ForrestBrown®

Innovation incentives

Consultation on R&D tax relief advance clearances

Response from ForrestBrown Limited

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About ForrestBrown

ForrestBrown is passionate about the transformative power of innovation in supporting businesses to develop and grow. We are the UK's leading R&D tax relief consultancy and help businesses access funding for their innovation from a range of incentives including capital allowances, grants and Patent Box, helping to drive innovation and economic growth.

Our 100-strong multi-disciplinary team is made up of qualified chartered tax advisers, accountants, lawyers, industry sector specialists and former HMRC inspectors. We are a member firm of the Chartered Institute of Taxation and professional standards have always been at the heart of our culture. We were named 'Best Independent Consultancy Firm' at the Taxation Awards 2023, with the judges highlighting our integrity in what they described as a crowded market.

For the past five years, we have been vocal in sharing our desire for the R&D tax relief industry to be regulated as a means to increase quality and protect businesses from poor advice or rogue agents. We therefore fully support HMRC's aims of reducing error and fraud, increasing certainty for customers, and improving customer experience and we welcome the opportunity to respond to this consultation.

Advance clearances for R&D tax relief: the bigger picture

While we have responded to the specific questions posed in the online form, we have also considered why effectively applying advance clearances to R&D tax relief has proved challenging to date (as evidenced by the uptake data shared in the consultation document) and which could make it difficult to implement the options currently under consideration. These are summarised under the following four themes:

1. *Suitability*

Advance assurance schemes are most effective in areas of tax and accounting (such as group restructuring) where the details are clear at the outset and are not subject to change. By contrast, uncertainty is at the heart of the definition of R&D for tax purposes. This means that seeking certainty about the outcome of a claim, often before the R&D has been completed, is more challenging.

2. *Eligibility*

The consultation provides a timely opportunity to review the eligibility criteria for the existing advance assurance scheme should it be decided to maintain or enhance it.

Eligibility is currently limited to SMEs with a turnover under £2 million and fewer than 50 employees, with other stipulations around linked companies. Simplifying eligibility by making advance assurance open to businesses of all sizes would better align with the principles behind the merged scheme.

3. *Value*

Low uptake of advance assurance in its current format suggests the benefits of the scheme are not motivating to businesses. Many businesses and agents view it as effectively volunteering for an enquiry in advance, with the same burden on the business that a retrospective enquiry brings - although without the same right of appeal. The inclusion of options considering both voluntary and mandatory approaches suggests a lack of clarity over whether advance clearances should act as 'carrot' or 'stick' for businesses. This lack of clarity over the purpose and value of advance clearances will continue to be a barrier to business engagement unless resolved.

4. *Resourcing*

It is acknowledged that all options considered in the consultation would require additional resourcing and potentially draw resource away from current compliance work. This highlights the risk that an increased focus on advance clearances could impact customer service at other points in the claim process – or result in lower service levels for businesses who choose not to make use of the service or are excluded from doing so. Of particular concern would be the potential impact of delays if assurance takes place 'pre-activity'. There is a danger this could prevent businesses from undertaking R&D at all.

Grasping the opportunity for reform

This consultation raises several questions with potentially wider implications for R&D tax incentives, considering topics such as a de minimis level of expenditure and the potential to take a targeted approach to specific industry sectors.

With the merged scheme now in place, there is now an opportunity for a wider reset of R&D tax relief which considers these questions with the objective of providing clear direction for UK businesses investing in R&D.

An effective R&D tax relief system starts with a clear statement of intent from the government on the purpose and focus of R&D tax relief. This should include target sectors, examples of the types of commercial R&D projects which should benefit, and what measures of success will be applied in reviewing the incentive.

This statement of intent would provide a foundation for a modernised definition of R&D, which is more accessible for taxpayers, particularly those businesses working in emerging areas of science and technology. Building on the examples provided in HMRC's Guidelines for Compliance (GfC3), we believe businesses would benefit from clearer guidance on how the definition of R&D applies in different sectors, helping to

reduce error and fraud in the process. However, GfC3 doesn't go as far as to address the question of why R&D tax relief is important in the first place, or the thinking behind the potential sector focus introduced in the advance clearances consultation. Addressing this gap would be a positive step.

There may be an opportunity for HMRC to work more closely with the Department for Science, Innovation & Technology (DSIT), as well as the Expert Advisory Panel once appointed, to shape this guidance. This has the potential to recapture the positive intent of R&D tax policy by encouraging private sector investment in innovation.

Current approach

Question: Were you aware of the advance assurance scheme before this consultation?

Yes.

Question: Have you or your clients used the current advance assurance scheme?

Yes.

Question: If you or your clients have used the current advance assurance scheme, please tell us if and how this met your needs?

Since being founded in 2013, ForrestBrown has prepared more than 15,000 R&D tax relief claims for clients. During this time, we have very rarely used the advance assurance scheme. Clients do not often enquire about this service, and it is not something we have actively recommended to them, for reasons set out in our response to later questions.

Question: If you or your clients have used the current advance assurance scheme, please tell us about what worked less well in the process?

Our experience is consistent with the uptake data shared in the consultation document, and indicative that advanced assurance in its current form offers little perceived benefit to businesses claiming R&D tax relief.

Question: For those who are aware of the current assurances, but chose not to use them, what were the reasons for this?

There is a widely held perception that advance assurance is effectively an 'enquiry up front' and offers limited, if any, benefits to businesses.

This view is reinforced by the approval rate published in the consultation document. Furthermore, it is only available for a minority of claimants who have not claimed before.

This could support the argument that advance assurance is not well suited to R&D because of the uncertainty at the heart of the definition of R&D for tax purposes. Seeking certainty about the outcome of a claim, often before the R&D has been completed, can be challenging, and this may be at the root of low uptake for the existing scheme

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Question: Which issues in R&D claims are of the most concern?

Given concerns about the suitability of advance assurance for R&D tax relief, we remain cautious about proposals to widen its scope, particularly where this would be on a mandatory and/or paid-for basis.

Having said that, a more flexible approach to advance assurance may deliver improvements on the current, one-size-fits-all approach.

If a more flexible approach is adopted, then we anticipate that the question which HMRC is most commonly asked to determine will be whether or not a project qualifies as R&D. This is entirely correct, since it is, in our experience, one of the things businesses find hardest to get right (despite having remained unchanged throughout recent changes to the legislative landscape).

R&D is, by its nature, uncertain and tax clearances work best when the event for which clearance is sought is fully understood before clearance is applied for. They are less well suited to R&D, which may evolve as it takes place. This raises questions about exactly how advance clearances would be applied to R&D claims. For example, at what point might an R&D project cease to be the same project for which advance assurance has been given, and might it be necessary to re-apply at that point?

Given recent changes to the definition of contracted out R&D, which are likely to mean that some companies have lost the right to claim while others have gained it, this is one area in which advance clearance might be of value.

The advance clearance process should, in this case, anticipate the scenario where more than one member of a supply chain might apply in respect of the same project. A mechanism will need to be in place to prevent double claiming at this stage.

Further complexities which will need to be considered include methodology, SME status, and the complexities of grant funding and, where relevant, State Aid.

We have addressed the interaction between advance clearance and the role of the competent professional (CP) elsewhere in this response.

Question: Do you have any views on the current criteria for eligibility for advance assurances?

Notwithstanding the reservations highlighted in previous responses regarding the suitability of advance assurances to R&D tax relief, the eligibility criteria for the current scheme should be revisited with the intention of removing unnecessary barriers.

Eligibility is currently limited to SMEs with a turnover under £2 million and fewer than 50 employees, with other stipulations around linked companies.

Simplifying eligibility by making advance assurance open to businesses of all sizes under the merged scheme would remove unnecessary administration to establish and check eligibility.

If resources do not permit this then, for simplicity, access to advance assurance could be linked with the requirement for claim notification. If a company is obliged to notify, then it would automatically have access to advance assurance.

Following the introduction of the AIF and claim notification in recent years, both of which have made claiming R&D tax relief more time-consuming and complex, it is important that any extension of advance assurance does not increase the administrative burden on businesses claiming R&D tax relief.

Design of clearances

Question: Can you foresee circumstances in which paid-for voluntary assurances might be attractive?

We do not support this proposal on the grounds of maintaining fairness in the tax system. We also have concerns about whether revenue raised through a paid-for assurance scheme could be effectively ring-fenced to improve the service to taxpayers. We would urge caution about setting a precedent for a two-tier service which could create an imperative for businesses to pay to ensure they receive a timely response to claims.

Question: Do you agree that a voluntary service could be focused on growing and high-potential companies as well as sectors set out in the government's Industrial Strategy? If not, at which companies should a voluntary service be focused?

There may be merit in exploring this further, although it is not clear how, in itself, this would address low uptake as seen in the current advance assurance scheme.

There could also be a danger that HMRC makes assumptions about businesses who choose not to take up this option, potentially prejudicing the way their claims are assessed.

Furthermore, measuring 'high potential' is unlikely to be straightforward and any ambiguity could open the door to boundary-pushing or abuse by some businesses and agents.

We have seen HMRC use Companies House standard industry classification (SIC) codes as a way of identifying claims for enquiry. However, SIC codes do not always accurately reflect the underlying economic reality and many were simply selected on incorporation and left unchanged.

There can also be a difference between the SIC code of a business and the type of R&D it carries out. Basing eligibility solely on SIC code could rule out a qualifying R&D project carried out in a sector not viewed as 'high potential' at industry classification level.

This is illustrated by the experience of a ForrestBrown client delivering complex construction projects for the South Wales semiconductor cluster. The company encountered repeated challenges to its R&D claims relating to work on highly sophisticated clean rooms for chip manufacturing – a priority sector for the Welsh and UK governments – potentially as a result of being seen by HMRC as solely a construction company.

After a long-running enquiry, our client's R&D claims have been vindicated. However, the time and resources required to challenge HMRC's initial decision has led the company to question its appetite for taking on more complex projects of this type.

We also echo the point made by techUK (of which we are a member) that key emerging technologies are often inadequately captured by options available under the current SIC code system.

Question: Do you agree there is a minimum expenditure below which significant R&D does not take place?

In our experience, there is not necessarily a correlation between costs and results. A company could have qualifying R&D, yet very little eligible expenditure – for example, if founders do not take salaries and are assisted by subcontractors or externally provided workers (EPWs) outside the UK, then there will be little or no eligible expenditure.

There is a de facto de minimis already in place as a result of the PAYE/NIC caps. This has been reinforced by the increase in the effective cost of making a claim following the introduction of the AIF, the reduction in the rate of relief for SMEs, and higher fees charged by agents.

Taken together, these factors arguably make the introduction of a de minimis unnecessary, as we have already seen a significant drop in first-time claimants and smaller claims.

Question: Do you agree that assurances should be mandatory for some?

In our view, making advance assurance mandatory for some companies comes with several risks.

Firstly, it could be argued that it undermines self-assessment, and the central role of the CP in determining whether R&D has been undertaken in his or her specialist field. These are important principles, the latter of which has been tested in recent Tribunal cases. Diluting or undermining these principles could create more uncertainty at a time when the merged scheme has offered a clearer way forward after several years of uncertainty and change.

If advance assurance is made mandatory, it is important that it comes with a statutory right of appeal if the company is dissatisfied with the conclusion. There is currently no right of appeal against an unsatisfactory advance assurance decision. Although the company retains the right to claim, it does so at risk of compliance action by HMRC.

Claimant companies and their advisers are likely to be circumspect about mandatory advance assurance given the experience in recent years of enquiries into R&D claims under the 'volume compliance' approach.

We know of a substantial number of enquiries which were closed by HMRC on the basis that there was no R&D, only to be reversed on appeal (either at ADR, statutory review or in the early stages of the Tribunal process).

It is possible to see a parallel between this experience and a potential mandatory advance assurance scheme, in which companies with genuinely qualifying R&D are wrongly deterred or legally prohibited from claiming.

Agents

Question: How can HMRC best recognise the role of agents in designing a clearance service?

Reputable agents are effectively already playing a screening role by discouraging businesses they believe not to be eligible from claiming.

HMRC could build on this by making use of the data available through the AIF to focus compliance resources on repeat offenders, and by continuing its efforts to communicate more openly with reputable agents.

Options under consideration

Question: Do you see value in pre-activity advance assurance?

In our experience, the flow charts included in the consultation document do not accurately represent the way R&D operates in most businesses.

Requiring pre-activity advance assurance could hamper the R&D process, as companies might have to put their R&D on hold while HMRC decides whether or not to give advance assurance.

We believe the R&D tax relief system should continue to accept that R&D is not always recognised as such until after the event, and that there is not necessarily anything suspicious about this. Correctly identifying qualifying R&D relies on a good understanding of the tests set out in the DSIT Guidelines. The Guidelines say that it is ultimately the role of the CP to decide whether or not R&D has taken place. A CP who is not already familiar with the Guidelines – perhaps because he or she is new in post, or because the company itself is new – will not always R&D for what it is at the time it is undertaken, and it is therefore easy to see how opportunities to seek advance assurance might be missed.

Question: If so, what sorts of issue might be raised with HMRC?

There is a risk of duplication of administration with claim notification, adding a further burden to companies who might have to apply for advance assurance, notify the claim (unless these two steps are harmonized as we have suggested) and then make the claim, with slightly different information being required at each stage.

Question: Please give any other suggestions you have for useful changes to R&D relief administration, particularly those that would address error and fraud.

There is a danger that the options considered could add complexity for taxpayers without offering tangible benefits. This would be counter to the intention of the merged scheme to simplify R&D tax relief for businesses.

Before adding complexity with an additional step in the claim process, we would like to see continued progress towards reducing the disconnect between policy intent and delivery, recapturing the positive motivation to encourage business investment in R&D.

A clear statement of intent on the purpose and focus of R&D tax relief (including target sectors, examples of the types of commercial R&D projects which should benefit, and what measures of success will be applied in reviewing the incentive) would provide a foundation for a modernised definition of R&D. This would be more accessible for taxpayers, particularly those businesses working in emerging areas of science and technology.

Building on the examples provided in GfC3, we believe businesses would benefit from clearer guidance on how definition of R&D applies in different sectors, helping to reduce error and fraud in the process.

There may be an opportunity for HMRC to work more closely with the Department for Science, Innovation & Technology (DSIT) as well as the Expert Advisory Panel once

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