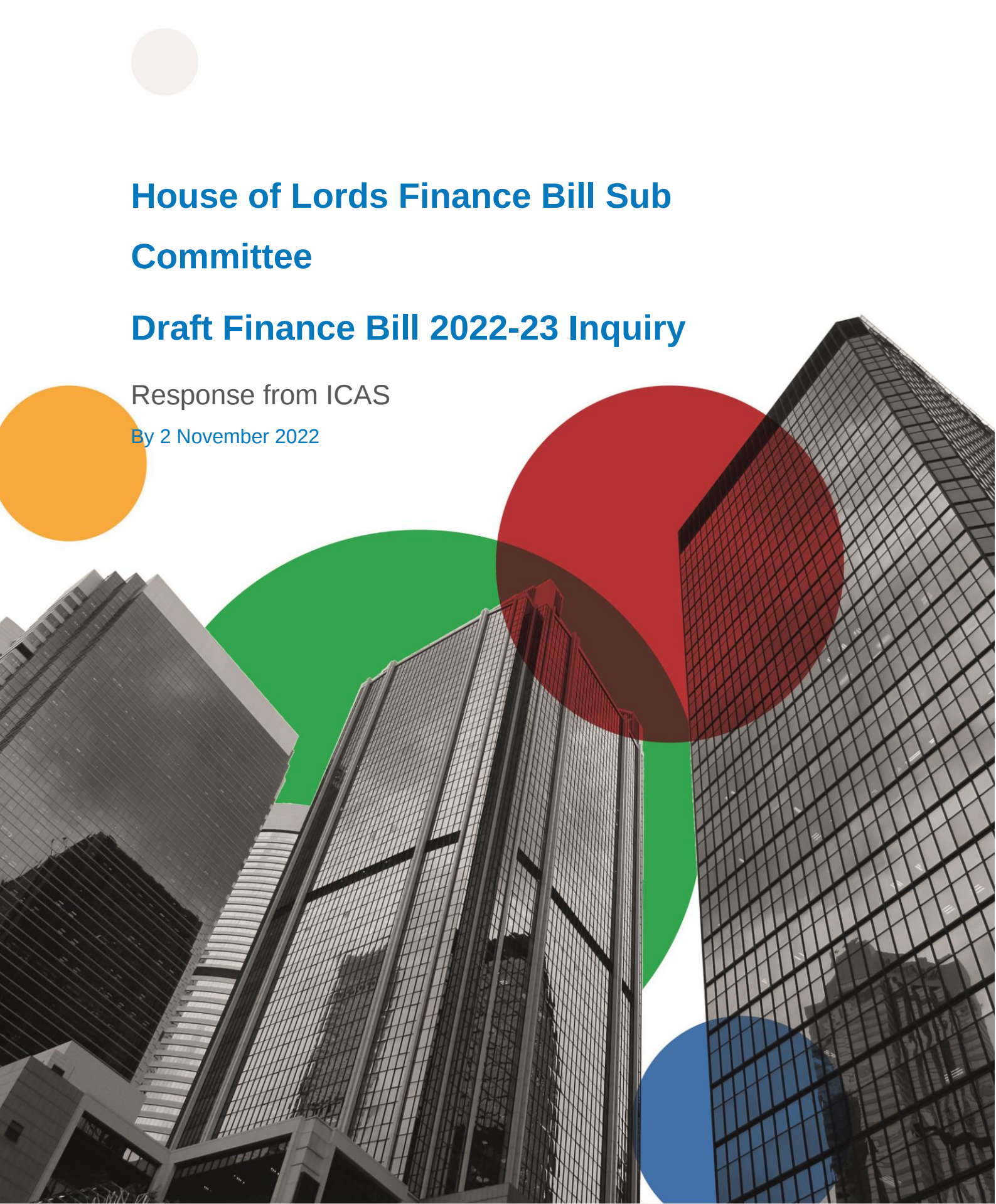




House of Lords Finance Bill Sub Committee

Draft Finance Bill 2022-23 Inquiry

Response from ICAS

By 2 November 2022

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About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 23,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England.
2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.
3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and regulatory system design, and to point out operational practicalities.

General comments

4. ICAS welcomes the opportunity to give evidence to this inquiry into the 'Finance Bill 2022-23', regarding Research and Development measures, which opened in October 2022.
5. ICAS oversees approximately 1,000 practices, firms of chartered accountants, of which 78% are based in Scotland and 21% in England. In general, ICAS firms service the SME market and therefore our evidence is directed towards the SME R&D tax credits scheme and to the situations in which the Research and Development Expenditure Credits (RDEC) scheme applies to SME (e.g. in situations of contract or funded R&D).
6. The objectives of the Finance Bill measures are to:
 - extend the scope of qualifying expenditure;
 - refocus the reliefs towards supporting innovation in the UK; and
 - tackle abuse and improve compliance.

It is the third objective which is of most concern to ICAS and its members.

7. A key concern regarding R&D tax credits and RDEC is around who can give advice and the scope for abuse. In our view, it is an important objective of the reforms that abuse is tackled, and compliance improved. However, whilst most of the new administrative measures are a step in the right direction, there remains scope for poor advice and unscrupulous advisers, because anyone may put themselves forward as an R&D adviser (regardless of qualifications or professional memberships). As has been seen from the R&D claims market, whilst there are many professional agents, working with integrity and specialist knowledge, there are also those agents who may be cavalier, at best, in their approach and who wish to take a percentage of any tax savings. Many of those rogue agents have no background in tax and no tax or accounting qualifications. Often their background and experience is in working in sales, which they deploy in their marketing methods, cold calling companies and persuading them to make claims on a no win, no fee basis.
8. We have extensive feedback from members about the problems caused by some agents offering R&D claims services – generally, these agents are not members of professional bodies. In many cases, the claims do not appear to have any sound basis, or the prescriptive rules have been

ignored. This causes difficulties for members of professional bodies, whose clients are approached by such agents. Historically, many of these claims went unchallenged by HMRC, which caused further problems for members of professional bodies who had warned clients away from making claims. The rogue agents can also cause difficulties for the businesses making the claim, where the agent may have disappeared by the time HMRC challenges the claim or a problem is identified during a due diligence exercise (for example, ahead of a company sale or refinancing).

9. The problems with rogue advice in the R&D market have led to the 7 leading tax professional bodies issuing in June 2020 [Topical guidance covering the application of professional standards to the provision of R&D tax credit services](#). The guidance discusses how the professional bodies' 'Professional Conduct in Relation to Taxation' (PCRT) applies to the making of R&D claims. Our members also report that they find the guidance very helpful to show to their clients when the member has concerns about an R&D claim that seems to be aggressive or without sufficient merit.
10. We have said to HMRC that in relation to its Raising Standards project, R&D would make an excellent case study. In our view, R&D firms (whether claims service or advisory) are giving tax advice – they are advising on the application of the R&D tax relief rules. ICAS believes that they should be members of a professional body and whilst the Finance Bill measure to include the name of the agent on the claim may assist HMRC in its compliance activities, it does not fully address the problem that anyone may give R&D advice.

Specific questions

Question 1: Have the changes to the definition of R&D gone far enough in modernising R&D relief, and if not, what more needs to be included?

11. Our members have not reported significant concerns, or any particular views, regarding the proposed changes to the definition of R&D.
12. Some concerns have been expressed in relation to how some R&D 'specialists' interpret the definition. As noted above, some agents offering R&D claims services adopt an interpretation which is wider than an ICAS member considers to be appropriate. This is not a problem with the definition, as such, but the approach taken by these agents, as outlined above.

Question 2: How effective will the changes be in countering error and fraud resulting from spurious R&D claims and is there more that can be done, or different approaches that could be adopted?

13. The making of digital claims only, unless the company is exempt from the requirement to deliver a company tax return online, is a sensible proposal. We also support the requirement for the claim to include a breakdown of costs, subject to this not being overly onerous and being proportionate to the size and nature of the claim – a 'one size fits all' approach to the reporting requirements is unlikely to be efficient or helpful.
14. We believe it will be a considerable improvement on the current scheme if the claim needs to include details of any agent who has advised the company in compiling the claim although, as discussed above under 'general comments' this will not fully resolve the issue that there are no conditions around qualifications, experience or professional memberships applying to R&D advisers. It should, however, assist HMRC to identify claims that have been prepared by certain agents identified by HMRC as 'high risk' on the basis of previous claims. These can then be subject to additional review before being paid out. It should also help HMRC to identify agents that cause problems. HMRC does not have the resources to check all claims, so it is crucial that information to properly identify and assess questionable claims is available.
15. These measures detailed above should assist HMRC in obtaining information to help it assess the risks attaching to any claim and, hence, target its reviews of claims before making payment. More effective risk analysis by HMRC, and additional review of high risk claims, should help to counter error and fraud.

16. We are less sure about the effectiveness of the proposal that the claim needs to be signed by a senior officer of the company; the R&D claim is part of the corporation tax return, which needs a declaration of completeness and a declaration that it is correct, so there is already a requirement for a director to sign.
17. Our greatest concern is with the proposal that pre-notification is required, as discussed in question 6 below, as this is likely to have unintended consequences for genuine claimants and be counter to the purpose of the R&D tax relief regimes, i.e. rewarding innovation and driving economic growth.
18. We remain of the view that all tax advisers should belong to a professional body and that the provision of R&D tax credit advice is tax advice. ICAS believes that a requirement should be introduced that everyone acting as a tax agent should be qualified, and should belong to one of the main professional bodies that subscribe to, and enforce, PCRT.
19. We continue to receive anecdotal evidence from our members that when claiming R&D relief for companies, unqualified agents can undercut our members. Our members report that they face competition on two fronts: one being the fees that may be charged (as unqualified agents may not have professional fees, CPD costs, or PII) and the other being the quality of the advice provided. It can be difficult to obtain or retain a client if other advisers are cold calling and offering lower fees, claiming that they can achieve greater tax savings, or claiming they can obtain relief that our members think is not legitimately due. For example:
20. *"We are regularly contacted by clients who have been approached by R&D agents who are aggressively selling their services where it looks very unlikely that real R&D is being undertaken. The rise in the number of these types of agent is the biggest risk to the long term viability of the UK's R&D regime in my opinion. For example, we're aware of a number of restaurants being approached to make R&D claims and being told that their competitors are making successful claims. These are small restaurants with a single premises (not big chains), which are simply experimenting with new recipes and menu combinations during downtime in the kitchen. We would not make a claim for companies like these and do not believe they are advancing scientific knowledge and capability or facing scientific/ technological uncertainties within the meanings of the BEIS Guidelines. But there are agents out there targeting them and the assumption is that these claims are going through successfully, presumably due to a lack of scrutiny, perhaps as they are low value. It makes it more difficult for us too, when we tell companies they cannot claim for something, and then other agents successfully submit claims for others in respect of the same ineligible activities. Often these agents are not members of CIOT, ICAS etc and not subject to the same ethical / professional standards. There is nothing stopping someone opening a website tomorrow to claim that they are an R&D tax credits expert and selling contingent fee services."*
21. Members have noted that not only may rogue agents undercut them, but also there is a greater awareness amongst taxpayers that HMRC itself has been operating in a way that has in general reduced the level of checks/enquiries into returns for all taxes, therefore the risk of claims being checked by HMRC has reduced. Combining a rogue agent with a client who is willing to take greater risk (happy to submit a claim on the assumption that there is a much lower chance of HMRC looking at returns/claims) particularly in the current economic climate makes it feel as if professional advisers are being 'jobsworths' and simply protecting their own corner. This perception may change following HMRC's recent crackdown on R&D claims.
22. We have also had examples reported to us where the rogue adviser has amended returns directly without consulting or making the normal Corporate Tax agent aware. This can lead to errors in future years, such as if losses have been surrendered and no longer available for carry forward.
23. The Finance Bill measures do not address the problems that are created by anyone being able to set up as an R&D adviser; nor do they assist professional advisers who are being negatively impacted by the rogue advisers. In this respect the measures will not be effective.

Question 3: How successful is the refocusing of the relief in encouraging activity in the UK without adverse consequences?

24. Our members have not reported significant concerns, or any particular views, regarding the proposed changes to the refocusing of the relief.

Question 4: How aware are smaller businesses of R&D relief? Is there more that HMRC could be doing in practice to help smaller businesses access relief to which they are entitled?

25. Smaller businesses are not always aware of all entitlements, including R&D relief. However, the number of R&D agents cold calling companies has raised the profile and awareness of the relief significantly in recent years. The R&D schemes are complicated and combined with complex tax administration processes (reflecting the complex underlying rules), may deter small businesses from interacting directly with HMRC, including making their own claims for repayment. Tax rules often drive business towards agents.

Question 5: How helpful is HMRC and BEIS guidance in interpreting and applying the R&D relief rules?

26. The HMRC and BEIS guidance covers a broad range of technical issues, but lacks sufficient depth and can therefore be exploited by the so called rogue adviser. There are many grey areas in the R&D tax rules and, in relation to these, HMRC tend to give examples that focus on either end of the spectrum, where it is more black and white, rather than giving more helpful examples to deal with the more challenging areas in between.
27. The HMRC Advance Assurance scheme could be given more publicity to help SMEs.

Question 6: What view do you take of the requirement to give advance notification of R&D claims? What effect would you expect it to have on genuine and spurious R&D claims respectively?

28. We understand that the policy objective behind the requirement to give advance notification is that it will help to clamp down on spurious advisers who are cold calling companies and encouraging them to make retrospective claims for activities that were undertaken in previous years. However, we are concerned that many companies that have undertaken genuine R&D will be inadvertently impacted and could be prevented from claiming relief to which they are entitled. This would be against the overall policy objective of the R&D tax reliefs, which is to drive economic growth by rewarding investment in innovation.
29. The problem arises from the way in which companies claim R&D tax relief in practice. In practice, it is often not until after the end of the accounting period that companies will be aware of the nature and scope of their eligible R&D activities. That will particularly be the case for companies who have not claimed before. The nature of R&D projects is such that it is not always possible to predict whether technological challenges are going to be faced and whether eligible work is going to be undertaken, ahead of those projects developing.
30. It adds an extra requirement for the company to consider in a much shorter time frame. The company will need to decide whether it is likely to wish to make an R&D claim in 6 months rather than 2 years. For many SME companies this will also depend on the active involvement of their advisers to forewarn them that pre-notification is required, and may be prejudicial to the smallest companies that are still in the start-up phase and may be without advisers. We note that the pre-notification is required where no claim has been made in the last 3 years.
31. On the other hand, we hear reports of businesses that will have experienced significant cash flow impacts (and in the worst cases affecting ability to pay salaries and key running costs at a time when bank funding is more costly or less available) as a result of the additional scrutiny in recent months on R & D refunds. This regime could be more palatable if it meant that refund claims were processed more quickly when they are made.

32. For spurious claims, pre-notification may not necessarily make a difference in preventing claims that should not be made. In fact, with any sales orientated R&D agent it may provide extra leverage to push a company into a quick decision (perhaps without due consideration).

Question 7: What is your experience of HMRC's approach to dealing with claims to R&D relief which it suspects to be invalid, either through misunderstanding of the rules, or fraud?

33. One of the issues to date with R&D claims that may prove to be invalid is the time this takes to emerge. For instance, HMRC may not initially question a claim because the amounts claimed by a small start-up company may be relatively small and therefore do not trigger any review process in HMRC. The amount is simply paid out. This may also happen in year 2 even if the next claim is slightly larger. However, at the time, say, the third or later claim is made – and is larger because the company is growing – it may trigger HMRC checks. Once checked, the claim may be questioned and found to be invalid, along with the earlier claims. The process of using self-assessment – claim now and check later – can cause significant delays in finding errors and cause much upset amongst the claimants who, having had previous claims paid out, thought that their claims were compliant.
34. Rogue advisers also argue that claims being accepted is indicative of acceptance by HMRC when this is not the case. Again, it makes the reputable agent's job more difficult.
35. It is also the case that any errors identified within a company's R&D claim impact on potential penalties and a company's overall risk profile with HMRC.

Question 8: Are there lessons the UK could learn from the tax systems of other countries about how to encourage R&D?

36. We have no comments on this question.

Question 9: How successful are the changes in R&D relief likely to be in encouraging innovation and development?

37. In summary, the widening of what may qualify for relief should be helpful. On a practical level increased awareness of R&D amongst SMEs and a consistent and positive experience of dealing with HMRC would also be useful. Administration of R&D claims should support businesses making legitimate claims at the same time as providing information to enable HMRC to target its resources on those claims that pose the greatest risks of fraud. Legitimate claims should be paid out promptly without undue delay, in order to provide support to those businesses undertaking R&D – often these amounts are a vital part of the cash flow in a start-up.
38. We also believe that the policy objectives would be better supported if R&D tax advisers were required (along with other tax advisers) to belong to professional bodies that worked within the Professional Conduct in Relation to Taxation (PCRT) standards. ICAS believes that a requirement should be introduced that everyone acting as a tax agent should be qualified, and should belong to one of the main professional bodies that subscribe to, and enforce, PCRT.

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