

Response to the R&D Tax Reliefs Review: Consultation on a single scheme published 13 January 2023

Catax (including Access2Funding) is a national tax relief and grants specialist with its headquarters in Greater Manchester. We specialise in a number of tax reliefs including R&D tax relief; making a large number of claims a year for clients of various sizes from start-ups to multi-national companies, under both the SME and the RDEC schemes.

We attend HMRC's R&D Communication Forum (formerly RDCC).

This report has been compiled by Nigel Holmes FCA CTA, Director of Tax, with input from key members of our R&D tax teams.

Our views on the matters in the consultation document are as follows:

1. *Do you agree a new scheme should be an above the line RDEC like credit? If not, what alternative would you propose?*

Yes, we agree that a merged scheme should be an above the line RDEC like credit. Whilst the above the line element is of less relevance to many SMEs, it is simpler to have one scheme where the net impact is the same regardless of profit or loss levels, allowing a better understanding of the impact of an R&D tax relief claim at any point. However, we do feel that SMEs should not be disadvantaged any further (following the recent rate reductions to the SME scheme). For example, a pre-trading mechanism that exists in the SME scheme should be introduced for any merged scheme. Ideally, there should still be a rate differential favouring SME companies over larger entities.

2. *Does the taxability and subsequent different post tax net benefits impact your decision making when allocating R&D budgets?*

We are R&D tax advisers. However, we know some of our clients rely on the R&D tax relief system to help fund subsequent R&D and decisions of future spend are made accordingly. In particular, early-stage companies and loss-making entities find the R&D tax relief benefits to be extremely important to continue with the projects.

3. *If you use RDEC now, is there anything in your view that should be changed?*

We are R&D tax advisers, many of our clients claim under RDEC. The obvious change is with regard to subcontractor costs and the PAYE cap which are addressed below.



4. *Do you agree the same treatment of subcontracting should apply to all claimants in the merged scheme?*

Yes

5. *If so, where R&D activity is subcontracted, do you think that the customer should claim the tax relief, as in the SME scheme, or the subcontractor, the person carrying on the R&D, as in the RDEC?*

We are of the opinion that the SME scheme methodology for subcontractor costs is best. This allows the company that is going to exploit the R&D and which takes the financial risk to be the sole claimant. The current SME claimants probably rely on subcontractors more, as they have less in-house resource and, therefore, retaining the SME methodology would make most sense.

6. *Can you see any positive or negative impacts on your business or sector from the Government adopting either approach?*

There would be a negative impact on SME claimants if the RDEC methodology was adopted as stated in 5. above. This could impact their entire plans for innovation and R&D, as companies may be more reluctant to outsource if the relief was not available for subcontractor costs even if this is a better solution to their R&D resource planning.

7. *Do you have an alternative model you think could apply all claimants in the new scheme? Please provide qualitative and quantitative evidence with your proposal.*

We don't have any alternative models but would suggest that at the same time this is being addressed the concept of "subcontracted R&D" and "subsidised R&D" is revisited to align with the original CIRI guidelines and the outcome from the Quinn (London) v HMRC case.

8. *What are your experiences of the PAYE / NICs cap?*

The current SME PAYE cap restricts genuine start up claimants caught by what was supposed to be an anti-abuse measure. Such companies may have little by way of staff costs but have genuine R&D by way of subcontractor costs or consumable items yet lose out by not having the cashflow advantage of the tax credit. The IP exemption is too vague and would be difficult to prove in respect of the likes of "know how". It would be interesting if HMRC would publish some data regarding how many claimants have been impacted by the SME cap and has it researched to see if any of these claims are abusive claims?



We have seen the RDEC PAYE cap apply for SMEs in receipt of grant funding which was, obviously, disappointing for the claimant company.

9. *Are there any ways the Government could simplify the PAYE / NICs cap whilst ensuring there is protection against abuse?*

The SME cap and the overseas activities rule should be merged to have one anti-abuse measure that does not impact genuine claims.

10. *Which of the SME and RDEC PAYE & NICs cap should the Government implement in the new scheme?*

Neither. The SME cap is too complex and the RDEC one too limited.

11. *Should the Government change the way either cap is calculated if it is taken forwards? And if so, how?*

As stated above in 8. it would be interesting to see any data as to the impact the cap has had. Has it just reduced payments of credits to genuine claimants, or has it prevented abuse? If it has prevented abuse then that is great, but at what cost to genuine claimants?

Currently any capped SME benefit is carried forward as losses which may only be offset against trading profits and cannot be surrendered for a cash benefit. By contrast, in the RDEC scheme, such 'Step 3' amounts are added to the following period's RDEC and may be paid out as a cash benefit, subject to that year's PAYE cap, so we favour the latter for any merged scheme.

12. *Do you consider the government should provide more generous support for different types of R&D or more R&D intensive companies relative to less R&D intensive companies?*

We have concerns that picking certain sectors for more generous support is both too political and too open to interpretation. Who decides which sectors deserve more support? What happens if, say, the sector was energy saving and a project saved energy as a by-product of the R&D as opposed to being the main scientific or technological advance? Would that qualify? Scientific and technological developments become outdated quickly. Such a move would bring administrative challenges and could be subject to abuse. Companies tend to undertake R&D regardless, not just to obtain a tax relief.

Therefore, we do not consider sector based more generous support to be a good idea.

However, looking at more R&D intensive companies, then we would be comfortable with such companies, being truly at the cutting edge of their industry's scientific and



technological knowledge, to be worthy of additional support. Such companies could be measured by those in a pre-trade position, those with R&D related grant funding, those with patents or patents pending (thus driving patent box claims too) and those with funding or access to resource from scientific research bodies.

13. In the event this were to be done, how might this best be achieved within an overall cost envelope?

If any steps were taken in respect of 12. above this should not be at the detriment of other claimants.

14. If the schemes are merged do you agree the Government should implement the merged scheme on 'accounting periods starting on or after 1 April 2024?'

Firstly, paragraph 1.36 refers to expenditure from 1 April 2024 whereas 3.36 refers to accounting periods beginning on or after 1 April 2024.

Any merged scheme should be from the start of an accounting period, as a hybrid claim across two schemes will cause administration issue such as tax software being unable to cope, as well as, more worryingly, companies would struggle to estimate their claim as the project progresses.

However, we consider 1 April 2024 to be too soon. There are far too many imminent changes with regard to R&D tax relief against a backdrop of a large upturn of compliance checks being underway. We consider 1 April 2025 to be more reasonable, to allow all the other changes to bed in and HMRC get to grips with the estimated £469m fraud and error in the industry.

15. How can Government ensure SMEs are supported in the transfer into a new scheme?

Similar to how RDEC was phased in alongside the old large company scheme, a transition period of a couple of years to allow an SME to choose which scheme to claim under would be useful.

HMRC should develop a first-time claimant education programme (but not too onerous on the claimant or the adviser such that it results in the claimant being "put off" future claims) and retrain their staff to be more supportive in claims, as they used to be, as opposed to being confrontational (House of Lords report para 179).

More emphasis needs to be placed on the benefits of the scheme as opposed to all the negativity the scheme is receiving around error and fraud.



16. Does claiming for expenditure on qualifying indirect activities influence your decision to undertake R&D?

The activities included in Qualifying Indirect Activities (QIA) are fundamental to the delivery of R&D projects. R&D projects cannot function properly without HR, admin, finance, maintenance etc.

That said, we very much doubt any of our clients would allow such inclusion of costs to drive the decision to undertake R&D.

CIRD83000 implies that only indirect activities undertaken by those directly and actively engaged in R&D activities can be included as QIA whereas BEIS 31 appears to allow any staff undertaking QIA to be included. This requires clarification.

A cap on a maximum QIA claim compared to the total claim (say no more than 20% of total claim) could be introduced if HMRC considers QIA to be an area of abuse.

However, we do not consider that it warrants such detailed scrutiny but HMRC has never confirmed why they are now so interested in QIA costs.

17. Do you think a threshold should be implemented? If one was implemented what at what level should it be introduced?

In theory this is a good idea. R&D activities by their nature are costly and smaller claims could be indicative of a poor understanding of the definition of R&D for tax relief purposes. However, we have numerous concerns:

- Genuine claimants will miss out – an alternative funding source would be beneficial such as easy to obtain grants
- It disproportionately impacts start-ups
- Advisers could spend considerable time with a potential claimant to only discover the threshold is not met
- Companies on the cusp of the threshold could look for ways to inflate their claims
- Thereafter, companies just over the threshold could be more likely to receive a compliance check, adding a further admin burden to genuine claimants

18. What is the average amount of R&D expenditure per year per firm in your business or sector?

The current average amount of R&D expenditure by our clients is circa £250,000.

Finally, as a general comment, with regard to all the proposed changes to R&D tax relief, please be aware that all of the negativity coming from HMRC and HM Treasury around fraud



and error is actually scaring away some legitimate claimants. We have seen first hand some clients with very robust R&D projects being put off claiming due to all the commentary around fraud and error and not enough being done to promote the value of having such a relief.

Catax would be delighted to assist HMRC in discussing any of the above matters further.

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For and on behalf of Catax



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