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PREVENTING THE ABUSE OF THE R&D TAX RELIEF FOR SMES

Response by Association of Taxation Technicians

1 Introduction

- 1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the HM Treasury and HMRC consultation document *Preventing abuse of the R&D tax relief for SMEs* ('the Consultation') issued on 28 March 2019¹.
- 1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.
- 1.3 Our response to each of the questions posed by the Consultation is set out in Section 2 below. We would be pleased to discuss any aspect of this response further and contact details can be found in Section 3.

2 Consultation questions

Q1: 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?

- 2.1 We welcome the proposed introduction of a threshold below which payable tax credit claims would not be subject to the cap. This appears to be a pragmatic approach which will be of benefit to smaller and start-up businesses.
- 2.2 The level at which this threshold is set needs to be considered carefully to ensure that it is high enough to provide a valuable simplification and yet low enough to ensure it excludes abusive practices.
- 2.3 We do not have the appropriate data to carry out a detailed analysis of what an appropriate level might be. We consider the illustrative annual figure of £10,000 used in Annex A of the Consultation to be a reasonable starting point. However, we think that it would be helpful if HMRC could use the data already held on the size and number of historical tax credit claims to establish whether that or any alternative figure is appropriate to meet the aims of the threshold.

¹ https://www.gov.uk/government/consultations/preventing-abuse-of-the-rd-tax-relief-for-smes?utm_source=9dbc01a2-fb69-4ad9-975b-a765db819744&utm_medium=email&utm_campaign=govuk-notifications&utm_content=immediate

Q2: 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?

- 2.4 We agree that measures are required to prevent abuse of the threshold through artificial fragmentation of claims within a group. However, it is unclear from the Consultation exactly how such measures would operate.
- 2.5 The Consultation refers to only allowing one *below the threshold* claim per group per year. We understand this to mean that only one company in a group could ever benefit from the threshold in a given year. For example, if the threshold were set at £10,000 and group company A made a below the threshold claim (i.e. without applying the cap) for £6,000, then other group companies could not benefit from the threshold, even if their claim was under £4,000.
- 2.6 This approach seems unusual, and also potentially unfair as groups are unlikely to be able to benefit from the full threshold unless any one company can make a claim of exactly the threshold limit. It might be more equitable to instead model the threshold on existing corporation tax rules such as those for the Annual Investment Allowance, or the deductions allowance available under the corporate loss restriction rules. Such an approach would see a single threshold amount of, for example, £10,000 available to each group which they can allocate to individual companies as they see fit. To continue the example in the previous paragraph, group company A could make a claim for £6,000 and other group companies claims of up to a further £4,000 in total without applying the cap.
- 2.7 Finally, we note that the Consultation states that “...the government intends to allow only one “below threshold” payable tax credit claim per year for any given group of companies under common control.” We assume that in a situation where one group company makes the permitted below the threshold claim, that a claim by another group company which is below the threshold, but within the cap, would still be allowed in full. This is not immediately obvious in the Consultation, and we would recommend that the point be clarified in the final legislation and accompanying guidance.

Q3: If an element of the PAYE and NICs liabilities of another group or connected company were included as 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 payable tax credit?

- 2.8 We do not have the evidence base to comment on whether such a proposal would deliver any material benefit to companies.
- 2.9 We note that such rules would introduce extra complexity into the cap. However, provided this is an optional extension to the cap (such that it does not have to be considered if deemed too complex or impractical) then this should not cause significant difficulties in practice.

Q4: 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?

- 2.10 We do not have the evidence base to comment on the practicalities of this proposal in any detail.
- 2.11 However, we note that where a company claims R&D relief under the SME scheme in respect of externally provided workers from a connected party staff provider, they are already required to gather certain information from that connected party, including the amount of relevant staff costs they incur. We therefore

would not expect a requirement to also obtain PAYE and NICs information would be particularly problematic provided that employee confidentiality could be appropriately maintained.

- 2.12 As noted at 2.9 above, this proposal would increase the complexity of the cap, but provided that it remains an optional extension this should not be unduly problematic.

Q5: 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?

- 2.13 We believe that the option to carry forward losses to surrender for a tax credit in future periods where there is a sufficient PAYE and NICs liability could be beneficial to some companies. In particular, it could be of benefit to start-up businesses who may begin operations with very few employees (or even just director-shareholders), but then take on further employees as they begin to increase operations and generate revenues.

- 2.14 However, we do not believe that two years is a sufficient time limit for this proposal to be of benefit. It is unlikely that many new businesses will have generated enough revenue from their R&D activities to take on significant numbers of staff within two years. This is especially true in industries such as life sciences, where research projects can last for several years.

- 2.15 We would in fact query whether any time limit at all is needed? It is difficult to see how imposing such a time limit would achieve the stated aim of the cap, which is to prevent abuse of the R&D tax regime for SMEs. We also note that the UK does not currently impose time limits on any other form of utilising carried forward corporation tax losses (except where there is a change in ownership and/or activities). Our preference would therefore be for there to be no limit on the carry forward of losses. However, if one were to be introduced, we would recommend that this be at least five years. Consideration could also be given to allowing for a longer period where a company can demonstrate to HMRC's satisfaction that it could not reasonably be expected to be able to utilise their losses in any other way during this time limit.

- 2.16 We do not believe that companies would face undue burdens in tracking the origin of losses. Companies already have to identify whether losses arose before or after April 2017 for the purposes of the new relaxed carry forward loss rules, and it would not require much further record keeping to identify the year in which losses arise. In practice, we would imagine most companies would include a schedule tracking this information in their corporation tax computations, and merely roll this forward each year. Some consideration would have to be given to the order in which losses are used, and which losses can be surrendered for a credit, though we note that this complication would fall away if, as we suggest in 2.15 above, no time limit were to be imposed for the surrender of such losses.

Q6: 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?

- 2.17 We do not believe that the availability of a future payable tax credit would have a material impact on hiring decisions. The significant administrative burdens and additional costs (both tax and non-tax related) of taking on employees are likely to greatly outweigh any potential benefit received by way of a tax credit. We therefore feel that the future availability of a payable credit would be a helpful benefit for companies, rather than an influencer of hiring behaviour.

Q7: 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?

- 2.18 The companies most likely to be affected by the cap are those which incur losses and have high R&D expenditure but low staff costs. This will include both start-up businesses (who are highly likely to generate losses in the first few years and have few employees) but also more established companies where the majority of work is undertaken by director / shareholders who draw only modest salary from the company.
- 2.19 Those companies which have significant trading activities in addition to R&D are likely to be least affected by the cap. This is on the understanding that the cap will be applied by reference to a company's total PAYE and NICs (not just those amounts relating to R&D staff). Those companies without successful products in the market will be much more likely to see a claim restricted by the cap.
- 2.20 We also note that companies that use self-employed workers to carry out R&D work will be doubly disadvantaged, as they will receive no enhanced deduction for payments made to such workers and no aspect of those payments will count towards the cap.
- 2.21 One area in which we have particular concerns is the interaction of the cap with employee share option schemes. It is fairly common for innovative new businesses to set up schemes such as Enterprise Management Incentive (EMI) schemes to reward key employees. EMI schemes are popular as they allow such businesses to reward employees by granting them share options in the company at a time when it may not be possible to pay them high salaries. The tax efficient nature of EMI schemes means that such companies will have lower PAYE and NICs bills, and may therefore suffer disproportionately under the cap. We would therefore recommend that consideration be given to extending the cap where companies use approved share schemes such as EMI to reward staff. This could include, for example, allowing for notional PAYE or NIC amounts on option awards to be taken into account when calculating the cap.

Q8: What else could the government consider, regarding how the cap is applied to preventing abuse, to ensure genuine companies can continue to access the payable tax credit? Are there any alternative measures that could prevent abuse of the payable tax credit?

- 2.22 We appreciate that there has been an increase in fraudulent and abusive claims for repayable tax credits in recent years, and therefore action needs to be taken. However, we are unsure why HMRC cannot use their existing powers and the large amount of data available to them to spot and address such abuse directly.
- 2.23 If, as is proposed under the cap, UK staff are to be taken as a proxy for UK involvement with R&D, it should be possible for HMRC to use data analytics to identify where companies have made a material claim for a repayable tax credit but have returned limited amounts of tax under Real Time Information (RTI). By comparison, imposing a cap which may affect genuine businesses as well as abusive claims seems to be a disproportionate and unfair way to address this issue.
- 2.24 One way to ensure that genuine companies are not affected by the cap would be to provide for the opportunity to over-ride it where HMRC are satisfied a claim is genuine. For example, if a company submits a claim which is above the threshold and potentially subject to the cap, that claim could be allowed in full where the company is able to submit such supporting evidence as required to demonstrate the *bona fides* of the claim to HMRC. Such a provision would, inevitably, introduce further complexity into the rules (which would need to consider the information required, rights of appeal etc.) but could be useful in ensuring the cap did not impact genuine claims. We would expect the broad gateways of the cap and threshold to work

for the vast majority of companies. This suggested *turnstile* entry to uncapped payable tax credit would only be used in cases where the cap would otherwise result in an inappropriate restriction. A company using this route would in effect be inviting HMRC scrutiny – thereby supporting the aim of preventing abuse.

- 2.25 Finally, we note that the previous cap (which was removed in 2012) was based on the amount of PAYE /NICs *paid* in the year, and not the amounts actually *due* for the year. This could lead to some confusion, as the amounts accrued for a financial year would not be the same as those used for calculating the cap. For example, a company with a December 2010 year-end that paid employees on the 15th of the following month in arrears would have to include amounts accrued from December 2009 (paid in January 2010) to November 2010 (paid in December 2010) when calculating the cap for that year. If this treatment is to be mirrored in the new cap then this point should be brought out clearly in HMRC guidance in order to minimise confusion.

3 Contact details

- 3.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson (erawson@att.org.uk, mobile 07773 087111).

The Association of Taxation Technicians

4 Note

- 4.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 9,000 members and Fellows together with over 6,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.