



Chartered
Institute of
Taxation

30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E:post@ciot.org.uk

Preventing abuse of the R&D tax relief for SMEs: consultation

Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 We refer to the consultation published in March 2019 into how a proposed cap on the amount of payable R&D tax credits that a small and medium sized enterprises (SME) can claim should be implemented. This follows the announcement at the Budget in November 2018 that the amount that a loss-making company can receive in R&D tax credits will be capped at three times its total PAYE and NICs liability – to prevent fraud and other abusive claims.
- 1.2 We set out our comments and responses to the questions posed in the consultation paper below.
- 1.3 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT 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.
- 1.4 Our stated objectives are for a tax system which includes:
 - a legislative process which 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); and
 - responsive and competent tax administration, with a minimum of bureaucracy.

2 Policy aims

- 2.1 We welcome the recognition of the importance of R&D to increasing productivity and the commitment of the government to supporting innovation. This consultation focusses on SMEs and the R&D tax relief scheme

offered to them. We accept that HMRC must work to counter fraudulent attempts to claim the SME scheme payable tax credit and support HMRC in this aim. However, we are concerned that the proposed cap will have an impact on some genuine businesses and may prevent claims from some genuine businesses, consequently acting as a deterrent to such companies from undertaking R&D.

- 2.2 The potential impact on genuine businesses is recognised in the consultation paper and it seems to us inevitable that the smallest businesses will be affected by the application of a cap. The types of company most likely to be adversely affected are discussed in response to question 7 below. We welcome the aspects of the consultation around minimising the effects. In particular, as discussed below, the level of the threshold will be very important, as will allowing the PAYE and NIC liabilities of externally provided workers (EPWs) and staff of subcontractors to be taken into account in arriving at a company's cap.
- 2.3 There is clearly an underlying issue around simplicity v fairness with this proposal. Introducing a cap immediately increases the complexity of the SME R&D relief, as it requires claimants to compare the credit to a multiple of PAYE and NIC liabilities. It also creates unfairness as genuine businesses are disadvantaged. This leads to the inclusion of a threshold which significantly increases the complexity level (but which is necessary to reduce the unfairness). As mentioned above, we support HMRC in its efforts to prevent, so far as possible, fraudulent and abusive claims. However, we do question the cost/benefit of this proposal in terms of the increased complexity (and unfairness) being introduced into the SME R&D relief – will the perceived benefit of the cap (in stopping fraudulent and abusive claims) outweigh the costs arising from the loss of R&D relief to smaller, genuine claimants?
- 2.4 In any event, we encourage HMRC to ensure that the impact of this cap on genuine businesses is minimised as much as possible and to use other tools at its disposal, rather than rely on this cap, to continue its campaign against fraudulent and abusive claims. As discussed in response to question 8 below, we would encourage HMRC to consider what other steps it can take to identify abusive claims either before payment of the tax credit is made or through a subsequent enquiry process.
- 2.5 It is important that, in seeking to prevent abuse of the relief the government does not inadvertently make it harder for innovative small businesses and start-ups to grow by restricting genuine claims.

3 Question 1: *If the cap is only applied for payable tax credit claims above a defined 'threshold', at what level would this be useful at reducing any potential administrative burdens on genuine companies?*

- 3.1 The consultation document suggests that the purpose of the threshold is to minimise the administrative burden for the smallest claims for the R&D payable tax credit. More importantly, permitting claims for a payable tax credit up to a threshold will be a key factor in ensuring that innovative small businesses and start-ups, who for good commercial reasons do not have PAYE and NIC liabilities, are still able to fully benefit from the SME scheme for R&D, thus encouraging investment by them.
- 3.2 For that reason, we would like to see the threshold set as high as possible. We think that a threshold of £10,000 (suggested in the example in Annex A) is too low – very few claims would fall beneath a threshold at this level. In order to allow for a payable tax credit on qualifying expenditure of a realistic amount of around £60,000, we suggest that the threshold should be set at, at least, £20,000.

- 4 Question 2:** *If a group was only able to submit one payable tax credit claim at or below a certain threshold per year, how would this fit with the way that claims are currently made? How common is it for more than one company in a group or common control entity to make a claim for the payable R&D tax credit?*
- 4.1 Whilst it is not uncommon for more than one company in a group to submit an R&D claim, these tend to be larger groups, which are probably also profitable and thus not claiming the R&D payable tax credit. This restriction to one claim per group is unlikely to effect the smaller claimants that will be relying on the threshold to make claims in the future. Thus we do not envisage that this proposed restriction would cause difficulties in practice, and we understand the reasons for it.
- 5 Question 3:** *If an element of the PAYE and NICs liabilities of another group or connected company were included as a part of the cap (where R&D has been subcontracted to it or EPWs provided by it), to what extent would this benefit companies? How much additional complexity would this add to claiming the payable tax credit?*
- 5.1 We welcome the proposal that companies can take into account the PAYE and NIC liabilities of workers of other group (or connected) companies subcontracted to it and/or EPWs used by a company in order to determine its cap for claims of payable tax credit. This would be very helpful and would mirror the provisions in the R&D Expenditure Credit (RDEC) cap.
- 5.2 However, this will not assist many of the smaller claimants, as they are unlikely to be sourcing EPWs from, or sub-contracting R&D work to, group or connected companies (as they are unlikely to have such related entities). We suggest, therefore, that HMRC considers broadening this aspect of the proposals so that companies can take account of PAYE and NIC liabilities paid by any subcontractor or EPW provider used by the SME (whether related or not). If PAYE and NICs are being collected and paid in respect of the R&D activity, even by a third party, it is hard to see that a claim in respect of the cost of the R&D could be considered 'abusive'.
- 6 Question 4:** *Would it be practical for claimant companies to obtain the PAYE and NICs information from other group or connected companies? Are there any limitations to their doing so? Would the other company be willing to provide this information?*
- 6.1 Whilst this is a practical issue that would need to be addressed by claimants, we do not envisage that it would present a problem in practice. We are not aware of any issues around obtaining the necessary information in relation to the RDEC cap. Whilst it may be harder for claimants to obtain the relevant information from an unrelated party, that would be a commercial point for the parties to deal with and it would be very helpful if the proposed cap had this flexibility built into it.
- 6.2 It is already a feature of the R&D scheme that the claimant and subcontractor can make a joint election to be treated as connected (CTA 2009 section 1135). We do not envisage that it would necessarily be difficult for the discussions between the parties to extend to the provision of PAYE and NIC liability information.
- 7 Question 5:** *How beneficial would surrendering carried forward losses, to claim a future payable tax credit when sufficient PAYE and NICs liability has been generated, be to a company affected by the cap? Would a*

time limit of 2 years be appropriate? How straightforward would it be to keep track of the origin year of the losses?

- 7.1 The ability to carry forward a surrenderable loss, and convert it to a payable tax credit in a later period, is preferable to the loss of any ability to claim a payable tax credit if not used in the current year. However, while this feature may be valuable to some companies, it is unlikely to be particularly beneficial to the smallest start-up. This company needs the funds in the current period to continue to innovate and grow – which is why we suggest that the key feature of this cap must be setting the threshold at a sufficiently high level to continue to support the smallest start-up companies.
- 7.2 That said, if a key R&D project leads to full production, and the company at this later stage is able to take on significant staff to grow the business and go into production, the ability to claim a payable tax credit in respect of the carried forward surrenderable losses will be valuable. This feature would, in such circumstances, fulfil the aims of the SME scheme in relation to its support of R&D. We would, therefore, welcome the ability to be able to carry forward surrenderable losses.
- 7.3 A time limit of two years for the carry forward is too restrictive. Many R&D projects last considerably longer than two years and we suggest that a longer time limit is considered. We would suggest aligning with the rules around carry forward of losses on change of ownership and major change in nature/conduct of trade – so in essence surrenderable losses can be carried forward indefinitely, unless and until such time as those rules bite and then they are extinguished.
- 7.4 A carry forward mechanism would necessitate separation of ‘normal’ trading losses from ‘surrenderable’ trade losses which is clearly a new aspect of complexity, but we envisage that most corporation tax software packages would be able to cope with it. We suggest that further thought needs to be given to how any future PAYE and NIC liabilities are allocated. Is the amount of the available cap set first against the carried forward losses or used to ‘frank’ the payable tax credit generated in the current year?
- 7.5 This will obviously be important in determining when a carried forward credit expires – and just how useful any carry forward option will be in practice. We suggest that brought forward credit should be paid before any current period amounts. This will be less important if there is a longer time limit, or the losses can be carried forward potentially indefinitely.
- 8** **Question 6:** *Would carrying forward losses make companies consider taking on more staff in the future - to unlock some (or all) of the rest of their payable tax credit?*
- 8.1 In our view it is most unlikely and unrealistic to suppose that companies would take on more staff, or otherwise contract for more R&D work, to access PAYE and NIC liabilities simply to unlock some (or all) of the carried forward surrenderable losses and claim a payable tax credit. What drives this decision for companies will predominantly be consideration of the ability to be able to fund the staff (and/or, assuming that the PAYE and NIC liabilities are able to be taken into account, the sub-contractors or EPWs), as well as the significant commercial and human resource implications of taking on employees.
- 9** **Question 7:** *The government is interested in the characteristics of companies that could be affected by the cap. For example, if you are or represent a company likely to be affected by the cap, how large is the company*

in terms of employees? How many staff are primarily engaged in R&D activity? How old is the company? What sector does it operate in?

- 9.1 The companies that are going to be adversely affected by this change are the very smallest companies that cannot yet afford to take on employed staff, and, therefore, value the flexibility of subcontractors who can be used for specific projects and time periods. Clearly, these are not the companies this change is aimed at.
- 9.2 As suggested above, if the PAYE and NIC liabilities of subcontractors and EPWs (whether related or not) were able to be taken into account, this would alleviate the impact of the proposed cap for many companies, although it is not wholly satisfactory that these companies would then be reliant on obtaining the information around the PAYE and NIC liabilities of the subcontractors/EPWs and also dependent on how those subcontractors pay their staff.
- 9.3 Another category of start-up businesses which will be affected are those that attract staff by offering equity incentives or EMI options. These employees may form a considerable part of the R&D effort, however their PAYE and NIC liabilities would be relatively low (as EMI options would have no such cost).
- 9.4 For these reasons we would again urge HMRC to set the threshold as high as possible and better focus on the resource and information that is has available to it to counter fraudulent and abusive claims, as discussed in paragraph 10 below.

10 Question 8: *What else could the government consider, regarding how the cap is applied to preventing abuse, to ensure genuine companies can continue access the payable tax credit? Are there any alternative measures that could prevent abuse of the payable tax credit?*

- 10.1 HMRC should consider what steps it can take to identify abusive claims either before payment of the tax credit is made or through a subsequent enquiry process. We would be surprised if HMRC does not have a set of indicators that it can apply to claims in order to identify those that are more likely to be abusive. Alternatively, we suggest that there may be indicators that can be used to identify companies that are more than likely making genuine claims: for example, those backed by venture capital companies or university spin-offs.
- 10.2 We suggest that HMRC should also consider whether better use can be made of the anti-abuse provision in CTA 2009 section 1084, or at least greater consideration given to it.
- 10.3 Tackling the problem from these perspectives will have less of an impact on genuine businesses than a blanket cap on payable tax credits, even if the impact of the cap is mitigated in the ways suggested in the paragraphs above.

11 Acknowledgement of submission

- 11.1 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.

12 The Chartered Institute of Taxation

12.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 18,500 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation

23 May 2019