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PREVENTING ABUSE OF THE R&D TAX RELIEF FOR SMES: SECOND CONSULTATION

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 HMRC consultation document *Preventing abuse of the R&D tax relief for SMEs: second consultation* ('the Consultation') issued on 19 March 2020.¹
- 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 Of the five questions posed by the Consultation, questions 1, 2, 4 and 5 relate to the subcontracting of R&D to related parties and/or the use of externally provided workers by a related party. As we have limited practical experience in these areas, we have restricted our response to addressing question 3, which considers the IP management activities carried out by SMEs and the evidence of these which they may be able to provide.
- 1.4 We would be pleased to discuss any aspect of this response further. Relevant contact details can be found in Section 3.

2 Question 3 – IP management activities and evidence

- 2.1 The consultation proposes that the cap on the repayable credit available under the R&D scheme for SMEs (the 'cap') would not apply where the claimant company can provide proof that they are actively managing the intellectual property (IP) arising from, or expected to arise from, the R&D project. Whilst we welcome the aim of taking genuine SMEs out of the scope of the cap, we have concerns as to how this requirement could be met in practice, especially by the smallest and newest companies.
- 2.2 The focus on IP management activities will require SMEs to consider what are, in essence, transfer pricing principles. It is unlikely that many SMEs will have encountered these before. We note that the Consultation states at paragraph 4.13 that a similar requirement is a feature of the UK's patent box regime, but again the

¹ <https://www.gov.uk/government/consultations/preventing-abuse-of-the-rd-tax-relief-for-smes-second-consultation>

vast majority of SMEs are unlikely to be familiar with that regime. It is therefore important that the operation and practical application of this exemption from the cap is made as straightforward as possible.

- 2.3 Our main concern is that the smallest and newest SMEs (who are most likely to be in need of the support offered by the payable credit) are unlikely to have considered IP management activities in any detail. Even where they have, it is unlikely that these considerations will have been documented in much detail. Paragraph 4.13 gives examples of possible IP management activities, and whilst these may seem reasonable for established or larger companies, it is unlikely that a start-up company which has just started R&D activity, with no certainty of success, would have thought in any detail about deciding whether to grant licenses, or protect the IP in other jurisdictions.
- 2.4 We are pleased to see that the Consultation states at paragraph 4.15 that the Government's aim is to only require information which is already likely to be held by the claimant company. However, we are concerned that the smallest and newest SMEs may struggle to provide some of the examples of evidence of active management of IP suggested in paragraph 4.14 In particular:
- It is unlikely they will have staff whose roles are dedicated to IP management, and contracts and job descriptions for other staff may not go beyond the legal minimum where a company has limited experience or access to external advice.
 - In our experience, board minutes of such companies tend to be fairly minimal and are unlikely to extend to IP management issues. This is particularly the case for companies with only a few directors.
 - Whilst business plans may be produced when applying for bank loans etc., the level of detail on R&D activities or IP is likely to vary depending on how central to the business they are.
 - Where R&D is still in its early stages, or is not proceeding successfully, it is unlikely that any agreements for licensing or exploiting IP will be in place.
- 2.5 We are therefore concerned that the smallest and newest SMEs may struggle to provide the required evidence to qualify for this exemption from the cap.
- 2.6 An alternative to requesting evidence of active IP management could be to require claimants to make a statutory declaration that the company *will* actively manage the IP arising from, or expected to arise from, the R&D project. Companies who make this declaration would then benefit from the exemption from the cap. This could be backed up by powers to allow HMRC to clawback amounts paid where a declaration is made incorrectly, and apply penalties in the case of fraudulent declarations.
- 2.7 In our response² to the first consultation on the cap (issued in March 2019) we noted that, under the cap, UK staff are taken as a proxy for UK involvement with R&D. It should therefore 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). Such a targeted approach to compliance, together with the suggested introduction of a statutory declaration (and associated penalties), could help to reduce fraudulent claims, whilst minimising the impact on genuine businesses.
- 2.8 If the proposal in the Consultation for claimants to provide proof of active IP management in order to be exempt from the cap is adopted, it will be important for HMRC to issue clear and practically focused guidance including for smaller businesses. As noted above, SMEs may be unfamiliar with the concepts and terminology used, and could struggle to provide the required evidence. We would therefore encourage HMRC to take a wide view of what may constitute acceptable evidence, rather than a prescriptive list of documents being included in the legislation or guidance. In particular, the focus should be on the kind of 'proof' which SMEs themselves, or a generalist accountant / tax adviser could produce – claimants should not feel they have to go

² <https://www.att.org.uk/technical/submissions/preventing-abuse-rd-tax-relief-smes-att-response>

to the expense or trouble of consulting an R&D tax specialist in order to qualify for this exemption. Similarly, it would not be a good outcome if the complexity of the exemption pushed claimants towards boutique firms of advisers who set out to claim more relief than is strictly due.

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 on 07392 824718 or erawson@att.org.uk.

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.