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R&D Tax Reliefs Report

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.

1.2 We welcome the confirmation that the government will legislate to expand qualifying expenditure for both R&D reliefs to include data and cloud computing costs and we understand the policy aims of seeking to ensure that the R&D activities that are supported by the UK's tax relief schemes are conducted in the UK. We agree that the proposed measures to refocus the reliefs towards innovation in the UK will mean that the broader benefits that arise for society because of R&D activity are more focussed and encouraged within the UK. Some further clarity around how the rules will work in relation to this is required, and some de minimis exceptions should be included.

1.3 We welcome efforts to target the error and fraud across both R&D tax relief schemes. However, some of the measures proposed in relation to tackling abuse and boundary pushing are not clear in terms of the overall policy aims of tackling error and fraud, nor are we convinced that they are necessary and/or will be effective.

1.4 In particular, we do not support the proposed measure that companies will need to inform HMRC, in advance, that they plan to make a claim. It is poorly targeted because, although it will prevent some dubious claims, it will also mean that many genuine claims will also fall out of time. There will be significant collateral damage from the measure and taxpayers that already have tax advisers will be at an advantage to those that do not. The proposal will exacerbate an unfairness that can arise between taxpayer companies that undertake R&D activities, based on whether or not they have an awareness of the tax relief rules at the appropriate time. It is difficult to see how making it harder to claim R&D tax relief will help deliver the government's overall policy of encouraging R&D, and delivering the overall additionality benefits of the schemes.

1.5 We agree that it is reasonable to require all claims to the R&D reliefs to be made digitally and we support the change that will require claims to include more detail in the future (but would welcome further consultation

as to what detail will be required). Conversely, it is difficult to see what HMRC is gaining from the proposal that each claim for R&D tax relief will need to be endorsed by a named senior officer.

1.6 We welcome HMRC taking steps to clarify difficult areas of the law and ensure that the legislation is clear and operates as intended. We would encourage the government consider clarifying the rules around subsidised expenditure and contracted out R&D during the next steps of their ongoing review of the R&D tax relief schemes. There is currently disagreement around HMRC's current interpretation of the rules and our view is that HMRC's interpretation will lead to considerable confusion in the short term and, if successfully pursued, to undesirable policy outcomes and unintended consequences.

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 in order 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 We refer to the *R&D Tax Reliefs Report* (Report) published on 30 November 2021 that provides an update following the consultation on the two R&D tax relief schemes that ran from March to June 2021 and asks some further questions in relation to reforms announced at Autumn Budget 2021. The reforms to R&D tax reliefs announced are to:

- support modern research methods by expanding qualifying expenditure to include data and cloud costs;
- more effectively capture the benefits of R&D funded by the reliefs through refocusing support towards innovation in the UK; and
- target abuse and improve compliance.

3.2 We have had the opportunity to discuss the measures proposed in the Report with HMRC since it was published and our comments below reflect our understanding of the measures following those discussions, and build on the comments we made to HMRC during those meetings.

3.3 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.

4 Data and cloud computing costs

4.1 We welcome the confirmation that, following a consultation in July 2020, the government will legislate to expand qualifying expenditure for both R&D reliefs to include data and cloud computing costs. Specifically, the following new categories of expenditure will be brought into scope:

- licence payments for datasets; and
- cloud computing costs that can be attributed to computation, data processing and software.

4.2 With regard to the question posed in paragraph 2.15 of the Report around how to distinguish in practice to exclude costs that are not R&D, we suggest that a 'just and reasonable' test is used. Different suppliers will charge for these services in different ways so it will be difficult to legislate for all of the possible permutations that may arise and a 'one-size fits all' test would not work in many cases. We suggest that some examples in HMRC's guidance around how they envisage a 'just and reasonable' test would work would be very useful.

5 Refocusing the reliefs towards innovation in the UK

5.1 We understand the policy aims of seeking to ensure, so far as possible, that the R&D activities that are supported by the UK's tax relief schemes are conducted in the UK and the proposed measures to refocus the reliefs towards innovation in the UK. This will ensure that the broader benefits that arise for society because of R&D activity are focussed and encouraged within the UK.

5.2 With regard to whether there should be any exceptions to the proposed changes to the reliefs, we suggest a de minimis limit to ensure that complying with these rules is not an impediment to the overall government aims of encouraging R&D activity. Thus, it would be helpful to have an exception where overseas work is only a small proportion of the total R&D spend; we suggest an exception of up to 10% of the total R&D spend for the relevant accounting period. This will ensure that companies that are conducting R&D predominantly in the UK can obtain relief in respect of an R&D project even if there is some knowledge in a particular area which is critical to the project but which is not available in the UK and cannot be brought to the UK.

5.3 There may be practical issues around, for example, identifying where a sub-contractor undertakes the work. It may be reasonable for a contract to specify that the work will be undertaken by UK workers of the sub-contractor in order to permit the contractor to claim R&D in respect of its expenditure, rather than to expect

a contractor to monitor which workers the sub-contractor uses on any particular project. In addition, the term 'UK workers' is a bit vague, and could mean UK located, or on a UK payroll, or UK resident.

5.4 For example, we would welcome some further clarity around how the rules will work in relation to workers that are on the UK payroll, but are undertaking work overseas. This seems to be a grey area and it is not currently clear how this will be approached in the rules. If the intention is that UK workers is meant to mean 'workers carrying out all their duties on the project in the UK', we suggest that a further exception could be considered to cover circumstances where the R&D has to be carried out on-site and that site is outside of the UK. Thus individual employees on a UK payroll may have to travel overseas to undertake R&D work for their UK employer.

6 Abuse and compliance – general

6.1 We welcome efforts to target the error and fraud across both schemes identified by the National Audit Office (as per paragraph 2.29 of the Report). It is important that the tax relief afforded by the schemes is delivered to make best use of taxpayer funds and in accordance with the legal framework of the schemes. The Report also refers to 'abuse and boundary-pushing', but neither of these terms are explained. We assume that they are intended to be somewhat wider than error and fraud. We have, of course, a general understanding of the term abuse, but it can be used to describe different behaviours in different circumstances. For example, if abuse is intended to mean more than error then what? Deliberate errors are, of course, fraud. Normally abuse would be understood to also refer to avoidance. Although we would not go so far as to say that one cannot ever envisage avoidance in this territory, it is hard to do so, because to avoid tax, as opposed to just not applying the rules correctly (effectively getting its compliance wrong), a taxpayer has got to do some planning and, generally speaking, the R&D area is not much about planning, so far as we are aware.

6.2 What is intended by 'boundary-pushing' is also not explicitly set out but we take it to be a reference to (a) stretching the definition of what constitutes R&D, or (b) seeking to claim R&D tax relief in circumstances that are not intended by the rules, or both. We also wonder whether it is intended to be a reference to claims for R&D tax relief that go beyond HMRC's interpretation of the law. In relation to this, we recognise that some borderlines in tax are sometimes hard to apply, and there are often 'grey areas'. However, at the end of the day the law is applied either correctly or incorrectly: which would lead to a conclusion, that the result, if the law is applied incorrectly, is an error in compliance with the law. In addition, with appropriate disclosure taxpayers are entitled to claim R&D tax relief based on their understanding of the law, even if this does not accord with HMRC's interpretation.

6.3 The terminology that is used is important in order to be clear as to the problems that are arising, and that the proposed changes set out in the Report are intended to tackle. We understand that the government perceives that much of the issue – that is to say the error and fraud – arise from R&D advisers that encourage companies to submit 'dubious' claims (to use the language of the Report).

6.4 Thus we understand the phrase 'abuse and boundary-pushing' to be a means of describing the cavalier, optimistic attitude that some advisers take to the law, and in seeking to establish whether the activities of the company they are advising do properly comply with the law and entitle the company to the R&D tax relief. Thus, as we understand it, abuse and boundary-pushing is a reference to the behaviour of some agents, and the companies that they advise, that leads to claims that should not be made because either the activity is not

R&D and/or they include costs which do not meet the legislative criteria for a claim to be made. This results in error and, in more egregious cases, fraud in relation to claims for R&D tax relief.

6.5 Accordingly several of the changes that are proposed focus on either the agent that is advising the company that is making the R&D claim, or the information that must be provided with the claim. We understand from our discussions with HMRC that the intention is to improve the quality of advice that companies receive in relation to R&D tax relief claims and make it easier to identify the agents that are minded to make dubious claims and, indeed, harder for them to make such claims.

6.6 We welcome these efforts. We have always recognised that, as well as being bad for the integrity of the tax system, dubious claims are unhelpful for 'good' agents, because taxpayers are attracted by promises of R&D tax relief by 'bad' agents. It is also problematic for a 'good' practitioner, who advises a client that R&D relief is not available, when the client reports that a business competitor has had a similar claim accepted without challenge.

6.7 There are some aspects of this part of the Report, however, that are not clear in terms of the overall policy aims of tackling error and fraud. Paragraph 2.34 comments on the fact that the number of claims has increased substantially over the past few years. It is not clear why, on the face of it, this should present a problem given the government's overall policy aim of encouraging innovation through R&D activities. We note that the Report is not suggesting that the increased number of claims are necessarily dubious claims. The suggestion seems to be that it is more the case that faced with an increasing administrative burden, HMRC also needs some new tools with which to assess the R&D claims. Hence it seems that not all of the proposed changes are aimed at preventing error and fraud; some are aimed at helping HMRC to evaluate the claims that are being made. Again, we welcome measures with these aims. It is important that HMRC have the most useful information to enable them to triage claims and focus their resources to where the problems arise, regardless of the size of the claims.

6.8 But, one of the suggested changes, the measure that companies will need to inform HMRC, in advance, that they plan to make a claim, appears to go further: as discussed in paragraph 7 below, this measure will have the effect of reducing the number of claims for R&D relief overall – both good and dubious claims. While this would no doubt reduce the 'bathwater' of error and fraud along with the 'baby' of valid claims, it does not seem in line with the government's overall policy intention of encouraging R&D.

6.9 As we note above, 'boundary-pushing' could be a reference to (a) stretching the definition of what constitutes R&D, or (b) seeking to claim R&D tax relief in circumstances that are not intended by the rules, or both.

6.10 With regard to dubious claims that fall within the first category – as to what constitutes R&D – we note that the R&D definition is based on the BIS guidelines which are now over 20 years old, and may, therefore, be somewhat outdated due to the progress of time and continued technological developments. There have been updates (for example in relation to software), that are useful and much more understandable to a taxpayer than the original guidelines. It may be an appropriate time to consider a rewrite of the BIS guidelines. We discussed how clarity could be achieved in our response to the R&D Tax Reliefs consultation last year[1].

6.11 With regard to the second category, it would help if HMRC would engage with a discussion about the policy intent of some of the rules within the R&D tax relief schemes. We refer in particular to ongoing discussions with HMRC about the application of the rules relating to contracted out R&D and subsidised expenditure, where there is current disagreement around the interpretation of the rules and how these should be applied. One aspect of that disagreement relates to a lack of explanation as to how the overarching policy aim of

[1] https://www.tax.org.uk/ref769 - see paragraphs 4.2 to 4.4

ensuring that the R&D tax relief schemes deliver 'additionality' is delivered by HMRC's current application of the rules. It is difficult to see how there can be 'boundary pushing' or, indeed, abuse if HMRC apply the rules on the basis of 'it is simply the way the rules work' – without engaging in a discussion around the policy implications of their interpretation. We accept that HMRC have to apply rules in the way they think they work, but to decline a discussion about what the rules should say for the policy intention to be best achieved is unhelpful. Also, HMRC's interpretation of the rules in relation to contracted out R&D and subsidised expenditure are based on a very broad meaning of the words in the statute, which HMRC then decline to take to its logical conclusion in practice. This is also unhelpful and encourages 'boundary-pushing', because HMRC are themselves drawing an arbitrary and unclear line in the sand in applying their interpretation of the rules. If boundaries are unclear and/or make little policy sense, they are more likely to be 'pushed'.

7 Abuse and compliance – proposed changes – informing HMRC in advance of intention to claim

7.1 Of the changes set out in paragraph 2.36 of the Report, the one that will have the most substantive impact on the current compliance framework for claiming R&D tax reliefs is the proposal that companies will need to inform HMRC, in advance, that they plan to make a claim.

7.2 In our view this measure is not focussed on what we understand the policy intentions to be: that is to say tackling error and fraud, also referred to as abuse and boundary-pushing. There is no distinction within its design between claims that would qualify for R&D relief and dubious claims that would not. The measure will clearly have an impact on all R&D tax relief claims, that is to say those being made by compliant businesses, as well at those that are engaged in abuse or boundary-pushing. We do not support this measure. It is poorly targeted because, although it will prevent some dubious claims, it will also mean that many genuine claims will also fall out of time. Contrary to the intentions in paragraph 2.35 of the Report about protecting compliant businesses (so far as possible), the measure will have a significant impact on compliant businesses, particularly the smallest, start-up businesses that probably do not yet have advisers. It may also affect those which are growing quickly or who are just starting to innovate and have not realised in advance that they could get R&D relief (until their tax adviser suggests it at some point during the year-end compliance process).

7.3 The principal effect of this measure will be to reduce the period in which a company must become aware that it has undertaken R&D and is entitled to tax relief in order to ensure that it can comply with the compliance obligations and make an R&D tax relief claim. Currently a company makes a claim for R&D tax relief in its Company Tax Return. The claim can be made in the return as originally filed, or by way or an amendment to it. This effectively makes the current time limit for making a claim two years after the end of the accounting period in which the qualifying expenditure is incurred; meaning that the company must become aware that it has undertaken R&D, and is entitled to make a claim for tax relief, prior to this time period elapsing. The proposal is that, in order to be able to make a claim for R&D tax relief through its Company Tax Return, the company must have already informed HMRC that they intend to do so – a 'pre-notification'. Whatever the date by which this pre-notification must be given (discussed further below), it will have the effect of reducing the time by which a company must become aware that it has undertaken R&D and is entitled to make a claim.

7.4 We understand that HMRC wish to reduce the number of claims that are made towards the end of the current two year period, and may then involve claims for several accounting periods that remain within the time limit being made at the same time. HMRC's view is that claims made later in the period available under the current compliance regime pose the most risk of being dubious claims. Because HMRC does not have the resource to review all claims for R&D tax relief in detail to ensure compliance, it is considered necessary to reduce the

number of claims overall, by reducing the period in which companies can become aware that they can make a claim.

7.5 We agree that the current system can encourage a business model for R&D advisers to seek out companies and encourage them to identify activities that may be considered to be R&D, and to make a claim for R&D tax relief, even when it becomes clear (or should be clear) on further consideration, that the activities do not qualify as R&D: thus abusive or boundary-pushing, dubious claims are made. We support efforts to seek to erase or minimise this issue – and some of the other changes set out in the Report will help, as discussed in paragraph 8 below. But, in our view, the proposed pre-notification measure is not a good solution to this problem. This is because there will be significant collateral damage from the measure in terms of companies that are undertaking genuine R&D activities that are simply identified late (for example following a change in adviser, who spots that the previous adviser overlooked the possibility of making claims). A claim being late does not necessarily mean it is wrong.

7.6 In our discussion with them, HMRC recognised that a requirement for pre-notification would also mean that claims for genuine R&D may be prevented due to the shorter period in which the R&D activity must be identified. HMRC have said that they accept that this measure would put the onus on the government to undertake an educational and awareness exercise to try to ensure that as many taxpayers as possible are aware of R&D tax relief and the time in which it must be claimed. We welcome any increased effort aimed at increasing taxpayer awareness of the reliefs, But, notwithstanding this effort, timely awareness of the R&D tax relief schemes can mean that one company is able to claim the relief, while another cannot.

7.7 In addition, the measure does nothing to attack the business model of the R&D agents that are encouraging or facilitating the dubious claims; it merely shortens the period that they have in which to identify companies who may have undertaken R&D. Unfortunately it does so for genuine R&D activities as well. Perversely, the shorter time period could also add a 'selling point' to a 'pressure sale' by an aggressive agent along the lines of 'buy now before it's too late'.

7.8 We understand that HMRC is under resourced and, as noted above, cannot review all R&D claims in detail. But in our view it would be preferable to tackle the problem of dubious claims by developing HMRC's risk assessment mechanisms to deliver a more effective triaging system for R&D tax relief claims; many of the other changes suggested in this part of the Report will help with this. In particular, the requirement for claims to include details of agents who have advised the company on compiling the claim should help HMRC build a useful data base of 'bad' agents so they can focus their resources on organisations rather than tax returns and stop the bad behaviours. Properly designed and utilised by HMRC, the requirement that more detail is provided with the claim could help as well. These measures are discussed in paragraph 8 below.

7.9 Conversely, this additional compliance burden of a pre-notification for the R&D tax relief schemes will put them into a very distinct category from other similar, structural tax reliefs, for example, capital allowances. There are not any other tax reliefs that require an additional step along the lines of the suggested pre-notification before they can be claimed through the corporation tax system. HMRC have said that the fact that an election is required to be made in respect of the patent box before the company can apply these rules is a precedent for something being required in advance of a favourable tax treatment. We do not accept that this is a fair comparison. The election for the patent box is to opt in to a low rate regime, not to get a relief intended by Parliament for actual expenditure. In addition, it is a one off election to enter into the regime and, although it is not yet clear, the implication with regard to this measure is that a company would need to notify intent to claim R&D for each relevant accounting period. More particularly, the deadline for electing into the patent box in respect of a particular accounting period is two years after the year end date, so it is not a pre-notification.

7.10 When this measure was first announced, we thought that the pre-notification would be linked to the start of an R&D project – such that company had to know that tax relief was available at the time it started the R&D. Clearly such a requirement would be a significant change to the basis of R&D relief within the UK system, making the relief more akin to a grant than to a structural tax relief, but such a measure would provide a direct policy link to the government's concerns about ensuring additionality from the reliefs. But the proposed change is not that. Although the new compliance requirement will put the time that the taxpayer has to engage with HMRC closer to the time at which it decides to do the R&D, that does not seem to be a factor driving the design. The change seems to have little policy rationale beyond reducing the number of R&D tax relief claims: the additional compliance burden and shorter period that companies will have to become aware of the relief and begin the compliance process will have this effect. HMRC hope that a significant proportion of the claims that are now not made would have been dubious claims. But, of course, many will be genuine claims.

7.11 We accept that claims made towards the end of the current two year period are, of themselves, probably less likely to be 'additional', because the time at which the company becomes aware of the R&D tax relief is further from the time at which the decision to undertake the R&D activities is made. But, it is difficult to see how making it harder to claim R&D tax relief will help deliver the government's overall policy of encouraging R&D, and delivering the overall additionality benefits of the schemes. 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, by introducing arbitrary new compliance measures and hurdles, 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'. We would also reiterate that this measure will put well-advised taxpayers at a big advantage compared with those who are not professionally advised.

7.12 In conclusion, it is our view that the proposed change, that companies will need to inform HMRC, in advance, that they plan to make an R&D claim, may not deliver on the policy intentions of preventing error and fraud. But it will damage the overall additionality of the scheme and detract from the government's overall policy of encouraging R&D, as a result of its impact on compliant businesses.

7.13 We also envisage many difficulties with how this measure might operate in practice.

7.14 We understand that HMRC has not yet decided by when a pre-notification will have to be made. It is very hard to see when a sensible time would be to require the pre-notification. We understand that the pre-notification will be required at some point after the end of the accounting period in which the R&D takes place, but before the current deadline by which a claim must be made, that is to say, two years after the end of the accounting period. We agree that the pre-notification should not be required before the end of the relevant accounting period. This is because in many cases, particularly for growing businesses and those that change advisers, R&D may not be identified until the company is in the post-year end compliance cycle. After all, it is only the largest companies that have the ability via their Customer Compliance Manager to discuss tax on a 'real time basis'; other companies do not. Consequently medium and small companies tax is on a 'compliance cycle' basis – meaning that if the pre-notification is required before the end of the accounting period legitimate businesses would lose out on some R&D tax reliefs, which would undermine the effectiveness of it as an innovation incentive.

7.15 As mentioned above, the timing for this seems to be driven solely by the numbers and reducing the amount of R&D tax relief claims overall, rather than by any policy rationale. We assume that HMRC has data which

indicates the proportion of dubious claims v genuine R&D claims as the period after the end of the accounting period elapses. However, we expect that this data will largely arise in relation to the second year (in which Company Tax Returns can be amended) because most R&D tax relief claims made through the Company Tax Return in the first instance will be made at, or close to, the deadline for filing the return. In order to be a notification given in 'advance', the information must be provided to HMRC in advance of something, such as the filing date of the Company Tax Return? If this is what the government decides to do, the measure will effectively be ruling out all R&D tax relief claims that are currently made by way of an amendment to the Company Tax Return – all genuine claims, as well as dubious ones.

7.16 The Report does not provide any detail around what form the pre-notification might take, or the information that would have to be included within it. We would like to see a simple and sensible online portal at which taxpayers can give the notification and a very succinct, basic level of information about the R&D that they intend to claim tax relief in respect of. Requiring too much, or very detailed, information would effectively supersede the claim for relief itself and bring forward the time limit of this. However, whatever the final form of the pre-notification, this measure is undoubtedly adding an additional level of complexity, which is generally unhelpful for all taxpayers. As noted above, this measure will put unrepresented taxpayers at a disadvantage. We would be interested to know what HMRC intends to do with the information received via the pre-notification. Will the information be helpful to HMRC in triaging the subsequent claims themselves for enquiry?

7.17 It will also be necessary to consider and address whether a pre-notification is required for each accounting period, or in respect of each R&D project. This may be relatively straightforward to decide and legislate for where a project runs from one accounting period to another or in respect of entirely different projects within a company. However, it may be more difficult when a Project A develops into Project A1, which may not require a separate pre-notification, but then morphs into Project B. In addition, many companies have a large number of small R&D projects running at any one time. For a company with, say, 50 live projects in a year, a pre-notification would be impractical.

7.18 We have raised with HMRC the fact that this measure will cause taxpayers to make 'protective' pre-notifications before the position is clear in order to ensure that they are not prevented from making a claim as a result of a failure to comply with this new compliance obligation. HMRC should give some thought as to how it will deal with a large number of pre-notifications that may or may not be followed up by R&D tax relief claims.

7.19 There are likely to be unintended consequences that arise as a result of this new compliance burden. Advisers will, whether due to aggressive practices or just to avoid being sued, encourage clients to claim on as much of a protective basis as the law allows, thus encouraging pre-notifications to be made, possibly at a time when it is not yet clear whether there have been R&D activities that qualify for tax relief. The more HMRC counteract this tendency to make protective pre-notifications, by requiring more upfront detail for example, the more impediments to genuine as well as dubious claims there will be. Leading to a spiralling of unnecessary effort and wasted time for both taxpayers and HMRC.

7.20 We would also cite the Australian R&D tax relief system. The scheme in Australia is dual administered by the Department of Industry, Innovation and Science ((‘DIS’) who act on behalf of Innovation and Science Australia) and the Australian Tax Office ('ATO'). Taxpayers are required to pre-register with the DIS, who tackle the technical merit of the application and eligibility surrounding the claim, before claiming the relief via self-assessment to the ATO. In order to ensure that waiting for approval by the DIS does not prevent a taxpayer filing its tax returns on time, the system works to provide 'pre-approval' to permit self-assessment. Clearly, the purpose of the pre-registration is different in the Australia to the reasons for proposing a pre-notification

in the UK; in Australia it is as a result of the dual administration of the system. However, some observations can be made. Firstly we would note that the time limit for the pre-registration with the DIS is ten months after the end of the accounting period. This is close to the deadline for filing the self-assessment return (which, similarly to the UK, is generally twelve months after the end of the accounting period), allowing as much time as possible for taxpayers to identify the eligibility for the relief and gather documents to support a claim. Nevertheless, it is accepted in Australia that companies miss the opportunity to make claims if they miss the pre-registration date.

7.21 Secondly, we understand that the two stage process in Australia can cause confusion amongst taxpayers. There is a tendency to assume that the pre-approval given by the DIS (given only to allow the system for self-assessment in respect of tax to run to time) is approval for their R&D activities. This leads to disgruntlement when, further down the line, the claim is audited by the DIS and questions around the eligibility of the claims are raised. We can envisage a similar assumption arising with regard to the pre-notification number/reference that is issued by HMRC to permit a company to make a claim for the tax relief in its Company Tax Return. Although we would expect an education exercise to be undertaken, and the situation is less complicated because there is only one government department involved, we can see how confusion could arise – with taxpayers assuming that the number/reference issued to them by HMRC is pre-approval for the R&D tax relief claim. This could cause a sense of unfairness if there is a subsequent enquiry, albeit following a false assumption around the comfort provided by the additional compliance step. This could feed into a negative narrative that could be detrimental to the government's overall policy of encouraging R&D, and delivering the overall additionality benefits of the schemes.

7.22 In order to mitigate many of the downsides discussed above that will arise from the new pre-notification compliance step, we suggest that the government considers making the pre-notification measure optional in the first instance. Using it could be incentivised by ensuring that having a pre-notification number/reference causes a fast tracking of the R&D tax relief claim once this is submitted. In the meantime, HMRC could monitor the impact of the other proposed changes on the occurrence of error and fraudulent claims.

8 Abuse and compliance – other proposed measures

8.1 In addition to the measure that companies will need to inform HRMC, in advance, that they plan to make a claim, which is discussed in paragraph 7 above, the Report says that a number of other changes will be made:

- all claims to the R&D reliefs – either for a deduction or a tax credit – will in future have to be made digitally (except from those companies exempt from the requirement to deliver a Company Tax Return online)
- these digital claims will in future require more detail – for example, on what expenditure the claim covers, the nature of the advance sought, the field of science or technology, the uncertainties overcome
- each claim will need to be endorsed by a named senior officer of the company
- claims will need to include details of any agent who has advised the company on compiling the claim.

Broadly, we support these changes and agree that they will help HMRC tackle the error and fraud claims that they are seeing.

8.2 We agree that it is reasonable to require all claims to the R&D reliefs to be made digitally (except from those companies exempt from the requirement to deliver a Company Tax Return online). It is not clear, but we

understand that the digital requirement will be filing by way of the Government Gateway, and not by way of some specific online form. It will be important to ensure that agents, as well as the companies, are able to submit the claims for R&D tax reliefs.

8.3 With regard to the change that claims will require more detail in the future, whilst we would welcome further consultation with HMRC as to what detail will be required, we support this change and note that most reputable agents already provide a good level of detail to HMRC in support of an R&D claim.

8.4 As to what information should be required, we have previously suggested that the rules should require companies to provide sufficient information to HMRC to enable HMRC to assess the claim and ensure that the necessary conditions for tax relief have been satisfied before the tax relief is given. The additional detail should make it easier for HMRC to identify the quality and quantity of supporting information at the point of submission, such that the HMRC system can flag returns containing claims but, for example, no attachments to the return. Currently there is no suggestion that claims submitted without supporting evidence are more routinely targeted by HMRC in terms of opening enquiries into them. Formalising the requirement to provide reasonable information could ensure that those that do not comply could be targeted for review prior to the tax relief being awarded.

8.5 That said, the requirement for more detail should not be so onerous as to discourage claims. The emphasis should be on helping HMRC to identify issues: what is the most useful minimum set of information? We would also caution against a pro forma/one size fits all approach as much as possible.

8.6 It is difficult to see what HMRC is gaining from the proposal that each claim for R&D tax relief will need to be endorsed by a named senior officer. A claim for R&D tax relief is a part of the tax computation and the Company Tax Return. This is already subject to a declaration as to its completeness and correctness etc by a director of the company before it is submitted. In most small companies – where the problems are – the person most closely involved with the R&D tax relief claim is likely to a director of the company, so will be signing the Company Tax Return in any event. In larger companies, usually a director is responsible for SAO and related matters. They should already be taking a close interest in R&D claims, are likely to have the requisite tax knowledge about how the claim fits into the business' overall tax position, and can work with their in-house R&D people to ensure that the claim is appropriate. Thus, the most appropriate 'named senior officer' is likely to be the person already closely involved with, or aware of, the R&D tax relief claim who is signing the Company Tax Return in any event. However, if HMRC considers that an additional box on the Company Tax Return focussing specifically on R&D will increase awareness and understanding of the R&D tax relief claim, some flexibility as to who can be the named senior officer would be helpful. This would cater for the different ways in which the smallest and largest companies are managed and deal with their R&D.

8.7 We welcome that HMRC has confirmed that they do not envisage this change leading to a personal liability for the named senior officer as the measure is intended to be an awareness and behavioural prompt, rather than a mechanism to impose an additional penalty or liability. However, if HMRC finds that the R&D tax claim contains deliberate errors then existing law (FA 2007 Schedule 24 paragraph 19) means that HMRC may transfer the resulting tax geared penalty onto company officers (as defined), which may include the director that signed the Company Tax Return if that person is culpable for the deliberate error. Also the new legislation in FA 2020 Schedule 13 may trigger joint and several liability for directors if the other criteria are met. An educational exercise raising awareness of these existing potential personal liabilities may do more to change behaviour around R&D tax relief claims than the inclusion of a further box on the Company Tax Return.

8.8 We also understand that HMRC are not intending to use the identity of the named person to risk assess the claim.

8.9 We welcome that claims will need to include details of any agent who has advised the company on compiling the claim. We suggest that this measure should be very effective in providing HMRC will useful information to triage claims and focus their resources to where the problems arise, regardless of the size of the claims. Please can HMRC clarify how they intend to use this information? We suggest that this measure should be sufficient without the pre-notification requirement and would encourage HMRC to introduce this measure and evaluate its usefulness, before introducing the pre-notification requirement that will hit compliant businesses as well as 'dubious' claims.

9 Addressing anomalies and unforeseen consequences in the R&D tax relief legislation

9.1 We welcome HMRC taking steps to clarify difficult areas of the law and ensure that the legislation is clear and operates as intended.

9.2 It is not clear how the suggestion at the fourth bullet point will work (amending the time limit for making a claim). The Report refers to the end of the period of account, but it will be necessary to cater for long periods: for example, if a company has an 18 month period. Also at present the legislation permits consequential claims (FA 1998 Schedule 18 paragraphs 61-65). Is this bullet point intended to mean that a company will never be able to use these provisions for R&D? For example, consider a company which thinks it is not UK resident and does not have a UK permanent establishment, but is then investigated. It is concluded that it does have a UK tax presence such that Corporation Tax is due. Normally in calculating the tax to be paid for the past, consequential claims can be made such that ultimately the company pays the same Corporation Tax as it would have done had it filed on time (with interest and potentially penalties). The wording of the Report suggests that the company would not be able to make a claim for R&D tax relief in this situation. Is this what is intended? We understand that the circumstances in which this may arise will be rare, but it would be helpful if HMRC could clarify how the rules would work.

9.3 We note in particular that legislation will be introduced to clarify that expenditure generally qualifies where a payment is made within two years of the end of the accounting period in which the expenditure incurred; this is in response to a Tribunal finding.

9.4 We would encourage the government consider this option to clarify the rules around subsidised expenditure (Corporation Tax Act 2009 section 1138(1)(c)) where there is currently significant uncertainty as a result of the recent Tribunal decision in *Quinn (London) Ltd v HMRC* TC/2020/01846.

9.5 That recent Tribunal decision is completely at odds with HMRC's current interpretation of the law. Although this is a First-Tier Tribunal decision, and thus it does not set a precedent that HMRC (or other courts) must follow, the judgement is quite clear in its thorough rejection of HMRC's approach to the legislation. It also sets out clearly the view that HMRC's approach is contrary to the policy intentions and scheme of the tax relief overall. The judgement will be persuasive in developing case law going forward. Since to date HMRC has merely reiterated their view, but has not taken the opportunity to clarify the situation – either by appealing the decision or by legislation - taxpayers are put in a very difficult position, knowing that submitting an R&D claim on the basis of their understanding of the law, supported by the decision in *Quinn*, will be challenged by HMRC. This uncertainty and the generation of future conflicts between HMRC and taxpayers cannot be helpful for the

overall picture of seeking to encourage companies to undertake R&D, compliance with the rules or the additionality aspects of the relief.

9.6 We also refer to ongoing discussions with HMRC about the application of the rules relating to contracted out R&D. We disagree with aspects of HMRC's current interpretation of the rules relating to contracted out R&D and consider that HMRC's interpretation will lead to undesirable policy outcomes and unintended consequences (as a result of the denial of relief to the company making decisions about incurring expenditure on R&D activities undertaken to deliver a commercial contract).

9.7 However, regardless of which interpretation is correct, this review of the R&D tax relief regimes in the round, and the focus on unintended consequences offers an opportunity to clarify the policy intentions of the reliefs and, to the extent necessary, make legislative changes to ensure that the law is clear. We would urge the government to consider these points during the next steps of their ongoing review of the R&D tax relief schemes.

10 Acknowledgement of submission

10.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

4 February 2022