequences. The current uncertainty and rushed implementation are undermining the policy intention of supporting and encouraging R&D in the UK.

1.6 In addition, an important opportunity to simplify the UK tax system is being missed because the time is not being taken to incorporate the additional relief for R&D intensive small and medium-sized enterprises (SMEs) into the new scheme. As a result, the UK will continue to have two R&D schemes, an outcome inconsistent with the objective of embedding tax simplification within the tax policy making process and the tax system.

Additional HMRC data requirements

1.7 We will only know how straightforward it will be for businesses to provide the additional data to HMRC when HMRC publish the regulations specifying which information is required. In terms of employee hours worked, for example, employers not already capturing this on their payroll systems will have to set up new systems to do so. Data on employers' HR systems might be separate from their payroll systems, and not in a format that can be easily transmitted to HMRC via the Real Time Information (RTI) return.

1.8 HMRC's estimated costs are not insignificant, but do seem substantially underestimated, particularly in relation to the impact on businesses of providing data on employee hours worked. We would welcome sight of the calculations, as we expect real-life costs to be significantly higher. It is difficult to gauge whether costs are proportionate to expected benefits as it is unclear what government will use the data for.

1.9 We are unable to provide any meaningful comment on whether the current timetable is reasonable or not because the details will be in regulations which have not yet been published. Although the amendments will not have effect until the tax year 2025-26, this does not provide much time for businesses and employers to budget for, investigate, develop, and implement any software upgrades and new internal data collection processes that may be needed to comply with the new obligations.

2 About us

2.1 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 to achieve this aim; we are a non-party-political organisation.

2.2 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.

2.3 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.

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

3 Introduction

3.1 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.

Dealing with promoters of tax avoidance and increasing the maximum prison term for tax fraud

4 How effective are the criminal offence for promoters, the power to seek disqualification of directors of relevant companies and the doubling of the maximum prison term for tax fraud likely to be in deterring the promotion of tax avoidance and tax fraud?

4.1 **Criminal offence for promoters**: promoters can already face enormous financial civil penalties for continuing to promote schemes specified in a stop notice. Only a small number of stop notices have so far been issued[1], but it appears from what HMRC say that a handful of promoters continue to promote their schemes despite receiving a stop notice so the deterrent effect of the penalties is not working in all cases; hence the Government proposing the introduction of this new criminal offence. Whether focussing the proposed

[1] 12 stop notices have so far been issued by HMRC – see https://www.gov.uk/government/publications/named-tax-avoidance-schemes-promoters-enablers-and-suppliers/list-of-tax-avoidance-schemes-subject-to-a-stop-notice#:~:text=Stop%20notices%20are%20one%20of,get%20caught%20up%20in%20them.

offence on the continued promotion of a scheme covered by a stop notice will help to deter that small number of promoters will largely depend on how realistic they believe the prospect of a criminal conviction is.

4.2 Because some of these promoters are not based in the UK[2], we are doubtful whether the measure will deter such promoters from continuing to promote their schemes. HMRC should explain how the offence will be enforced, eg if it is extraditable, how the individual could end up in prison, how any criminal fine could be collected (will the authorities enforce against UK situs assets or can they collect the money with help from the authorities in the country in which the person is based). Additional publicity setting this out would help overseas promoters understand that this new offence could realistically affect them.

4.3 It will no doubt be easier for HMRC to enforce the measure against UK based promoters than those operating outside the UK so there may be a higher deterrent effect on promoters based in the UK.

4.4 We would suggest that HMRC should set out how the offence could affect the promoter when they issue a stop notice – so at the point at which the promoter must decide whether to abide by the notice and stop promoting the scheme or to ignore it and continue to promote the scheme - thereby automatically committing the criminal offence. Ideally HMRC should also flag to all those involved in promoting an avoidance arrangement as early as possible – ie before a stop notice is issued - the prospect of the measure being used - perhaps even by writing to them at both their home and businesses addresses, given HMRC's worries about stooge directors (see below). It will be important to ensure the message gets through to all those who could be affected to increase its deterrent effect, and the relatively small number of promoters should enable HMRC to adopt a more targeted approach.

4.5 **The power to seek disqualification of directors of promoter companies** may not be effective in deterring the promotion of tax avoidance if the directors are unaware of the role they are playing and so equally unaware that these proposals may apply to them. This could happen where the promoter behind a scheme, or 'controlling mind', operates through limited companies, concealing their involvement in the promotion of their schemes, and inserting stooge or intermediate shadow directors who distance the promoter from the company. As noted above, it will be essential to publicise and raise awareness of the new power, and target communications accordingly, so that these stooge directors are aware of it and it has maximum deterrent effect.

4.6 We suggest that HMRC explore how the Department for Business and Trade and Companies House can be involved in publicising the measure and educating directors about the risks and responsibilities. Perhaps this could be in the information Companies House provides to newly appointed directors. The Government could consider generating media interest, in conjunction with HMRC and Companies House, via press releases and social media posts. It would need to be done on a regular basis not just when the new measure is announced, to reach people who are asked to be stooge directors in the future. Awareness for accountants, tax agents and legal advisers can be raised through webinars, HMRC's Agent Update and the professional tax and accountancy bodies.

[2] Para 1.3 of HMRC's consultation document stated that '*there are currently around 20 to 30 active promoter organisations, some based offshore and hiding behind complex corporate structures'.*
https://www.gov.uk/government/consultations/consultation-tougher-consequences-for-promoters-of-tax-avoidance/tougher-consequences-for-promoters-of-tax-avoidance--3#:%7E:text=a%20criminal%20offence%20to%20apply,or%20exercise%20influence%20over%20such

4.7 **Doubling of the maximum prison term for tax fraud** - we do not have the expertise to offer specific comment on whether this will help deter tax fraud, over and above general comments such as the importance of raising awareness of such consequences and reinforcing the likelihood of being convicted of such an offence.

5 What approach to prosecution is needed to support these measures? And is HMRC adequately resourced for the work involved?

5.1 The approach to prosecution should be in line with HMRC's published criminal investigation policy[3]. We would also support HMRC publishing the steps that would be involved in a decision to prosecute a promoter for the new criminal offence of failing to comply with a stop notice.

5.2 We do not have sufficient information on HMRC's resources to say whether they will be adequate for the work involved and suggest this is a question which is more appropriate for HMRC themselves to answer.

6 Are there sufficient safeguards and appropriate governance around the criminal offence/disqualification measures? How necessary are these additions to HMRC powers?

6.1 Our comments here are restricted to the proposed criminal offence.

6.2 The promotion of tax avoidance schemes persists despite all the previous measures that have been introduced in recent years to address the problem. We recognise that the government considers it necessary to create this new power in an attempt to drive out the remaining promoters who continue to flout the rules. The CIOT strongly supports the raising of standards in the tax advice market and driving out those people who continue to promote tax avoidance schemes[4], but this needs to be done in a way that has due process with adequate safeguards. In our view the proposed new criminal offence fails this test. An important constitutional line is being crossed by this legislation, namely that (in principle at least) something can potentially be a crime on HMRC's say-so, given that a decision to issue a stop notice will rest entirely with HMRC with no external oversight. The lack of external scrutiny prior to the issue of the stop notice presents a risk that a notice could be incorrectly issued and / or inappropriately targeted with significant consequences for the promoter concerned.

6.3 In HMRC's recent consultation document, the Financial Secretary to the Treasury helpfully makes clear in her foreword that the measure does not target legitimate tax advisers but is aimed at promoters who seek to exploit every opportunity to profit by sidestepping the rules. Whilst these words provide some reassurance that it is the Government's intention that the proposed criminal offence will only be targeted at the 'hard core' of promoters (most of them not members of a professional tax or accountancy body, or even tax advisers at all), the fundamental problem remains that the offence itself will not be so narrowly drafted and there will be no external oversight before the stop notice is issued. While we do not doubt that HMRC will be very sparing in the use of this power, simply relying on their goodwill and good sense is not a sufficient safeguard against a (potentially arbitrary) criminal charge.

[3] https://www.gov.uk/government/publications/criminal-investigation/hmrc-criminal-investigation-policy
[4] Such behaviour directly contravenes the standards for tax advisers set out in Professional Conduct in Relation to Taxation. (PCRT) which sets out the fundamental principles and standards of behaviours that all CIOT members, affiliates and students must follow: https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac51cdc7bf0d99/d0836d40-5102-4ac1-89f3-efc9b7c75e8a/CIOT%20-%20PCRT%2003.01.23.pdf.

6.4 The position is exacerbated by the fact that:

(a) if, on appeal against the stop notice, the Tribunal determines that the stop notice shall 'cease to have effect' ab initio, it is unclear that this rescinds the criminal offence which has already been committed under proposed new s277A(1) Finance Act 2014.
(b) even if such a retrospective decision by the Tribunal does rescind the criminal offence, this puts intolerable pressure on a Tribunal in deciding (under s236E(5) Finance Act 2014) from what date the stop notice should cease to have effect: if the Tribunal chooses that the cessation should be prospective only (or from any date other than ab initio) then the Tribunal will be confirming the criminal offence; and
(c) even if the avoidance scheme is ultimately found to work by the courts, the criminal offence of failure to comply with the stop notice will still have been committed.

6.5 The proposal places a very high level of reliance on HMRC's internal governance working effectively. In addition, the governance process needs to be clearly articulated and transparent; at the moment it is too lacking in detail and visibility to provide external stakeholders with confidence that it is robust enough to avoid inappropriate use of the power. We would support HMRC publishing the steps involved in the decision to issue a stop notice so external stakeholders can have a clearer understanding of HMRC's internal governance process.

6.6 However, even then, this is not enough. There should be a higher external level of scrutiny before a stop notice is issued that will in future carry with it the risk of criminal charges. Using the existing safeguards which were designed for a regime attracting civil financial penalties, rather than criminal sanctions, will not be adequate.

6.7 We have suggested to HMRC that they should have to make an *ex-parte* application to the Upper Tribunal (Tax and Chancery Chamber) for 'judicial' approval before a criminal stop notice can be issued[5]. We do not believe that adding this additional step would significantly slow down the process of issuing a criminal stop notice and it would provide that extra level of assurance for all the parties involved, including HMRC, that a stop notice that carried with it the most serious consequences if ignored had been appropriately issued. Given that the likely number of such notices will remain limited, we do not think that this places an undue resource constraint on the Upper Tribunal. The exact question for the Upper Tribunal would no doubt need refinement, but there are several precedents which could be adapted. We provided some broad suggestions about how the process could work in our recent letter to HMRC[6].

7 What evidence have you seen of people being recruited as directors to 'front' companies involved in promoting tax avoidance in return for payment? How can the legislation allowing HMRC to apply for the disqualification of directors best be focussed on directors who have real control and influence over the companies' activities?

7.1 The disqualification of directors is generally outside the expertise of a tax adviser, even those experienced in dispute resolution. Any person or entity in this situation would need to be taking legal advice from a suitably

[5] CIOT letter to HMRC commenting on the draft Finance Bill clauses - 12 September 2023.
https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/85883d4e-17d9-43e2-871a-82b45fba2406/230912%20Dealing%20with%20promoters%20of%20tax%20avoidance%20-%20CIOT%20letter_Redacted.pdf
[6] Ibid.

qualified and experienced lawyer. Our comments on the director disqualification measures proposed are therefore necessarily limited and should be read in that context.

7.2 HMRC's consultation document noted that often the promoter behind the scheme, or 'controlling mind', operates through limited companies, concealing their involvement in the promotion of their schemes, and often inserting stooge or intermediate shadow directors who distance the promoter from the company. The CIOT's Low Incomes Tax Reform Group (LITRG) agreed in their response to HMRC's consultation document[7] that often 'innocent' people are being recruited as stooge directors to front umbrella companies paying people through disguised remuneration (DR). The recruitment often takes place on social media for a fee. A recent BBC expose highlighted that UK based directors are used in mini umbrella company (MUC) fraud as well as overseas ones[8] – each MUC needs a director, and these are usually incorporated with a UK based director initially. Once the company has been established, and relevant HMRC and Companies House correspondence forwarded on, the UK director usually resigns to be replaced by an overseas director, often from the Philippines.

7.3 When HMRC identify a person as being a director of a promoter company, they must ascertain whether that person has simply been recruited to 'front' the company or whether they are someone who has real control and influence over the company's activities, since the legislation can only best be focussed on those that have real control and influence if HMRC can identify who they are. This will presumably need to be investigated using the data and resources at HMRC's disposal and it may take some time before HMRC have the full picture and can decide whether to seek a director disqualification order. The legislation could best be focussed in the way suggested in the question if HMRC only seek disqualification in cases where they have identified the 'controlling mind' behind the company, but we do not think disqualification of a stooge director can be completely ruled out because each case will be dependent on its own facts. In addition, some of the 'controlling minds' may not even be directors if they have inserted stooges to act as directors, in which case it is unclear how the measure will affect them.

8 How should 'the public interest' be interpreted in the context of the decision whether to prosecute these offences?

8.1 We agree with HMRC that prosecution should be reserved for the most serious cases where HMRC need to send a strong deterrent message or where civil investigations are ineffective. Presumably this would include cases where a promoter has a track record of not complying with requests or notices from HMRC, cases where a promoter persists in promoting new schemes despite being involved in previous failed schemes and assessing what harm their actions have caused to those taxpayers caught up in their scheme(s) and the tax system in general. The assessment of whether a decision to prosecute a promoter who has committed the criminal offence would be in the public interest should follow the basic principles in the Code for Crown Prosecutors[9].

8.2 In terms of the director disqualification measure, the level of culpability of the director concerned should also be considered (see above). If it turns out that someone is a 'stooge' and has little if no knowledge or

[7] See https://www.litrg.org.uk/sites/default/files/230530%20Tougher%20consequences%20promoters.pdf
[8] http://downloads.bbc.co.uk/rmhttp/fileon4/PG01_Britains_Ghost_Companies.pdf
[9] 'The Public Interest Stage' https://www.cps.gov.uk/publication/code-crown-prosecutors

involvement in the promotion of the scheme, that would tend to suggest that disqualification may not be an appropriate sanction.

9 R&D reforms: a potential merged R&D scheme and additional relief for R&D-intensive SMEs

How much of a tax simplification would a merger of the two existing R&D schemes be?

9.1 While a merger of the two existing R&D schemes would be a simplification to the UK tax code, that is not what is happening with the current proposals. Although the new scheme outlined in the draft legislation would provide some opportunities for simplification, because of the way it is currently proposed with additional relief for R&D intensive SMEs, there will still be two R&D tax relief schemes in the UK. The two existing schemes are not being merged; rather most SMEs are being incorporated into the new single scheme based on a 'research and development expenditure credit (RDEC)' approach, and the SME scheme is remaining for a smaller group of R&D intensive SMEs.

9.2 The result is that most of the benefits of a simplification that would come from having a single scheme in the UK will not be realised. This is a huge, missed opportunity and is inconsistent with the overall policy objectives to embed tax simplification within the tax policy making process and the tax system.

9.3 The main justifications we have been given for this is that the statements about the additional relief for R&D intensive SMEs say that this support will be along the lines of the SME scheme. However, while this may necessarily be the case for at least the tax year from 1 April 2023 to 31 March 2024, this does not seem to preclude the additional relief from being amalgamated into a single scheme when the relief being given to SMEs more generally changes, with a different (higher) rate being available to R&D intensive SMEs. Although having different rates would add some complexity into the new scheme, in our view it would be less complicated overall than continuing to have two schemes. The complexity of continuing to have two schemes is discussed further in paragraph 10 below.

10 How easy will it be for SMEs to adjust to a single RDEC-based scheme for R&D?

10.1 We recognise that the RDEC scheme was specifically designed for the way large businesses operate, with the key feature being to provide a visible incentive for the specific departments that carry out R&D by giving the credit 'above the line'. As a result, the accounting for RDEC is more complex, because the credit can be recognised and is visible in the accounts, as opposed to the SME scheme, where, because the R&D credits are non-taxable, they only impact the company's tax charge. While most SMEs (and their advisers) would be able to deal with this, it could present challenges for the smallest businesses and, indeed, the smallest firms of advisers who may not understand, for example, that the RDEC is actually taxable. However, as we said in our response to the consultation when the single scheme was first considered[10], if there were only one scheme, based on RDEC, the accounting would become well-established and generally understood for all taxpayers and advisers considering R&D tax relief. In addition, many SMEs already also encounter the RDEC scheme because of subsidised or grant funded R&D, and where R&D is contracted to them by a large company.

[10] CIOT response to the HMT consultation on R&D Tax Reliefs.

10.2 However, the current proposals will result in new complexities for SMEs because of there still being two R&D tax relief schemes.

10.3 The position will be more complicated than exists under the current two schemes because of the population that will be entitled to claim relief under each of the schemes going forward. Currently, although some SMEs must interact with RDEC to claim relief in certain circumstances and, therefore, must deal with both schemes, more commonly a company is either large – and claims under RDEC, or is a SME – and claims under the SME scheme. A company may also move from the SME scheme to RDEC when it becomes 'large', but this is likely to be a one-time only, one-way movement.

10.4 Going forward, because a SME may have to (or be eligible) to claim under one or other of the two schemes (depending on its activities, expenditure and/or profitability within any particular accounting period), it is likely that many SMEs will bounce from one scheme to the other on a period-by-period basis. This will create considerable uncertainty as to what R&D relief will be available, particularly as a company will not know whether it is an R&D intensive scheme until the end of the accounting period when it is able to assess its qualifying R&D expenditure and whether this constitutes at least 40% of total expenditure.

10.5 The draft legislation does not include any detail about how the movement from one scheme to the other will be managed. For example, in Year 1 the company is a 'normal' SME and is, therefore, within the new 'RDEC' scheme. It has amounts carried forward under new sections 1042I (2) and 1042K (3). It seems that, if that company becomes an R&D intensive SME in year 2, it will obtain a super deduction at 86% and a payable credit (if applicable) at 14.5%. However, it would also still have the brought forward amounts (that can arise under the RDEC rules) to deal with. This does not feel like a simplification.

11 If the Government decides to merge the two existing R&D schemes, it has said the merger will take effect from 1 April 2024. What are your views on this timetable?

11.1 It is our strong view that, if a decision is made to implement a merged scheme for R&D tax relief, the start date for a merged scheme should not be fixed until the detail of the scheme is settled and has been properly consulted on. In any event, a start date of April 2024 is too soon.

11.2 In our view it is too early to have moved to draft legislation, presented for 'technical' consultation. There has been no consultation on, or discussion of, the issues that have become apparent following the publication of draft legislation and policy papers. These issues include the interaction of a new merged scheme and the remaining scheme for R&D intensive SMEs (discussed in paragraph 10 above), or the difficulties around the proposal to follow the SME rules for subcontracted R&D (discussed in paragraph 13 below). This latter aspect of the rules, in particular, is a significant change for large companies. These issues (and others) deserve a much more detailed discussion of the principles underpinning them, and their implications, than is possible with the proposed timetable of a start date of April 2024. This discussion would help determine the best way to achieve the policy aims, and to deliver a coherent and workable set of rules.

11.3 There needs to be more open discussion about the implications of the proposed merged scheme to minimise unintended consequences. From a policy perspective, it is important that the implications of the new scheme for the overall R&D spend by UK companies, and which companies will be able to claim the reliefs, are fully understood. It seems likely that the effect of the merged scheme will be to reduce the number of claims overall, and that larger companies may increasingly make these, with mid-sized businesses in particular being less likely to be able to claim relief than they are under the current rules. This is particularly because of the

effect of the rules on sub-contracting, which are discussed at paragraph 13 below, as these will consolidate the R&D undertaken by a company itself and the work contracted out into the larger company.

11.4 We recognise that this might be an intentional policy outcome, as the reduction in rate to the relief available to SMEs will cause many SMEs to have to re-evaluate the economic viability of their businesses and R&D projects. The rate of relief at 20% set out in new section 1042F will result in a further fall in value of the cash equivalent of the relief. It may be that the government's aim is to focus more on R&D being undertaken by larger companies. The consultation document published in January 2023, says (at paragraph 1.11) that additionality in the SME scheme is lower than the RDEC. We support the policy aim of ensuring that R&D tax relief delivers additionality, as this has obvious attractions from the perspective of getting best value for public money spent. However, if the government wishes to focus R&D tax relief more on larger companies, it should be more open and transparent about these policy aims.

11.5 Ensuring that there are clear and certain rules around the availability of tax relief for R&D will benefit the additionality of the scheme as a whole. Ensuring that the UK is a place where R&D tax relief is available to those undertaking R&D activities, and that the reliefs are administered fairly, will ensure that innovation is seen to be encouraged and supported. If the system makes it too difficult to claim tax relief or introduces arbitrary rules around who can claim the relief, the narrative around people who are doing R&D but are missing out on tax relief would operate as a general disincentive. Also, while additionality should drive design to an extent, an equally important consideration is that the principle of equity means that the tax system should not treat one claimant differently from another just because one is 'additional'. These points are important in an overall policy context. To date there has been no open discussion about the winners and losers from key design features of the proposed merged scheme, nor of the complications arising from the changes. This should happen to ensure policy intentions are implemented into statute accurately and effectively, without unintended consequences.

11.6 In conclusion, the government should pause its current rushed progress towards a partially merged scheme for R&D tax reliefs, and take sufficient time to consult fully on, and properly consider, the policy implications, as well as the areas of complexity and difficulty from a design perspective.

11.7 **How prepared are businesses, particularly SMEs, for these changes? What help and support will they need?**

11.8 In addition to the lack of consultation on the detail of the proposed single scheme, the proposed timetable is too short to allow businesses to react to it before the start date. April 2024 is too soon for businesses to organise their contracts and businesses arrangements to reflect the new rules, particularly when much of the detail remains outstanding. Businesses are not well prepared, and are not able to better prepare, due to the lack of detail.

11.9 It is unfortunate that the government is continuing to put businesses in a position of great uncertainty around the provision of R&D tax relief in the UK. The current situation is the antithesis of additionality. Businesses are unable to have any certainty about what R&D tax relief may be available to them in respect of investment decisions currently being taken due to the uncertainty about whether a new scheme will be introduced, at all, or in April 2024. In addition, a lot of important detail for a new scheme still missing. Certainty for businesses has a large part to play in delivering additionality.

11.10 We recognise that the changes to the R&D tax relief that have already been announced, namely the additional tax relief for R&D intensive SMEs and the delay to the restrictions on overseas expenditure in R&D tax reliefs need to be dealt with, regardless of the decision about the new merged scheme. Indeed, the

current unsatisfactory situation arises largely because of the decisions around the reform of R&D tax reliefs that have been taken in a somewhat 'knee-jerk' manner ahead of the completion of a coherent review of these reliefs. Decisions such as reducing the rate for SMEs generally, followed by the introduction of an additional relief for R&D intensive SMEs shortly afterwards, as well as the recent compliance measures (additional information form and claims notification) have resulted in a general perception of uncertainty and incoherent change. To rectify matters and introduce some certainty, in our view, the government should announce a slowed down timetable for a new single scheme that would ensure that the new rules are fully published, and the detail of what will be required from companies is fully available, in good time before the commencement of a new regime.

12 Are HMRC's estimates of the costs to businesses of adjusting to these changes realistic? How costly is it likely to be for businesses to adapt?

12.1 We recently noted (in the Technical pages of our *Tax Adviser* magazine)[11] that HMRC's estimated average additional annual cost of compliance for companies affected by the changes to R&D relief for small and medium-sized enterprises was equivalent to the price of a jar of beetroot. This is a reference to the 57 pence figure included in the Summary of Impacts in HMRC's policy paper[12]. We recognise that this is an average figure across tens of thousands of businesses, but the idea that anything to do with tax can cost just 57 pence a year seems incredible, never mind something as complicated as R&D. This is on top of a 'negligible' cost estimated for the one-off impact on businesses.

12.2 We do not agree that these costings are anywhere close to being realistic. Whilst being unable to put an estimate on it ourselves, we would expect the costs would be significantly higher.

13 What are your views on how a merged R&D relief scheme should deal with the treatment of subcontracted R&D?

13.1 The policy paper states that the decision has been taken to follow (broadly) the approach of the SME scheme in that companies will be able to claim for payments made as part of an R&D project to subcontractors.

13.2 HMRC's interpretation of the rules in relation to subcontracting and subsidised expenditure in the SME scheme has been challenged by many taxpayers and advisers. CIOT had several meetings with HMRC in an attempt to reduce the area of uncertainty, and to arrive at a pragmatic and commercial way forward, but difficulties remain. The decision to follow the SME scheme approach means that the issues around subcontracting will remain, and will now be relevant to all companies

13.3 We welcome that in our discussions with them, HMT and HMRC have confirmed that the aim is that the new scheme should take the opportunity to clarify the policy intentions of R&D relief in this area, and the desired outcomes, and endeavour to ensure that these are translated into statute accurately and effectively, without unintended consequences. We have discussed with HMT and HMRC two approaches:

[11] https://www.taxadvisermagazine.com/article/technical-newsdesk-october-2023
[12] https://www.gov.uk/government/publications/research-and-development-reform-additional-tax-relief-and-potential-merger/additional-tax-relief-for-research-and-development-intensive-small-and-medium-sized-enterprises

Option 1 – defining 'R&D subcontractor'. This approach might involve distinguishing in the legislation an R&D contract (only the customer can claim) from a non-R&D contract (the subcontractor may be able to claim).

Option 2 – notification from customer. This approach might be similar to the Irish system whereby a party initiating a contract notifies the subcontractor, ahead of payment, that the subcontractor cannot claim R&D relief.

13.4 Both options have their pros and cons. If option 1 could be clearly defined, this option would be preferable, as it would involve less of an administration and compliance burden and is less likely to affect how companies arrange their commercial affairs and contracts. However, we recognise the significant challenges around achieving clarity. The current draft Condition A in new section 1042C (2) largely mirrors the wording in the current legislation, the meaning of which is contentious. In addition, the wording considering the position from the perspective of the principal in new section 1042E(3), that describes R&D 'undertaken on behalf of the company' is not very clear. This approach would, therefore, require further drafting to provide clarity and certainty going forward.

13.5 A notification requirement (Option 2) could provide certainty. However, it will shift R&D tax relief into the commercial negotiations between parties, and the administrative burdens on companies that will have to determine whether a notification should be given and monitor information flow from the subcontractor to have sufficient information to be able to submit an R&D claim should not be underestimated. For the larger companies with the capacity to handle the information flow and contract records etc., the impact of this change to the rules is likely to be that R&D tax relief claims will become consolidated in the largest companies that are commissioning R&D spend. For companies currently within the RDEC, the proposed approach is to move the ability to claim R&D tax relief from the companies doing the R&D to those commissioning it. The companies that will lose out from this approach are the mid-sized businesses that are currently too large to be within the SME scheme and are claiming R&D relief under RDEC that has been subcontracted to them.

13.6 It is not clear what will happen in cases where insufficient information is provided to the company that should be entitled to give a notification and be entitled to claim the relief. A result of this requirement may be that there is no claim in respect of some R&D that is undertaken. This may be a positive outcome from an Exchequer point of view. However, we would question it as a desired policy outcome for reasons of fairness - the principle of equity means that the tax system should endeavour to treat companies that are undertaking similar activities in the same way, and not result in companies being unable to claim tax relief because of administrative burdens. This may also have a detrimental impact on additionality, with the company that might actually do some R&D not actually being incentivised to do it.

13.7 Overall, further thinking is required to establish clearly what is contracted out R&D and how this should be treated. This is recognised in the Explanatory Notes which comment: '*The government would like further discussions to understand how a potential merged scheme could distinguish between 'normal' contracts and 'subcontracted out R&D' so that those undertaking qualifying R&D are enabled to claim relief, whilst avoiding double claims.*'. The CIOT and others have been having those discussions with HMT and HMRC over the summer. In our view, the outcome of the government's deliberation following these discussions and the proposed way forward should be the subject of further consultation.

13.8 It seems likely that the issues regarding subsidised expenditure may fall away because of a single scheme. HMRC have indicated that the Condition B in new section 1042C(4) (which is in square brackets in the draft legislation) should not be required, and we agree with this. However, rules around subsidised expenditure will remain for the additional relief for R&D intensive SMEs. There has been no discussion as to how the

difference in interpretation of these rules will be resolved. The current position is causing administrative difficulties for taxpayers because of the ongoing uncertainty. In our view, the current position is detrimental to HMRC's overall efforts to address bad behaviour in relation to the R&D regime and encourage compliance, because HMRC are permitting a situation of uncertainty to continue and are not taking any of the steps available to government to resolve the uncertainty: by either legislating or pursuing the issue through the Courts to achieve a binding judicial precedent[13]. The opportunity should be taken to amend the legislation to ensure the legislation itself clearly accords with HMRC's interpretation.

13.9 Currently the draft legislation does not deal with any of these issues in relation to subcontracted R&D, or subsidised expenditure. This is a huge omission if the intention is that the rules should be implemented from 1 April 2024. An area as important as this should be fully considered and consulted upon before implementation. In addition, the administrative procedures necessary for Option 2 will have to be developed. There will need to be a very clear timeline and procedure for the giving of the notification, and consideration given to the implications of notifications incorrectly given etc. It is also not clear how HMRC intend to define who is entitled to claim or how they will approach compliance. In our view, there is not time to do this effectively or well to have legislation in place before 1 April 2024, and this is a key reason why the implementation of a single scheme should be pushed back.

14 What are your views on the proposed R&D scheme for R&D intensive SMEs? Has Government listened to business, as it said it would be doing, in designing this new scheme?

14.1 As discussed above, in our view the relief for R&D intensive SMEs should be incorporated into a new merged scheme to provide the greatest level of certainty for all SMEs going forward. As this additional relief has effect from 1 April 2023, legislation will have to be included in the next Finance Act. We suggest this additional relief could be built into the existing SME scheme for the time being, until proper consideration can be given to including it in a fully merged scheme.

15 Is the additional support for R&D intensive SMEs appropriately targeted to incentivise the types of innovation the Government wants to encourage?

15.1 The starting point for identifying R&D intensive SMEs by reference to their spend on R&D seems to be a pragmatic one. However, as noted above, complexities and uncertainty will arise from applying the definitions on a period-by-period basis. In addition, it may be difficult in border line cases for a company to know whether it qualifies until the end of the accounting period.

Additional HMRC data requirements

16 How straightforward will it be for businesses to provide this data to HMRC?

[13] HMRC's technical interpretation has been comprehensively dismissed by a First Tier Tribunal decision (*Quinn (London) Ltd v HMRC* [2021] UK FTT 0437). Although not a 'binding precedent', in our view HMRC have a broader obligation and responsibility for the orderly administration of the tax system and should, therefore, accept the decision, or appeal it.

16.1 **Employee hours worked**: employers may or may not be already capturing employee hours worked on their payroll systems. Those that currently do not will have to set up new systems to capture the information. We note that HMRC's policy paper[14] states '*The additional data HMRC will collect is in areas where taxpayers already hold the data…*', but we will only know whether this is correct when HMRC publish the regulations to specify which information is required. For example, an employee on a salaried contract for 35 hours per week may, in practice, work additional hours if and when the job requires it. But the employer may not gather data on actual hours worked, and at present the employer will only indicate on the RTI return that the employee 'normally' works '30 or more' hours per week. So, if the Regulations require actual hours worked, rather than 'normal' hours, for many employments this will not represent data already held.

16.2 Further, employers' HR systems, which capture data on contractual hours etc, might operate separately from their payroll systems, and so even if the requisite information already exists, it may not be in a format that can be easily transmitted to HMRC via the RTI return.

16.3 The expectation during the consultation was that the data would be provided to HMRC in real time, which places a significant administrative burden on employers to check for changes in hours worked of non-hourly paid employees. For many salaried employees, the employer does not track actual hours worked beyond normal management of an employee's workload, attendance, etc. If there is a requirement to report actual hours worked rather than contractual hours, it is unlikely that employers will have the time to keep on top of all the changes in this data. The concern is that HMRC will then seek penalties for an incorrect RTI return even though all the data on tax is correct.

16.4 **Dividends paid to shareholders in owner-managed businesses**: at present, only a total figure is required on the self-assessment tax return for dividend income. In general, we do not think splitting dividends between the amount of dividend income received by a shareholder from their own company separately to other dividend income, and the percentage share they hold in their own company would be a particularly onerous task.

16.5 However, there is the potential for complexity on percentage of share ownership. The percentage could change regularly, so we would suggest that the figure would need to be an annual snapshot. HMRC will also need to provide some guidance so taxpayers understand how precise the percentage will need to be, for example a person's percentage ownership might vary by a few percent because of other people exercising share options. Alternatively, HMRC could consider asking whether a person's percentage ownership is simply higher or lower than a certain percentage (ie 50%, 5% etc). Ultimately, the level of precision required will depend on what HMRC are intending to use the information for.

16.6 A single box on the return asking for the percentage shareholding will not necessarily be sufficient, for example some entities have different classes of shares or different rights to income compared to capital, and some shares may be held jointly, for example with a spouse or other family members. The tax return will need to cope with the different scenarios that could arise.

16.7 **Start and end dates of self-employment:** we do not consider this proposal to be too onerous, albeit there may be some difficulties identifying the precise start and end dates for some businesses. Appropriate guidance to help taxpayers identify the dates their business started and ended should be provided by HMRC in the tax return accompanying notes and on GOV.UK.

[14] HMRC Policy Paper 'Changes to HMRC data collection' - Summary of Impacts 18 July 2023
https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection

17 How accurate are the one-off and continuing costs of implementing the measure? and to what extent are these proportionate to the expected benefits?

17.1 The estimated one-off impact on transitional businesses costs (£44m) and continuing impact on administrative burdens (£9.6m), as calculated by HMRC are not insignificant[15], but they do seem hugely underestimated, particularly in relation to the impact on businesses of providing data on employee hours worked.

17.2 In the absence of regulations specifying the precise information requirements, and in the light of the potentially onerous nature of capturing and providing this additional data, we are mystified how HMRC have calculated the average transitional costs to business of providing data on employee hours worked as just £18.42 on average[16], and 'negligible' ongoing costs. We would welcome sight of these calculations, as we expect the real-life costs to be significantly higher.

17.3 It is very difficult to gauge to what extent these costs are proportionate to the expected benefits, principally because it is very unclear what HMRC will use the data for. The original consultation document[17] suggested that the data would be collected so it could be used for sharing across government departments (eg for the purposes of the Government's levelling up strategy), which does not seem to have much, if anything, to do with tax. The Explanatory Note[18] to the draft Finance Bill clause refers to the data providing an up-to-date picture of citizens and businesses to help build a trusted, modern tax administration system and improve policy across government, but there is no specific reference to sharing the data across government departments nor is it mentioned in HMRC's Policy Paper[19] published at the same time as the draft clause. Hence it is not at all clear what data HMRC will share with other parts of government, or whether they will use it only for their own compliance purposes, or both.

18 If this measure is implemented, what should be the timetable?

18.1 It is unhelpful that the details will be in regulations that have not yet been published which means that it is difficult to provide any meaningful comment on whether the current timetable is reasonable or not. Although the amendments will not have effect until the tax year 2025-26, this does not provide much time for businesses and employers to budget for, investigate, develop, and implement any software upgrades and new internal data collection processes that may be needed to comply with their new data collection and submission obligations. We would urge HMRC to publish draft regulations before the enabling legislation has been enacted so that businesses will have more clarity and certainty about what data they will be required to provide and in what form.

[15] HMRC Policy Paper 'Changes to HMRC data collection' - Summary of Impacts 18 July 2023 https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection
[16] £35m one-off impact, across 1.9 million PAYE-registered businesses including civil society organisations.
[17] Improving the data HMRC collects from its customers – consultation document - 20 July 2022 (note title incorrectly describes the document as 'consultation outcome') https://www.gov.uk/government/consultations/improving-the-data-hmrc-collects-from-its-customers/improving-the-data-hmrc-collects-from-its-customers
[18] Explanatory Note linked from the following page: https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers
[19] HMRC Policy Paper 'Changes to HMRC data collection' - https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection

19 How confident are you that the measure will deliver the benefits claimed for it?

19.1 It is difficult to answer this question when the detail will be in regulations, as yet unpublished, and whilst it remains unclear exactly what HMRC, and possibly wider Government, will use the data for (as noted above).

20 Acknowledgement of submission

20.1 We would be grateful if you could acknowledge safe receipt of this evidence and ensure that the Chartered Institute of Taxation is included in the List of Respondents when the Committee's report is published.

The Chartered Institute of Taxation

5 October 2023