

IFA REPRESENTATION 3/19



HM Treasury and HM Revenue & Customs: Preventing abuse of the R & D tax relief for SMEs

The IFA welcomes the opportunity to comment on HM Treasury's and HM Revenue & Customs consultation on the Preventing abuse of the R & D tax relief for SMEs issued on 28 March 2019.

We would be happy to discuss any aspect of our comments and to take part in all further consultations in this area.

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General comments

1. The IFA welcomes the government's consultation on how the cap will be applied on R & D tax reliefs so as to minimise the impact on genuine businesses. HMRC's latest R & D tax credit statistics reasserts the value of tax credits for innovative SMEs. According to HMRC's own statistics, there is a growing awareness and uptake of the R & D tax credit incentives and the average value per claim continues to rise.
2. As a professional body representing SMEs, the IFA has been working with our partner Catax to increase awareness of R & D tax reliefs for SMEs. We are concerned that the implementation of a proposed cap based on a company's total PAYE and NICs liability in any one year is likely to disadvantage genuine firms, particularly start-ups which may be reliant on sub-contractors. It does seem counter-intuitive that the proposed cap does not include costs associated with sub-contractors, given that R & D qualifying expenditure for R & D tax credit claims includes subcontractors and freelancer costs.
3. We are also concerned that the government is introducing a cap on R & D tax reliefs as a reaction to a few businesses making fraudulent R & D tax claims. Such a cap has the potential to affect genuine businesses and may not be an effective and efficient mechanism to prevent dishonest claims from being made. In other words, the actions of a few are likely to have detrimental effects for genuine SMEs. Tackling potential fraudulent claims by strengthening HMRC's compliance, investigations and prosecution departments may be a better solution to the alleged problem.

Specific questions

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?

4. Based on data from our partner Catax and that of other R & D specialist firms, the average claim for the SME market is anywhere between £40,000 and £60,000. These numbers are also supported by HMRC's own statistics referred to above.
5. A threshold of £75,000 would ensure that genuine innovative SMEs are not adversely affected while at the time deterring fraudulent claims. This threshold should be per company claim, per accounting period and should be reviewed on a yearly basis taking into account factors such as the average value of claims and inflation. Furthermore, the effectiveness and impact of implementing a cap on R & D tax reliefs should be reviewed and evaluated within 3 years to ensure it is fit for purpose and deters fraudulent claims.

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 in 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?

6. In principle, the IFA would support allowing one company in a group or under common control to submit a tax credit claim. However, the government must consider how changes in ownership in the group will affect R & D claims. For example, if the claimant company is no

longer under common control of the group or no longer part of the group part way through an accounting period, transition guidance will need to be drafted to clarify the position for the claimant company in the old and new group.

Question 3: 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?

7. While this may increase the administrative burden for companies, the financial benefits for genuine SMEs claims for R & D tax credits would outweigh burdens. We suggest that this threshold level should be £75,000 as detailed in our response to Q1.

Question 4: Would it be practical for claimant companies to obtain the PAYE and NICs information for other group or connected companies? Are there any limitations to their doing so? Would the other company be willing to provide this information?

8. Yes, it would be practical for claimant companies to obtain the PAYE and NICs information from other group or connected companies since most SME group companies will have the same systems infrastructure, payroll team and/or external accountant. Therefore, obtaining this information should be straight forward.

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 straight forward would it be to keep track of the origin year of the losses?

9. Administratively, this proposal would be difficult to implement since it involves keeping detailed records by the company and/or adviser of the origin year of the loss. It is not clear to us that the administrative burden of this proposal outweighs the R & D tax credit benefits.

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 the payable credit?

10. Carrying forward losses may stimulate additional expenditure by SMEs because the R & D tax credit benefit could be used for hiring new staff, investing in infrastructure and/or new premises. However, it cannot be assumed that carried forward losses would lead SMEs to take on more staff to unlock tax credits. The business case for recruiting staff for SMEs will be made on commercial need not to unlock R & D tax credit.

Question 7: The government is interested in the characteristics of companies that could be affected by the cap. For example, if you are or you 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?

11. Companies with fewer than 500 employees, annual turnover under €100million, or a balance sheet total under £ 86 million, are eligible for the R&D tax credit scheme for SMEs. SME R&D relief allows companies to claim a tax credit if the company is loss making, worth up to 14.5% of the surrenderable loss.

12. Given this context, the companies that are most likely to be affected by the cap are new start-ups which have been operational for less than 3 years. These types of start-ups are likely to be owner-managed and have sub-contractors rather than employees. Furthermore, the new start-ups may have low PAYE and NICs liabilities because the owners may not draw a salary due to limited funds.

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?

13. The Corporation Tax Act 2009, Part 13 Chapter 6, s1084 already gives the necessary powers to HMRC to prevent artificially inflated claims for R&D tax relief. This should be sufficient and there should be no need for a cap.
14. Setting of a threshold which takes into account the average claim of R & D tax credits, inflation and is regularly reviewed for its effectiveness will significantly contribute to reduce the number of genuine SME tax credits are caught by the cap.
15. We are concerned that additional HMRC compliance checks relating to the cap may slow down the speed that R & D tax payments are made, significantly affecting SME sources of finance, particularly start-ups in the first 3 years of operation.
16. Other more targeted measures that could prevent abuse of the payable tax credit include adequately resourcing HMRC to target, investigate and prosecute companies and/or their advisers creating artificial structures and/or submitting claims to fraudulently benefit from R & D tax credits.

Contact details

Should you wish to discuss our responses further, please contact Anne Davis by email at anned@ifa.org.uk