R&D Claims – the Ongoing Impact of HMRC's New Approach

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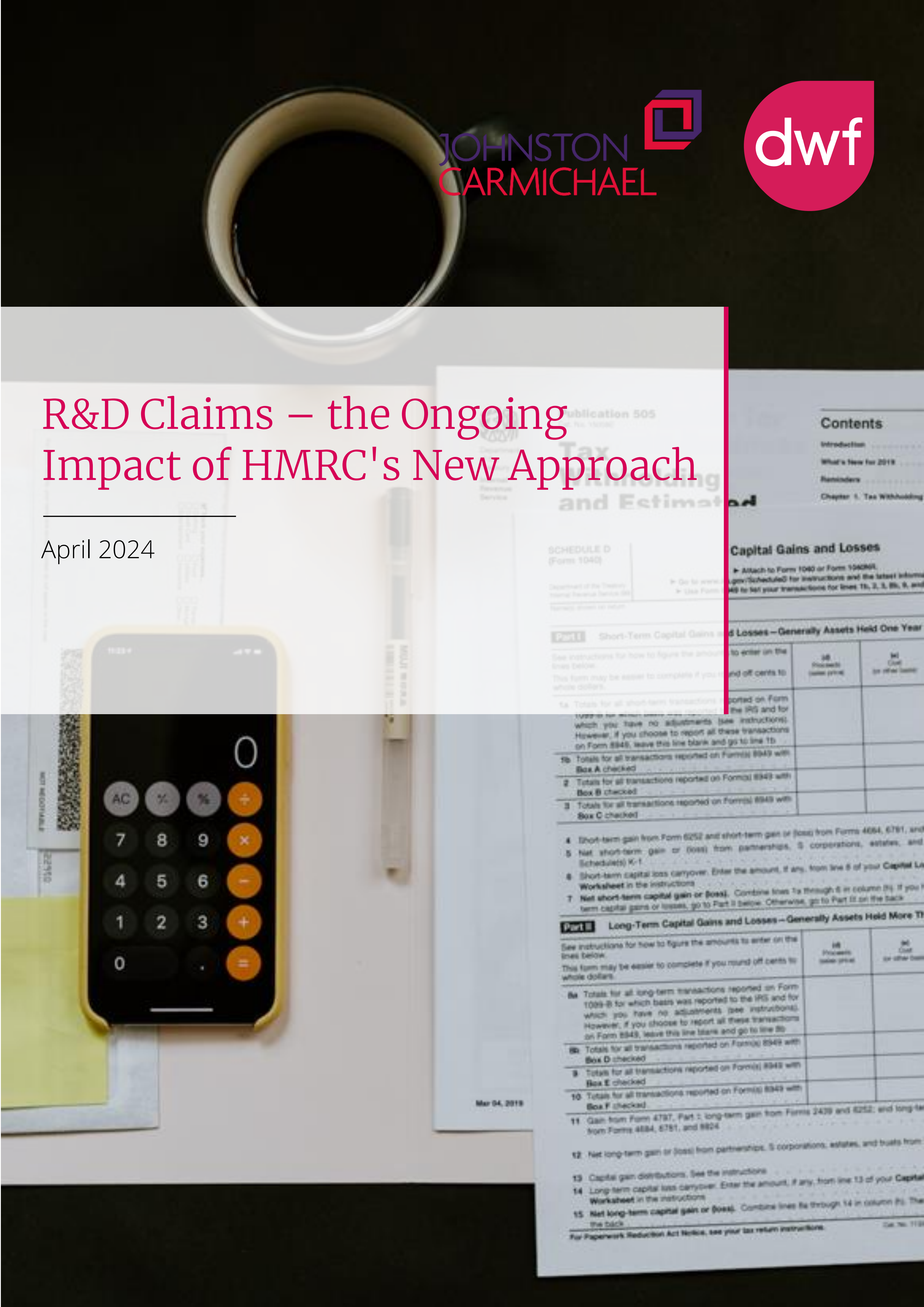


R&D Claims – the Ongoing Impact of HMRC's New Approach

In collaboration with Johnston Carmichael, Scotland's largest independent accountancy firm, DWF's Corporate Tax and Corporate experts discuss the impact of HMRC's new R&D approach on R&D claims and corporate transactions.

The research and development ("R&D") tax relief system is designed to encourage investment in innovation and drive economic growth. From April 2024, a new single merged R&D scheme will come into force for most businesses. Both the existing and new schemes allow eligible companies to claim tax relief either by way of a reduction to corporation tax that would otherwise be due or, in certain circumstances, via a cash payment.

Historically, most claims for R&D relief were paid out with little scrutiny by HMRC. This led to a perception that the risk involved in submitting an R&D claim was low and a 'cottage industry' of R&D claim firms developed, with large sales teams cold calling companies and encouraging them to submit claims, often on tenuous grounds. Professional firms and industry bodies highlighted the problem with HMRC, and attempts were made to raise awareness and warn clients, but the situation has continued for many years.

More recently, HMRC has become aware that levels of error and fraud within R&D claims was much higher than they had estimated. As a result, over the past two years, HMRC has introduced a series of compliance changes to identify potentially inaccurate or fraudulent claims and to target its enquiry resource accordingly. Although there is now evidence that the information being gathered is allowing HMRC to target high risk claims and/or agents, there is also concern that HMRC's new enquiry approach is resulting in many legitimate claims being rejected.

HMRC's new approach

HMRC has adopted a "volume compliance" approach to assessing R&D claims, meaning that there is now more chance than ever of HMRC enquiring into claims. Due to the scale of the volume compliance project and HMRC's resourcing problems, different teams within HMRC are now reviewing R&D claims. Historically, the Wealthy and Mid-sized Business Compliance team have been closely involved in R&D claim reviews and have built up expertise in this specialist area. However, to allow for the volume of enquiries, HMRC has engaged a large number of staff from the Individuals and Small Business Compliance team, who have limited experience in dealing with R&D claims and the training being put in place has not yet resulted in the level of knowledge and capability required. The result is that many genuine claimants are finding it extremely challenging to resolve enquiries into their R&D claims.

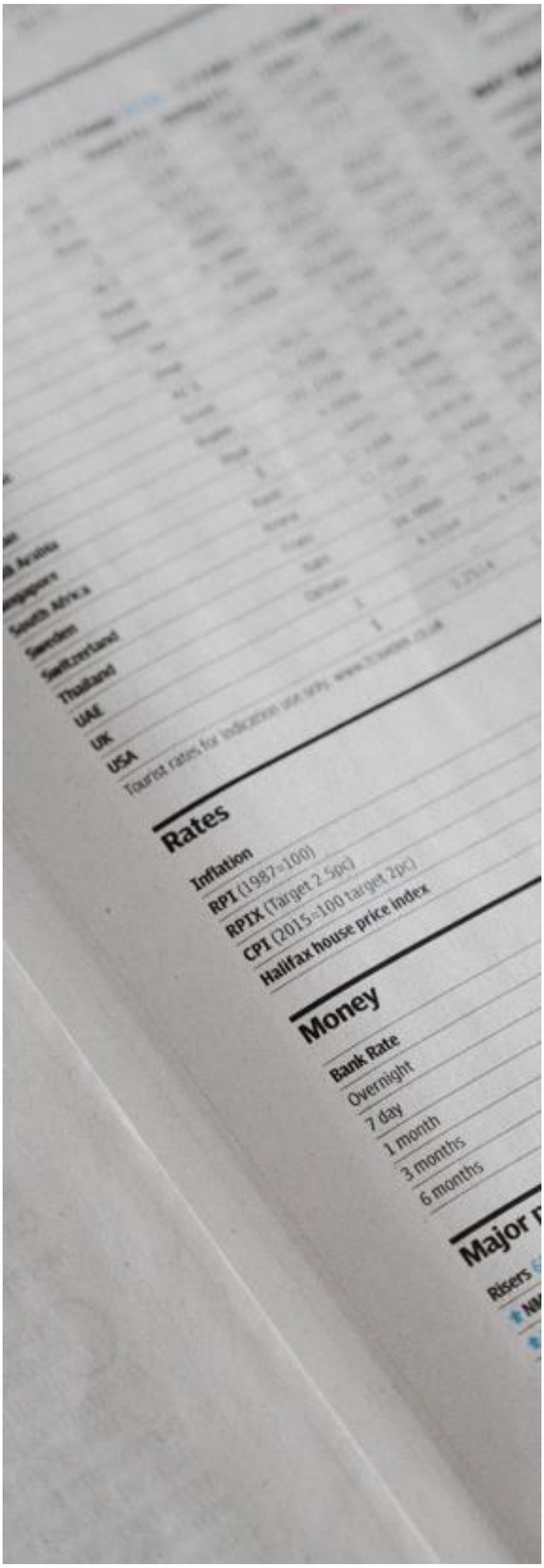
Impact on R&D claims

The concern with the volume compliance approach is that, although it may help in preventing fraudulent claims, it is also impacting many valid claims and discouraging companies from claiming in the future. It has also led to a huge backlog within HMRC in both processing initial claims and dealing with rejected claims. This volume compliance approach has been heavily criticised by many professional advisors and professional bodies, including the CIOT, ICAS and ICAEW.

The process for making an R&D claim has also become more protracted. HMRC has introduced a new online R&D claim submission portal and an Additional Information Form ("AIF") must be submitted using this portal. The AIF requires supporting information to be provided, including technical narratives for specific projects.

As a result of the additional requirements to submit an R&D claim and the increased risk of HMRC enquiring into a claim (sometimes after HMRC has paid out the relief claimed), many R&D claimants will incur greater costs; not only professional advisor fees but also management time in gathering information requested by HMRC in an enquiry. Unfortunately, the information requested in enquiry letters often includes the information that has has already been supplied (for example in the AIF) but appears not to have been reviewed or considered as part of what can appear to be relatively standard enquiry templates.

HMRC's compliance changes will not immediately improve the R&D claims advisory market and so it is important for claimants to consider carefully who they engage to assist them with their claims. It may surprise many that a lack of regulation means that anyone can set themselves up as a tax advisor, regardless of qualifications or experience. Companies should engage with tax advisors who are appropriately qualified and experienced, likely members of a relevant professional body, with reputable R&D and corporation tax specialists that understand the risk profile of R&D claims and who can help deal with, and even pre-empt, HMRC enquiries. Not only will this save claimants' time and money, it will ensure they maintain a good reputation and clean tax record with HMRC.



Impact on transactions

HMRC's new approach is also having an impact on corporate transactions where the target company in question has made R&D claims. Buyers are carrying out increased due diligence on the R&D risk profile of target companies and, if material risks are identified, are often looking for price retentions or even price adjustments to reflect the risk to value.

If either party to a transaction is looking to take out Warranty & Indemnity ("W&I") insurance, R&D risks are still potentially coverable by the W&I policy. However, insurers are more cautious of providing cover given HMRC's new approach and good reporting of R&D claims will be key if cover is to be obtained.

If, in carrying out its due diligence on a target company, a buyer uncovers concerns relating to R&D claims, this risk is likely to be excluded from cover under the policy as a "known risk". A buyer is likely to still want cover for the risk and so a specialist standalone tax policy may need to be sought (leading to increased costs for the buyer). If that cannot be obtained then an indemnity from the seller, a price adjustment or a price retention will likely be on the table.

Dealing with R&D enquiries

Many companies are finding themselves, after an exchage of letters, in a deadlock with HMRC, where they are unable to agree the eligibility of their claim, unable to engage in a discussion with anyone via a call or meeting and there is no clear escalation route.

There are several options that can be considered, including alternative dispute resolution, making a formal complaint to the Adjudicator's Office and requesting an internal review, requesting a closure notice to allow a formal appeal, requesting a statutory review and/or ultimately taking an appeal to the tax tribunal. With all of these, there are strategic decisions to be made, timing and cost implications to be considered and it's important to get advice to navigate through to a resolution in the most efficient way.

Where does that leave us

HMRC is aware that its approach is being criticised and has committed to further caseworker training and improving responses to claims. However, it is not expected that HMRC's approach will change soon.

It is therefore extremely important for claimants to engage qualified, experienced R&D tax advisors. If you are approached by an R&D firm, use Linkedin to check the background and qualifications of the individuals you are introduced to. Do they have relevant qualifications or experience or do they have a "sales" background. It is also fair to question the motivations of the advisor. Do they have a wider business relationship with you or are they seeking a standalone engagement to work on the R&D claim on a contingent fee basis, which might incentivise them to push the boundaries in preparing the claim. An HMRC enquiry could result in interest, penalties and other reputational consequences. Additionally, if claimants are looking to sell their businesses in the future, R&D compliance is even more important as a potential buyer is unlikely to take the risk on R&D unless claims have been dealt with appropriately.

In Summary

Understanding your corporate tax obligations and the potential industry changes can be overwhelming. Our Corporate Tax team can support your needs now and in the future. We do this by keeping ahead of developments in the market to ensure you and your business are well equipped, resilient and as risk free as possible.

We work alongside your corporate deal team to help cut through the complexities, advise on ways to mitigate personal and business risk and offer innovative and tax-efficient solutions to meet your business needs

We can help you to navigate the complexity of the UK tax rules, seek any necessary advance assurance or approval from HM Revenue and Customs, consider the impact of amendments to articles of association, share rights, management/employee incentive arrangements or investment agreements.

We would like to thank Andrew McMillan and David Ward at Johnston Carmichael for their contributions to this valuable insight

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