ForrestBrown®
R&D tax credit consultancy

Consultation response

R&D TAX RELIEFS REPORT (30 November 2021)

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INTRODUCTION

The objectives of the government's review of R&D tax reliefs announced at Spring Budget 2021 included:

- ensuring that the UK remains a competitive location for cutting edge research,
- that the reliefs continue to be fit for purpose.

The accompanying consultation[1] sought to ensure that the definitions, eligibility and scope of the reliefs were up-to-date, competitive and reflective of how R&D activity is conducted now.

These objectives were reiterated when the government set out proposed reforms at Autumn Budget 2021, whilst echoing previous statements that UK business investment in R&D is significantly lower than the OECD average. The government is seeking to update the reliefs to suit the modern world, ensure the UK's offering is as good as, if not better than, similar incentives offered in other jurisdictions, and to encourage UK businesses to spend more on R&D.

Executive Summary

ForrestBrown's recommendations aim to ensure that this genuine government incentive is targeted to businesses that deserve it. Many of these measures deal with abuse and boundary-pushing in the R&D tax advice market. Improving regulation in this market would better protect businesses and HMRC from this threat. Simplifying the rule base and reviewing the definition of R&D will improve accessibility and more clearly set expectations for those accessing relief, making it easier for businesses to be compliant.

We welcomed the broad review of R&D tax reliefs launch in 2021 as an opportunity to seek positive reform without continuing the trend of piecemeal changes which add complexity to the incentive. However, some of the measures outlined in this consultation appear at odds with the overall aims of the review.

We support changes which will improve targeting of the incentive, ensuring that genuine innovative businesses and activities attract relief. Modernising the software cost category to allow relief for data and cloud costs where these are necessary for R&D is a welcome change in line with this goal.

We do not support measures which simply aim to reduce the overall cost of the incentive because this is not the stated aim of these reforms. While these may reduce some abusive claims, they will also introduce unnecessary additional administrative burdens and in some cases deny relief to genuine R&D. This collateral damage is not acceptable. A blanket exclusion of relief for R&D carried out overseas is too broad and will erode UK based IP, undermining policy aims.

Abuse of the incentive must be tackled and most of the measures proposed in the report are necessary to achieve this. Better regulation of the tax advice is also essential to improve compliance, help HMRC and protect businesses. Many of the operational proposals will introduce new administrative burdens on companies accessing relief, so new measures should only be introduced when the case for them is clear. In implementing these changes, we would welcome a more open and transparent culture within HMRC, with better guidance available.

[1] https://www.gov.uk/government/consultations/rd-tax-reliefs-consultation

Summary of recommendations

Data and cloud costs	The inclusion of costs related to **licence payments for datasets** is welcome, although some of the exclusions appear excessively restrictive and could limit the genuine application of the benefit. We recommend that the actual use of a dataset within and after the R&D project should determine eligibility rather than the details of the licensing agreement. **Cloud computing** costs should attract relief because they are, in our experience, essential for product testing. The proposed measures would benefit from greater clarity in their practical application to ensure that such costs are simple to calculate. **Servers and data storage** are often the major proportion of costs in R&D projects using the cloud and should therefore also be included. Cloud based services often use aggregated costs and so a pragmatic approach to apportionment should be adopted.
Overseas R&D	We are concerned that the proposal to exclude relief for **overseas R&D carried out by subcontractors and EPWs** is aimed at overall cost reduction rather than better targeting of relief. The case for its introduction remains unclear. If it is introduced, some **protections** should be included to ensure that the proposed changes do not undermine the overall policy intent of the reliefs by eroding UK-based IP. A **de minimis threshold** would ensure that where companies only carry out a minority of their R&D overseas, they are not burdened with new rules nor denied relief. For those above the de minimis, a **general necessity rule** could introduce several acceptable reasons for activities taking place outside the UK. These include scarcity of specialist skills, regulatory requirements, geography and environmental considerations. Further consultation should be carried out to determine appropriate **evidence** requirements in each case. Skills shortages in particular could be supported by using the published government list of skilled worker shortage occupations. We recommend that **connected-party EPWs** are excluded from these measures, to ensure that global groups can continue to draw on employees of subsidiary companies to support R&D hubs in the UK.

Tackling abuse	Although not covered within this consultation, our primary recommendation for tackling abuse of R&D tax reliefs is to improve **regulation in the tax advice market**. We support compulsory professional body membership for anyone offering paid-for tax advice. **Digital filing of R&D claims** should become mandatory and most companies and agents already file in this way. Some small updates to the regulations governing late claims could ensure that missing a deadline due to technology failure would not prevent a company from making a valid claim for relief. We support the requirement for **supporting information** to be submitted alongside an R&D claim. Further consultation on the content and process for this measure would be welcomed. HMRC should be clear and transparent regarding how they will use this information, particularly in respect of risk assessing claims and the timing of compliance checks. Requiring a **senior officer of the company to endorse the R&D claim** specifically may have some positive impact. We are aware of cases where the directors of a company have not understood their R&D claim because they have relied too heavily on an agent. However, tax returns are already endorsed by a senior officer of the company, so this measure may have limited effect. Introducing a new process which requires businesses to **notify HMRC before making an R&D claim** appears to be aimed at reducing the overall number of claims made. We sympathise with the type of claim HMRC is trying to target with this measure, however we believe that targeted compliance efforts and the other measures included in this consultation would be a more effective method to target such abuse. We welcome the introduction of a new process to allow companies to **notify HMRC of the name of their R&D agent**. Much of the behaviour concerning HMRC centres on unregulated and malicious R&D agents. Directing some compliance resource to targeting such agents will be a more effective strategy, and one which helps to protect UK businesses.

ForrestBrown – about us

ForrestBrown is a specialist R&D tax consultancy. Formed in 2013 and a member firm of by the Chartered Institute of Taxation since inception, professional standards have always been at the heart of our culture. We are passionate about the transformative power of R&D tax relief and about our role in providing clear and accurate professional advice to our clients.

Our multidisciplinary team comprises a combination of chartered tax advisers, chartered accountants, lawyers, and industry specialists from R&D-intensive sectors. We also have an independent quality assurance process, overseen by former-HMRC inspectors. Each of the more than 2,000 claims-per-year we submit for innovative UK businesses, must pass that standard.

Our focus on technical excellence and professional standards led us to help form the CIOT/ATT professional standards working group, which drafted the topical guidance on the application of PCRT to R&D tax advice (published in 2020). We believe that reputable advisers, alongside professional bodies and HMRC, have an active role to play in raising awareness of professional standards and protecting more businesses from poor advice.

We support measures which help deliver the policy intent of R&D tax reliefs, which is to encourage greater business investment in R&D. Our recommendations create or improve simplicity, certainty and value for money for genuine UK innovative businesses.

DATA AND CLOUD

Licence Payments for Datasets

The inclusion of costs related to licence payments for datasets is welcomed and will assist many data-focused businesses we have consulted, where R&D is necessarily data-driven.

Exclusions are suggested on datasets which "can be resold" or "have a long-lasting value to the business" beyond the R&D project. These exclusions appear to be linked to the terms of the licence agreement or end-user agreement rather than the actual use of the dataset within and after the R&D project. We consider the overall impact of these exclusions as excessively restrictive and we believe they would limit the genuine application of the benefit to R&D costs.

Taking each proposed exclusion in turn:

- *Rights of resale over the data*

This seems overly broad where the business has no commercial benefit or intent to resell the data directly. We suggest this exclusion should be limited to situations where there is real demonstrable value in resale.

- Right for the company to publish, share or otherwise communicate the raw data within the dataset to a third party

We understand from discussions with HM Treasury that this exclusion is intended to prevent a company from profiting from the dataset (other than via its R&D), however there are numerous scenarios where this would impact legitimate use, for example where fields within the dataset represent identifiers such as postcode, material or date, and these may be within the public domain, but are extracted from a dataset during transformation for indexing of the output from an R&D project. This inclusion could be incorporated into the first exclusion, through applying a general rule which excludes from eligibility expenditure on datasets which have been sold or published for commercial gain.

- Ongoing rights of use, beyond the expected term of the R&D project

This would be problematic in practice given the nature of dataset licences, where purchases typically have no expiry date or have long durations for their use. We would suggest examples of legitimate continued use could be:

- A licence required for raw data which is transformed prior to use in production software where no expiry is provided and without which the R&D project could not be completed.

- A separate licence is required for presentation of raw data (which would not be acceptable use) and a data processing licence (which would be acceptable use).

As an alternative to the exclusions above, we suggest that the actual use of the dataset within and after the R&D project should be considered rather than the details of a licensing agreement. To this end, we would propose clarification and refinement of the acceptable use of datasets through a series of example scenarios including:

- The presentation of a raw untransformed dataset in software after the R&D project is not acceptable use (as per second exclusion).

- Data which is loaded and transformed during an R&D project, where the research benefit lies in the transformation e.g. generation of computed fields, and is then used in its transformed state after the R&D project is acceptable use.

- Use of datasets for multiple R&D projects is also acceptable use, for example in follow-up projects where costs are applied once.

Cloud computing expenditure

The inclusion of cloud computing costs is to be welcomed, but the measures would benefit from greater clarity in their practical application, with the intention of targeting support costs of genuine R&D.

Costs incurred in carrying out computational R&D in the cloud

Practically, the costs associated with an R&D project are often best described as an application ecosystem, which includes a set of applications and IT infrastructure to connect and secure these systems. As such, costs linked to cloud service infrastructure, such as VPN, IP address allocation and firewalls are essential for the standing up of such a testing platform, and should be considered part of the products needed to undertake R&D.

Cloud providers operate with a very similar model to Software-as-a-Service (SaaS), termed Infrastructure-as-a-Service (IaaS), which allows a set of infrastructure to be used for the duration needed. The usage models can vary from using services and servers only for processing single tasks to keeping such systems running for extended periods to save time in running repeat operations. The appropriate methodology adopted should not be dictated by R&D tax requirements. A clearer approach would identify costs linked to an R&D project by time period and then if necessary apportion between commercial and R&D use using a reasonable methodology.

Some R&D projects will use a mixture of traditional servers and data storage IaaS services along with cloud services best described as SaaS services (such as those for data collection and machine learning). We recommend that all services provisioned by a cloud service provider could in principle be used within an R&D project directly or indirectly and should therefore attract relief

Inclusion of servers and data storage

Servers and data storage are essential for almost all R&D projects using the cloud. They are often the major proportion of costs linked to such projects and should be treated in line with other cloud services. This would provide consistency in the description of essential services and infrastructure required to run an R&D project. Separation of R&D and non-R&D costs could be achieved through a similar approach to other consumables, such as power and water. For example, where the services can be identified precisely they should be, otherwise they should be apportioned based on a reasonable methodology.

There are general costs from a small number of services such as developer support packages, which could be excluded outright.

Practical application and methodology

The development of a list of eligible services to link to an identifiable R&D project would in theory be an ideal method of identifying costs, but unlikely to be picked up sufficiently in the software industry to be the only appropriate methodology. Services utilised directly for R&D could be identified by competent professionals based on their own understanding of how such services have been used in the R&D project.

Aggregated costs such as for data transmission and CPU time could reasonably be apportioned or excluded when of low value and hard to evidence.

A case-by-case assessment of reasonable use for R&D could be helpful to guide companies and agents when calculating qualifying expenditure. Providing examples specifically linked to Amazon Web Services, Microsoft Azure and Google Cloud Platform would clarify best practice. As a suggested level these scenarios explore the factors to consider:

Example 1

A company with one web-based application uses a single server (a virtual machine) and a single database to run its product, and chooses to use the same services to run R&D projects. The R&D project utilisation cannot be isolated in bills and is using minimal services not required for non-R&D projects.

We would recommend excluding eligibility for cloud service costs for such shared services as there would be minimal additionality effect and allowing an apportionment in these cases would be open to abuse.

Example 2

A company has a set of containerised (Kubernetes) services that can be deployed on demand. They will only run as needed and based on cost efficiency. It is reasonable to assume services for R&D projects will only be retained for the duration of the project operations. Billing information for these services may be aggregated e.g. minutes of container or CPU use. In this context a reasonable method would be to exclude a baseline apportionment for running non-R&D services based on historical billing data.

Individually identified services could be included at 100% utilisation, whereas aggregated services could use reasonable estimates for apportionment.

Example 3

A company has a range of services including servers, databases, lambda functions, firewalls, data and video processing services. Some services such as firewalls are shared, others are created at the start of an R&D project, whilst others only charge per use (lambda functions for example).

- Shared services – in this case the firewall - should not be included as R&D expenditure due to the minimal additionality and risk of abuse.
- "Charge per use" services could be included where identifiable specifically or apportioned to R&D using a reasonable apportionment.
- "Leave to run" services such as servers, would be apportioned in the same manner.

Identifying the qualifying element of a package payment

Cloud based services continue to improve their billing features, with some sources providing per-service costs that can clearly be linked to named operations and date ranges. However, many services, particularly those where cost is based on processing or time units, use aggregated costs as a service type. Where the service is not identifiable directly, an apportionment based on additional expenditure over and above routine usage could be reasonable to apply, and we would expect this to evolve over time with increased availability of cloud services and billing information. The monthly nature of bills may also act as useful evidence for periods of development activity for some businesses.

OVERSEAS R&D

Purpose of this measure

The desire to ensure that taxpayer money is effectively targeted, and that support is refocused towards innovation in the UK is well received and widely supported. However, a blanket restriction excluding overseas R&D ignores the fact that some R&D needs to be carried out away from the UK, while still accruing the benefits of that activity within our country.

Our understanding is that the target of this measure is overseas activity which could instead be carried out within the UK, where the main driver for outsourcing overseas is cost. It is felt that companies that benefit from a lower cost of carrying out R&D in this way should not also be eligible for UK government subsidy through R&D tax relief.

Cost is clearly not the only driver for businesses outsourcing R&D activity overseas. R&D also takes place outside the UK when it is simply not feasible to carry it out here. This may be due to scarcity of specialist skills, regulatory requirements, geographical factors or environmental considerations. In order to ensure that this measure is well targeted, it is necessary to consider how protections could be applied to support businesses in these circumstances.

It is also worth considering whether specific business models are being targeted with this measure, or rather decision-making within R&D projects. A business may be structured in such a way that while there is a core management team in the UK, almost all R&D activity takes place overseas. Conversely, there will be many businesses who undertake the majority of their R&D activity in the UK, but sometimes outsource within specific projects based on demand for skills, or capacity. How this measure affects these two types of business will be different and we would recommend given the stated aims that the latter model should not become a target.

It is unlikely based on information from businesses we have spoken to that restricting relief on such costs would result in them onshoring those activities in the short or medium term. However, we do believe that over time, blanket restrictions on overseas R&D activities would lead to an erosion of UK-based IP. This is because, whilst R&D relief is rarely the deciding factor, it is commonly one of a number of factors businesses consider when structuring their activities.

It is helpful to revisit the wider objectives of the consultation in the context of the proposed changes:

Modernise the relief

The government intends to update R&D tax relief to ensure it is fit for purpose and reflects how R&D is conducted now. Following the impact of the pandemic on working practices, a reported 41%[2] of businesses are expected to continue offering some degree of hybrid working, with almost a quarter of the workforce anticipated to be working remotely on a full-time basis by 2023. Combine this with the current well documented[3] hiring difficulties being faced by employers, particularly in tech industries[4], and it quickly becomes clear that it is unlikely businesses in the UK will continue to solely be able to offer UK based roles via traditional employment contracts.

[2] https://www.wtwco.com/en-GB/News/2021/08/the-future-is-hybrid-as-employers-plan-for-post-pandemic-working-patterns
[3] https://www.cipd.co.uk/knowledge/work/trends/labour-market-outlook
[4] https://www.glassdoor.co.uk/employers/resources/glassdoors-uk-job-hiring-trends-for-2020/

Ensure the UK remains competitive

A number of jurisdictions (including France, Norway and Ireland) do not restrict the eligibility of costs based on location. In many cases, those that do only restrict it by a limited degree (e.g. Germany, Austria and Spain who, amongst others, permit overseas costs so long as they are within the EU/EEA). The proposed changes would therefore make the UK's incentive less competitive than several of its neighbours'.

Whilst the proposed restrictions are unlikely to cause a mass exodus of R&D hubs from the UK on 1 April 2023, it is likely that we would see an erosion of IP generation away from the UK, as global corporates reassess their strategies the next time the subject of location is considered.

Improve compliance

HMRC is not alone in wanting to improve compliance. A major factor in achieving this will be to reduce complexity, ensuring that the rules governing the incentive are accessible and can be applied with certainty. Professional bodies like CIOT have long been seeking greater simplicity, clarity and certainty for taxpayers. However, the current proposed restrictions leave scope for uncertainty and misunderstanding and, in an increasingly digital world, could be complex to administer.

Scale of the issue

For 2019-20, the total expenditure on which an R&D tax relief claim was made was £47.5bn. The ONS estimated that businesses carried out £25.9 billion of privately-financed R&D in the UK in 2019. Overseas expenditure can qualify for R&D tax relief, but is not included within the ONS estimate of business R&D expenditure. HMRC previously produced an estimate of overseas R&D expenditure, suggesting that it measured between £4 billion to £7 billion in the year to March 2018. It is highly unlikely that the amount of overseas expenditure in 2019-20 was £21.6bn (the difference between UK R&D and total R&D claimed).

As set out in our response to the Spring 2021 consultation, our analysis suggests that the majority of R&D activity on which an R&D tax relief claim is made is undertaken in-house, with staffing costs being the largest cost category in 74% of cases we reviewed. The summary of responses to the consultation document also notes that 'many respondents made clear that they consider that subcontracting and outsourcing are valuable commercial strategies'. In some sectors, the nature of the development work undertaken relies on bringing together highly skilled specialists to collaborate on R&D projects, and for businesses in these sectors, it is unlikely to always be feasible (or even possible) to directly employ the individuals they seek.

Where R&D companies use subcontractors or externally provided workers, of our survey respondents, only 4% said that they mainly carried out R&D activity outside the UK. Again, this was the consensus from the responses to the original consultation, with the report noting that 'the majority of respondents did not report conducting any activity overseas, and where companies did outsource activity outside of the UK, they reported that the bulk of spending was still in the UK'.

This evidence suggests that the number of companies outsourcing significant portions of their R&D overseas is limited, making the case for pushing ahead with a broad restriction on overseas activities unclear.

The PAYE/NIC cap for SME R&D relief already acts, in part, as a disincentive for 'R&D tax credit tourism', by restricting the availability of R&D tax credits for companies with little or no employment presence in the UK. Given the desire to simplify tax law where possible, it is perhaps unnecessary to have two measures with similar goals, effectively doubling the administrative burden on SMEs compared to those accessing RDEC.

Overseas R&D by necessity – protections

R&D most commonly takes place outside of the UK when it is not feasible to carry it out here. Examples of such activities include scarcity of specialist skills, regulatory requirements, geography and environmental considerations.

Another reason that R&D activities may be carried out other than in the UK include where projects are carried out by an international group of companies, drawing on resources from overseas subsidiaries to support UK based projects.

De minimis expenditure threshold

As noted above, most companies we researched did not report that overseas R&D contributed a material proportion of their total R&D expenditure. A de minimis threshold would allow a level of overseas expenditure where such costs only represent a small portion of the total claim.

This would have the benefit of not impeding the overall aim of encouraging R&D activity and avoiding an unnecessary administrative burden where the measures would produce little benefit. Where overseas expenditure is below the de minimis, companies would not need to consider further the overseas R&D restrictions.

This approach also mirrors the PAYE/NIC cap on SME R&D tax credits, introduced in 2021.

General necessity rule

To ensure that the new measure does not exclude relief for overseas R&D in circumstances where it would not be possible to carry out those activities in the UK, we recommend a general necessity rule.

From a legislative perspective, this would be fairly simple to implement. Such an exclusion could introduce the categories above as acceptable reasons for activities taking place outside the UK. This would place the onus on the business to ensure that evidence would be available to support the inclusion of such costs on this basis, should HMRC request to view it.

Evidencing necessity for reasons of regulatory stipulation, geography or environmental considerations is likely to be simpler than for reasons of skills shortages, as these are more fact-based. However, based on our discussions with companies likely to be affected by this measure, a key reason for outsourcing R&D activities overseas is severe skills shortages affecting highly skilled technical roles.

It is no secret that there is a shortage of a number of key skills in the UK, and this problem has only been exacerbated by Brexit and the COVID-19 pandemic. On average, there were only five applicants for every high-skilled job vacancy in the UK in Autumn 2021[5], half the level only 12 months earlier[6]. Evidence also suggests that the skills shortage pre-dates the pandemic[7] so is unlikely to resolve as COVID-19 restrictions ease.

[5] https://www.glassdoor.co.uk/employers/resources/glassdoors-uk-job-hiring-trends-for-2020/
[6] https://www.cipd.co.uk/Images/labour-market-outlook-autumn-2020_tcm18-86411.pdf
[7] https://www.cipd.co.uk/knowledge/work/trends/skills-labour-shortages

An exception in the case of businesses outsourcing R&D activity overseas where there is a shortage of the required skills in the UK would address this. A relatively simple method to achieve this would be to utilise the published government list of skilled worker shortage occupations (used for skilled worker visas[8]). The list currently includes scientists, engineering professionals and software development professionals, demonstrating the scale of the problem being faced by businesses in some of the most R&D intensive sectors.

Connected parties

Consideration should be given to how these restrictions should apply to global organisations, where central R&D management takes place in the UK, but draws on resources and skills from subsidiary entities outside of the UK. In some of these cases, the UK's R&D tax incentives may have actively influenced the location of R&D activities, or an R&D hub, within the UK, which is clearly desirable. Changes that apply punitive measures against these businesses utilising their global employee-base would be counter to the intent of the incentive.

Continuing to permit the inclusion of eligible connected party overseas costs would ensure the UK remains competitive in attracting R&D-intensive global businesses.

In the majority of cases, these arrangements fall within the EPW regulations, so applying this protection to the EPW category would ensure that such arrangements can be retained.

[8] https://www.gov.uk/government/publications/skilled-worker-visa-shortage-occupations/skilled-worker-visa-shortage-occupations

TACKLING ABUSE

Abuse and compliance

We share many of the concerns raised in the R&D tax reliefs report regarding how the R&D tax advice market has evolved in recent years. We have highlighted examples of agents whose working practices fall below the standards which we believe taxpayers and HMRC are entitled to expect of anyone who calls themselves a tax adviser.

Nevertheless, it is important to note that not all agents act in this way. It is the actions of a minority (albeit a growing number) of agents that poses a problem. HMRC recognises that the agents who act unethically 'are typically not members of professional bodies'. We are aware from HMRC's own data that two thirds of complaints about tax agents relate to the one third of agents who are unregulated[9]. To us, this presents a clear case for increased regulation of the R&D tax advice market.

Our research[10] has shown that better regulation is what businesses expect, and that some 90% of business leaders believe that the R&D tax advice market is already regulated (almost half of whom believe that it is regulated by HMRC). We continue to support an approach which utilises the existing regulatory framework in the UK, with an enhanced role for professional bodies such as the CIOT and ATT. We believe this aligns with the comments HMRC has made on the impact of unqualified advisers in this space.

The report highlights the use of both cold-calling and a contingent fee model by some advisers. Both practices are used widely in business and not solely in connection with R&D tax advice, and neither are inherently unethical or necessarily a sign of poor behaviour.

However, it is easy to understand how such models could lead to the negative behaviours seen by HMRC if not tempered by an ethical code such as that which membership of a professional body brings with it (the Professional Conduct in Relation to Taxation guidelines). ForrestBrown helped to set up a working group led by the CIOT and ATT which drafted guidance on the application of PCRT to R&D tax advice. This guidance has been endorsed and published by all of the main tax and accountancy bodies and was cited by HMRC as a good example of the positive impact of reputable agents. Such initiatives should be welcomed, and more of this type of collaboration between professional bodies, reputable R&D agents and HMRC would help to raise awareness of the issues at hand.

Next steps to improve compliance

A greater focus by HMRC on compliance should be welcomed by reputable advisers, to the extent that it helps address the poor practice of disreputable ones. It has been widely reported that HMRC hired up to 100 new staff to undertake compliance work on R&D tax credit claims. We also understand that during 2021 HMRC undertook a programme of randomised enquiries into R&D tax credit claims, and it may be that this is what is meant by 'work to better understand the nature and scale of the error and fraud associated with the reliefs'. We would recommend that once available, HMRC shares early conclusions from this work about the nature of such errors.

We have anecdotal evidence of high turnover among the new R&D compliance staff, which raises concerns regarding the challenge of ensuring new staff are suitably trained and experienced in what is ultimately a complex and specialist area of tax.

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[9] https://www.aatcomment.org.uk/audience/members/regulate-the-unregulated-now/

[10] https://forrestbrown.co.uk/news/yougov-r-and-d-relief-survey-report/

We share the view that additional resources alone cannot address the underlying problems. In our view, a significant part of the solution is regulation. In addition, the new staff HMRC has hired should be well trained and suitably experienced. HMRC guidance should be clear, up to date, and actually followed by caseworkers (which regrettably in our experience is not always the case). HMRC should have an open and constructive dialogue with professional bodies such as the CIOT and ATT to apply checks and balances on both their member firms, and HMRC itself.

Digital filing of R&D tax claims

Implementing digital filing for all R&D tax relief claims will enable data on R&D claims to be captured centrally in HMRC's systems. This should encourage a more consistent approach to compliance, and save time for HMRC by eliminating the need to process significant numbers of claims manually.

We are not aware of any data from HMRC on the number of R&D claims filed manually compared to those already filed digitally. We understand that these manually filed claims will relate primarily to claims made by way of amendment to a tax return, where documents are emailed to HMRC's R&D mailbox. Such a process often takes place when a company engages with an R&D agent that does not have the capacity to file digitally.

Through our discussions with accountants, it is clear that there are a number of drivers and circumstances that lead to manual filing of an R&D claim by an R&D agent without capacity to file digitally on behalf of its clients.

Some R&D agents choose not to work transparently with their client's main tax agent or accountant. This is poor practice and an indication of poor behaviour on the part of the agent. We have seen extreme examples of R&D agents not even sharing claim documentation with their client prior to submission to HMRC. In these circumstances, often the company's accountant is left unaware of the R&D claim, affecting the accuracy of the wider return.

In some circumstances, such agents will request, either directly or via their mutual client, that the company's main tax agent file the R&D claim. Where that accountant does not feel comfortable filing the R&D claim (or sometimes where they don't have the capacity due to short notice requests), the R&D agent may default to manual filing. The topical guidance on the application of PCRT to R&D tax advice has increased the frequency of accountants challenging poor quality R&D claims at this point, however with manual filing still possible, not necessarily helped to prevent those claims from being filed.

There are limited circumstances where manual filing of an R&D claim may be necessary. Software does not always work as intended and experiencing technical difficulties with digital filing software is unlikely under the current system to be an acceptable reason for a late claim for R&D tax relief. The option of manual filing where the software fails and there is an impending statutory deadline will in some cases enable genuine R&D claims to be made. These cases will be in the minority, however it would be beneficial for some limited scope for manual filing to remain in order to protect against denying relief to genuine claimants due to software errors.

A potentially unintended outcome of this measure is that the obligation to file digitally may result in an increased number of non-qualified tax agents in the R&D tax market purchasing tax software in order to file R&D claims digitally. This could compound the issue referred to above where R&D agents do not operate transparently alongside a company's main corporation tax agent, potentially leading to more inconsistencies in presentation and more errors in the short term.

The proposed measure requiring companies to notify HMRC of the name of their R&D agent should mitigate this concern.

Mandatory supporting information

We agree that requiring more supporting detail alongside an R&D claim would be a positive step in respect of preventing fraud and supporting the future accessibility of the R&D tax incentive. In order to calculate accurately the amount of R&D expenditure and relief due, a company should be gathering relevant information, and those claiming relief are already required to keep sufficient records to support the figures in the tax return. It should not, therefore, be considered an unreasonable additional administrative burden to provide this information alongside a claim. Indeed, as the report notes, many claimants already do so.

Whilst we welcome this proposal, we would be keen to see careful consideration and further consultation on the mechanics of how this will work in practice. In particular, the format through which companies would need to provide any additional detail.

At ForrestBrown, we have experience of providing supporting documentation as attachments to the tax return submission, via separate attachments emailed to HMRC's R&D team and via the HMRC online form. Regardless of the format adopted to provide information, we have seen examples of this supporting information not being reviewed by case workers prior to initiating a compliance check. We would therefore be keen to see a mandatory requirement to provide supporting information linked to a commitment from HMRC to review information prior to opening a compliance check, to minimise any time spent repeating the same information during an enquiry.

We would recommend that this supporting information be provided digitally, to ensure that the amended tax return and the supporting R&D documentation can be linked easily and effectively.

We recognise that supporting documentation can currently be submitted in a variety of formats and this is not helpful for HMRC's review and risk assessment processes. While consistency in the supporting information required is desirable, compulsory use of a particular format would place a lot of pressure on the reliability and suitability of that format in all cases. This was a key learning point during the project to develop the existing online form, which while useful in many cases, is not always the most suitable format for providing supporting information.

To ensure consistency of information provided, we would suggest the additional information required broadly follows the existing online form with some additions:

- Details of the competent professional(s), potentially including a short biography of their relevant experience and skills.
- Technical narratives for a sample of projects (the online form currently requires projects representing at least 50% of the company's R&D expenditure).
- Total R&D expenditure claimed for each project described.
- R&D expenditure claimed for each category of qualifying expenditure.
- To address the limitations presented by a set format for providing information, a character limited information box could be added to allow for further explanation in cases where additional disclosures are necessary or helpful.

From our extensive experience of both testing and then using the HMRC form, it is limited in terms of the information that can be disclosed. This makes it unsuitable in cases where the claim is complex. In these situations, we consider that using our own report format enables us to structure the claim information in the most appropriate way to assist HMRC in reviewing the claim.

Mandatory supporting documentation and clear best practice guidance from HMRC should provide more reassurance that claims are being prepared and submitted with due care and attention within the boundaries of the BEIS guidelines and tax legislation.

This change would lead to a substantial increase in the amount of information provided to HMRC regarding R&D claims. Does HMRC intend to review all of this information? It would be a positive development if companies could have greater assurance that the information provided is reviewed prior to processing of an R&D claim. Many companies incorrectly assume that once a claim has been processed and paid, money can be safely reinvested into the business. This can add substantial stress if an enquiry is opened later. While this situation stems from a misunderstanding of the rules, and we recognise that HMRC has always favoured a 'pay now, review later' approach, we would welcome further consultation on timelines and KPIs for processing, risk assessing and opening enquiries into R&D claims.

Company senior officer endorsement

We understand that this measure is intended to target businesses that use R&D agents, acting as a reminder that the company retains accountability for the accuracy of its R&D claims. As one of a group of measures aimed at improving the quality of R&D claim submissions, this additional endorsement could help to raise awareness among businesses of their responsibilities in submitting a claim for R&D tax relief.

Corporation tax return is already subject to a declaration from a director of the company before it is submitted. However, based on HMRC's comments, there is still sufficient evidence of companies not reviewing their R&D claims despite the claim forming part of the same return. A specific confirmation regarding R&D should have some effect in addressing this. At the least, it is less likely that a company would accept an agent not sharing the R&D claim documentation with it prior to submission (which does sometimes happen).

Due to the nature of R&D claims, it is likely that several individuals within the company will have supported the calculation of relief, from gathering financial information, through to identifying R&D projects and supporting the apportionment of costs. In many circumstances, these individuals will not hold statutory responsibilities for the company, so should not be expected to endorse the R&D claim. We understand that HMRC does not envisage this change leading to a personal liability for the named senior officer, as the measure is intended to be an awareness and behavourial prompt, rather than a mechanism to impose an additional penalty or liability. We also understand that HMRC is not intending to use the identity of the named person to risk assess the claim.

Consideration could be given to the information / guidance provided alongside any signatory box, making clear what is being confirmed. For example, that the director has read and understood the R&D claim, is happy that the company has carried out qualifying R&D projects in the period and incurred qualifying R&D expenditure. Some guidance on the possibility of penalties if HMRC later finds that the company has been careless in preparing or reviewing the claim could be helpful, as would confirmation that HMRC may process the payment due prior to reviewing the claim.

Pre-notification of R&D claims

Purpose and drivers

We believe based on stakeholder discussions that this measure is intended to target malicious R&D agents who take advantage of companies that are unfamiliar with claiming R&D relief, encouraging them to submit dubious claims. These agents often charge on a commission basis and seek to maximise their fee by encouraging companies to claim for historic R&D costs, often with little investigation, validation or justification.

Currently it is generally possible to claim R&D tax relief up to two years from the end of the relevant accounting period, in line with the amendment window for a company's corporation tax return. We acknowledge that historic costs can be particularly vulnerable to manipulation and abuse, however clearly it cannot be assumed that all historical R&D claims are in some way less valid than those prepared earlier.

This measure as proposed would likely reduce the overall number of claims submitted, both spurious and genuine. We understand that HMRC considers the likelihood of error in claims submitted close to the two-year deadline to be higher than for those submitted earlier, however since the measure affects all claims, it will lead to some legitimate R&D expenditure not attracting relief. In that respect, the proposal appears disproportionate to the problem it is seeking to solve.

Over time, companies would no doubt become more aware of the shortened deadline and in the longer term, a requirement to notify HMRC could encourage companies and advisers to be more proactive in recording R&D activities as they occur. However, such encouragement could also be sought in a number of ways, for example through setting clearer expectations of when and what evidence should be gathered to support an R&D claim.

R&D is a conscious act in which a company intentionally seeks an advance in science or technology. However, there are nevertheless some genuine instances where companies are undertaking R&D but are not aware at the time that their costs are eligible for relief. Such claims should not be considered 'dead weight'. The incentive effect of R&D tax relief is often only realised once a company has received its first claim for relief and can begin to factor that funding into future investment decisions. Any notification requirement introduced should not bar these companies from making genuine retrospective claims.

We are fully supportive of measures to address malicious agents and spurious R&D claims. However, we do not support measures which are likely to result in companies with genuine R&D being denied relief. The effect of this measure should not be to simply reduce the overall number of R&D claims by making the submission process more administratively burdensome, and it is not yet clear how this could be achieved in the format currently explained.

On balance, it is our view that there is a much clearer case for the introduction of the other measures announced within the report.

We have considered below the various practical implications of this proposal, which raises a number of further concerns, encompassing:

1. The **timing** of the notification;
2. The **process** of making the notification; and
3. What **information** is included within the notification

Timing

R&D tax relief is potentially triggered each time an R&D project is started, however an R&D tax relief claim aligns with a company's accounting period (and therefore may encompass several projects). It would therefore theoretically be possible to align the notification with either each R&D project, or each R&D claim. We understand that the preferred approach currently would see the notification made for each R&D claim, rather than project.

There are several ways in which the timing of the notification could be linked with a company's accounting period. We have given our measured views on each likely possibility below:

Timing	Comments
Before the start of the relevant accounting period	This is included for completeness but it is clearly unworkable in practice. Many companies do not know in advance that they will be undertaking an R&D project. One of the fundamental aspects of R&D is that it can occur in

	response to a challenge or complexity that arises unexpectedly and a company is required to adapt and be innovative with little or no notice. Furthermore, notification prior to an accounting period would limit the information which could be expected and likely lead to a high proportion of 'protective' or 'just in case' notifications.
Before the end of the relevant accounting period	Given that R&D is a conscious act, it could be reasonable to expect a company to identify that it has carried out R&D within the relevant period. However, placing a notification deadline at the end of that period would result in an impractically short timeframe in which to expect a notification. A company could begin an R&D project towards the end of its accounting period, leaving it just weeks or even days in which to make the notification. Such a deadline would again encourage companies to submit a notification each year as a protective exercise.
By a set date after the end of the relevant accounting period	This option would mirror other jurisdictions, such as Australia where notification is required 10 months after the relevant accounting period. However, in Australia, the driver for requiring this notification is that the tax incentive is dual-administered by the tax office and the Department of Industry, Innovation and Science, which is not the case in the UK. A requirement to notify at this point would add a new administrative burden on the company depending on what information is required as part of the notification.
By the corporation tax filing date	Aligning the pre-notification with the corporation tax self assessment cycle would effectively reduce the deadline for identifying a possible R&D claim from the current 2 years to 1 year. Of all of the options on timing of the pre-notification, this option does potentially balance HMRC's desire to reduce the number of retrospective claims with the practical implications of requiring a pre-notification. Many businesses already prepare and submit their R&D claims in line with the tax return compliance cycle and so would be largely unaffected by the measure.
Before the two year amendment period	The requirement could be introduced to simply notify at some point before the end of the two year amendment window for corporation tax returns, and before a claim is filed. This is the only option which ensures that companies can still make legitimate claims within the current deadline of two years. The notification may have little impact if it was made very close to the deadline, however if HMRC is targeting companies who do not identify that they have undertaken R&D until a substantial time after carrying out a project, the notification in this form would enable them to identify when a company identifies that it has undertaken qualifying R&D. A notification close to the two year deadline could raise the risk profile of the claim, making a compliance check more likely. In such circumstances, a legitimate claim would result in processing after the compliance check, but a spurious claim would be identified through the enquiry process.

	The value of such a measure is unclear, however, since HMRC could already target retrospective claims for enquiries in much the same way as described above.

Process

At the RDCF[11] meeting in December 2021, HMRC explained that an option being considered could be simple portal, where a company submits its notification and receives a reference number, which it can then apply to its claim submission to validate the claim.

This would appear to be a relatively simple administrative procedure for companies to adopt. However, it suggests a separate system from the current technologies which support filing of the CT600 and visibility of tax payments. It would also then sit alongside the existing HMRC online R&D form, which we understand still requires manual intervention to link the data submitted to the return submission.

As HMRC moves towards Making Tax Digital, a more joined up technology approach would be beneficial.

Information

We understand from discussion at the RDCF meeting in December 2021 that HMRC envisages the notification would be quite transactional, with minimal information being required from the company. While this reduces the administrative burden on the company, it also raises a number of concerns regarding the value of introducing the pre-notification.

The greater the information required by HMRC at the pre-notification stage, the greater the onus should be on HMRC to inform taxpayers of how it intends to use that data to improve targeting of compliance activities.

As noted above, the concept of a protective notification is a likely outcome of this measure, and it is not clear how this could be effectively prevented or even discouraged. Any process of applying penalties for notifying without then making a claim would not be advisable as it would encourage companies to file even if information or evidence to support a claim is limited, in order to avoid a penalty.

Requesting more information alongside the notification could help to discourage protective pre-notifications, but as noted above, would also raise questions regarding what HMRC intends to use that information for, given that it will be imposing additional filing burdens on companies.

Notification of R&D agents

We are delighted that the government intends to require companies making an R&D claim to disclose details of the R&D agent they have worked with. We believe this will be an important step in tackling some of the abuse we have seen in recent years in the R&D tax relief market.

Currently, while HMRC has concerns about poor behaviour and bad advice in the market, they don't necessarily know which firms this is coming from. Furthermore, even if they have identified agents that they have concerns about, they don't currently have sufficient data to target compliance efforts towards tackling those behaviours. Many malicious agents seem able to fly under HMRC's radar, by simply filing R&D claims without any supporting documentation disclosing who that R&D agent is.

Better data on which R&D agents are making which R&D claims will give HMRC greater ability to target errors and poor agent behaviour, both formally and informally. As well as opening enquiries to target

[11] https://www.gov.uk/government/groups/research-development-consultative-committee

significant concerns, we would welcome HMRC resuming more dialogue with R&D agents directly, to provide feedback on their approach. This would be an effective way of helping avoid repeat mistakes, as well as demonstrating that HMRC are reviewing claims and monitoring agent behaviour.

We would recommend a clear set of guidelines detailing how and why HMRC should use the data on R&D agents, defining both formal and informal procedures for them to address concerns with agents. This should be published as part of the CIRD manual, similar to the guidance defining procedures for conducting enquiries.

How to collate this data

Form 64-8

Some agents currently use form 64-8 to allow them to evidence authority to discuss clients' R&D claims with HMRC. The form is not currently designed to allow for an R&D agent to be authorised alongside the company's main corporation tax agent. As a result, such authorisations can be missed by HMRC case workers, or sometimes R&D agents can mistakenly be allocated on HMRC's system as the main corporation tax agent.

Some minor updates to this form could be a good way to provide HMRC with useful data on R&D agents, as well as benefitting those who already work productively and transparently in this way. The 64-8 form is a process that is already familiar to agents, clients and HMRC.

An R&D section could be added to the form, so that companies can authorise a separate R&D agent, much like they can a VAT or PAYE agent. As well as providing HMRC with better data on R&D agents, this update to form 64-8 would much improve the current system for R&D agents to be able to discuss individual cases with HMRC to ensure claims are processed correctly.

Form CT600L

An additional measure could include a box in form CT600L for a company to disclose if they have worked with an R&D agent on their R&D claim and if so, the name of the agent. The form is mandatory for any company making an R&D tax credit claim, so it would appear the natural place to disclose details of the R&D agent.

Should HMRC update the CT600L and accompanying notes, this would be a good opportunity for HMRC to provide clarification regarding how boxes L185 and L190 should be used. Recently, HMRC has stated that all or most customer projects would result in R&D expenditure which is both subcontracted or subsidised, and has updated its guidance accordingly. The CT600L requires subcontracted and subsidised expenditure to be disclosed separately in boxes L185 and L190 respectively. Since HMRC think expenditure will typically be both, which box should be used?

ADDRESSING ANOMALIES

Contracted out R&D and subsidised R&D expenditure

The changes proposed to address anomalies in the current legislation are welcome. A further anomaly that is not addressed in the consultation at present relates to SME R&D relief and HMRC's changed interpretation of contracted out R&D and subsidised expenditure.

HMRC has taken the view that any R&D activities carried out to deliver goods and services to customers are being both contracted out and subsidised by those customers. This new position led to a recent First-tier (Tax) Tribunal decision against HMRC (Quinn (London) Ltd v HMRC [2021] TC08321). Judge Harriet Morgan's verdict in the case was clear and strongly overturned HMRC's position, with the judge commenting more broadly that HMRC's position was "wholly out of kilter" with the intention of SME R&D tax relief.

Since this case, HMRC has stated that while it has chosen not to appeal the judgement, an approach which would have provided certainty through a binding court precedent, its position has not changed and it will continue to challenge claims where the facts are the same or similar to Quinn's.

SMEs now face incredible uncertainty in filing R&D tax relief claims, with HMRC's published interpretation wholly at odds with the Quinn case. For an incentive designed to encourage behaviour, introducing such a level of inconsistency and uncertainty can only harm the policy intent of the incentive.

We recommend that action is taken urgently to clarify the legislation in line with the decision in Quinn.

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