HOUSE OF LORDS

Economic Affairs Committee

Finance Bill Sub-Committee

Corrected oral evidence: Draft Finance Bill 2022-23

Monday 31 October 2022

4.50 pm

Watch the meeting

Members present: Lord Leigh of Hurley (The Chair); Viscount Chandos; Baroness Noakes; Lord Monks; Lord Palmer of Childs Hill; Lord Turnbull.

Evidence Session No. 2 Heard in Public Questions 11 - 20

Witnesses

I: Jason Piper, Head of Tax and Business Law, Association of Chartered Certified Accountants; Emma Rawson, Technical Officer, Association of Taxation Technicians; Adam Harper, Director of Professional Standards and Policy, Association of Accounting Technicians.

Examination of witnesses

Jason Piper, Emma Rawson and Adam Harper.

Q11 **The Chair:** Welcome to our witnesses for the second part of the first oral evidence session of the Finance Bill Sub-Committee on the draft Finance Bill research and development tax relief proposals. I invite the witnesses in front of us to introduce themselves, please.

Adam Harper: I am the director of professional standards and policy at the Association of Accounting Technicians.

Emma Rawson: I am a technical officer at the Association of Taxation Technicians, with a focus on business taxation.

Jason Piper: I am the head of tax and business law in the policy and insights team at ACCA.

Q12 **The Chair:** Great. Thank you very much. I will start the questions. In your experience, how aware are smaller businesses of R&D relief, and is there more that HMRC could be doing to raise awareness of R&D relief, particularly among smaller companies?

Emma Rawson: It is fair to say that it is a bit of a mixed bag when it comes to small companies. Those with agents or tax advisers in place will be generally fairly familiar with the rules. Smaller and newer businesses might not. That is because there is a bit of a lack of understanding of what is meant by R&D—it is a very broad definition for tax purposes—and there is a perception that it is all about white lab coats and test tubes, when that is not the case. There is a lot of R&D going on that does not look like what the layman might think of as R&D. There is a range of understanding of what R&D is. Those with advisers are more likely to understand it.

We would certainly support HMRC doing more to raise awareness, not just of the fact that there is R&D tax relief, but if businesses understand more about what is and is not R&D, and what the relief is targeting, it might help them not to fall into the clutches of some of the more unscrupulous agents that you talked about in the first session.

Adam Harper: I am happy to add to that. We similarly agree that it is an improving scenario but that there are still potentially insufficient levels of awareness among SMEs, and that has manifested particularly in insufficient understanding about the complexity relating to those reliefs. One of the things that we would encourage HMRC to do is to provide clearer guidance and potentially look to align that guidance from the point of view of the interpretation that will be adopted by the tax agents and the compliance workers who are reviewing them, making sure that there is a greater level of alignment.

At the risk of sounding a bit like a stuck record on a topic that surfaced in the previous session, we would also suggest that the work being undertaken around regulation of the tax agent market is an area that would help to improve that. AAT contends that the risks represented by the current lack of regulation are manifested in HMRC's own figures, which state that two-thirds of the instances of non-compliance, errors and so on, are down to the one-third of tax agents who are not regulated. Obviously, that still implies that one-third of errors come from the regulated tax advisory market, but when you take into account the proportion of those who are unregulated, we would contend that more can be done by way of the ongoing work on the regulation of the tax advisory market that could help improve the situation from the point of view of awareness among SMEs.

Jason Piper: I have very little to add other than one specific point on HMRC's awareness and publicity. If you look on the HMRC website, the first thing it does is dive into a detailed description of what R&D is, whereas most of the private sector advisers start off with who can claim, which is a far more business-focused way of looking at it and raising awareness quickly.

Q13 **Lord Turnbull:** Has the definition of R&D that is eligible for claim been constant over the last five or six years? Has there been mission creep such that people are now claiming for certain things that five years ago, by and large, they were not claiming for, or are we seeing a genuine increase in R&D as it was defined at the start of the scheme?

Emma Rawson: The core definition has not changed. Certainly, the legislative definition has not changed. We have seen tightening from HMRC around certain areas, but there has been no widening—particularly of what qualifies as R&D. The issue is that you cannot have a prescriptive definition of what R&D is; because of the wide range of activities being undertaken, it has to be fairly flexible, especially with the pace of change that we see. We are seeing a lot of boundary pushing that is not necessarily coming from any change in the definition, but people pushing at what that definition might extend to cover.

Lord Turnbull: Can you give me an example of what boundary pushing might look like?

Emma Rawson: A claim that where you are having to look into how to do something for your business makes it R&D when it is not getting to the heart of resolving any technological or scientific uncertainty. Somebody might have had to do some work looking at how they can fit a bike rack into their car park, and they are told that, because they had to do a little bit of study into how that would work, it is R&D. It is not, because it is not achieving an advance in anybody's knowledge; it is just specific to that business.

Lord Turnbull: It does not sound like a happy scene to me. It is a very elastic definition. As someone puts in a claim of that kind, it immediately becomes, effectively, the new definition, and anyone else can then draw on it in order to make their own claim.

Emma Rawson: The definition has to be relatively elastic just because you can never have a comprehensive legislative definition of what is R&D and what is not; you would have to change it every year anyway as technologies change and improve. There is a little bit of a feel of, "We have put in so many claims for this already and had them accepted". That is used in marketing by some agents, admittedly. I do not know if it is changing the definition so much as the view of what people can get away with.

Lord Turnbull: If someone decided to reconfigure their office space, would that count as R&D?

Emma Rawson: Not necessarily in my view, not without being able to go into the technicalities of it.

Lord Turnbull: You have heard my scepticism before.

Q14 **Lord Palmer of Childs Hill:** My question is about the quality of guidance available from HMRC and BEIS on the relief and how helpful it is to you and your members. The comment was made that there could be clearer guidance. Could you elaborate on that? Is that guidance from HMRC asking the poacher to advise the gamekeeper, or vice versa? HMRC wants to get in as much tax as possible that is legally due. Does it adequately advise people, effectively, to reduce their tax bill? Is its guidance neutral?

Adam Harper: You work from the assumption that there should not be variance in what HMRC is looking for and what the regulated agents are committed to through their commitment to professional conduct in relation to taxation. Ultimately, it is about ensuring that businesses pay the right amount of tax at the right time. If we are working to that principle, it talks back to the point I made earlier in relation to HMRC's guidance, in that if there is a greater consistency in what is being driven from the point of view of guidance for agents and that it is being equally understood from the point of view of those who will be assessing the claims coming through, there will be an improvement.

In general, our perception of the current guidance is that HMRC's guidance is not sufficiently clear. We have had feedback to suggest that that in and of itself is likely to be a contributory factor to small businesses making errors. The guidance seems to be, at one end, too complex and, at the other end too brief, particularly if you look at the guidance document on making R&D easier for smaller companies. There is scope for improvement.

The guidance produced by BEIS is a little out of date; for example, one of the things that we have had fed through to us is that in the guidance there is reference to the development of DVD players. They were made available in the last century, so that is hardly up to date at this point, we would contend. At the very least, updating the examples would be a good place to start. In that respect, it would help with regard to the application of the definition, which would be another area of improvement.

Jason Piper: The evidence we have had from members is that elements of the base guidance are very useful and easy to interpret, but other areas are far more ambiguous. That particularly causes issues when HMRC is interpreting the guidance. For example, the guidance document on software is felt to be particularly ambiguous. Some offices have had no interaction with it and are therefore coming to it fresh, in effect, and they inevitably come up with a potentially different subjective interpretation from another HMRC office. That inconsistency can cause issues for agents, let alone taxpayers.

Lord Palmer of Childs Hill: Is part of the problem HMRC's lack of technical knowledge, or do you think there is the technical knowledge in HMRC of what really is research and development?

Jason Piper: That will very much depend on the individuals the taxpayer is interacting with in a particular case. There will be a spectrum of knowledge in HMRC. I cannot give you firm evidence one way or the other, but certainly, the increasing importance of software, for example, in the design and development of what we traditionally thought of as hardware, is becoming a far more contentious area. It is becoming far more important to businesses as they try to develop software licensing models as part of their ongoing revenue stream.

Q15 **Baroness Noakes:** Shifting to the claims processes, one of the changes is that the claims are to be made digitally in future. What do you see as the advantages and disadvantages of that? Can you see other ways in which the claims process can be made more modern and, at the same time, effective?

Adam Harper: In general terms, the shift towards digital engagement has to be recognised as something that is prevalent across much of our current day-to-day and business world. Similarly, if you take into account HMRC's more general commitment to modernisation, it is logical that the digital modernisation programme would extend to include this. Beyond that, we have had nothing by way of feedback from our members to suggest additional measures to modernise claiming R&D relief.

Emma Rawson: I agree with that. Businesses and their advisers are now very much accustomed to filing things digitally, so we do not see that causing any particular upset for those claiming or those advising them. It should, hopefully, do something to help streamline the processing behind the scenes within HMRC.

Jason Piper: The final thing to add is that, in theory, once HMRC is getting all the claims digitally, it should be easier for it to analyse and compare them, but as was raised in the previous panel, there is the issue of whether it has the resource and will actually to do that. All the businesses claiming have been filing their corporation tax returns on iXBRL for some years, and we have found evidence in one pilot scheme with Companies House that identified £14 million of fraud. Otherwise, I do not believe we have had any examples from HMRC of the benefit that it has had from that.

Baroness Noakes: This is just part and parcel of HMRC's processes becoming more and more digital; nothing special about it.

Adam Harper: It is currently the case that 85% of the processes are that way, so, yes, that is very much how we see it.

Q16 **Lord Monks:** HMRC has the idea of pre-notification of claims, and I am interested to know your view of this new requirement.

Emma Rawson: We have quite serious concerns about that measure. We do not think that it will do much to tackle abuse or errors. On the other hand, it is putting an extra hurdle in the way, and we think that will impact some genuine claimants. For example, the minority of agents who are pushing for inappropriate claims using high-pressured sales techniques will just factor it into their business processes. We do not think that it will be enough to put them off. You might see claims being put in earlier rather than not at all.

On the other hand, the smaller and newer businesses that really need support in the early days from R&D relief are the most likely to miss out. We are talking about six months after the end of the accounting period, before they will have finalised their accounts or started preparing their corporation tax return. They may not realise by that time that they are doing activities that constitute R&D and therefore have a legitimate claim. It seems to us slightly unfair that a business that is genuinely carrying out R&D and has genuine qualifying expenditure is excluded from claiming relief because it fails to meet this arbitrary six-month deadline. There is already a two-year time limit on claims; this is just additional. It feels as though we are introducing more hurdles for genuine claimants without getting to the root cause and tackling the abuse.

Adam Harper: I have absolutely nothing to add to that very comprehensive answer from Emma.

Jason Piper: It all sounds very familiar, from everything we have heard from our members.

Lord Monks: What will HMRC do with the pre-notification? Obviously, it cannot be the same as the actual notification; I would not have thought it could be quite as extensive in the information required and so on. Will HMRC rule you out? How will it work?

Emma Rawson: It has not yet been confirmed exactly what information will be needed in the pre-notification, but our understanding is that it will not be anywhere near as much information as you put in the claim. It may simply be a declaration that you intend to claim. They are really trying to get at people who come to businesses near the two-year deadline for claiming and say, "Oh look, you've got two years' worth here. You could claim", and they go back and put in claims. They are trying to get to the high-pressured sales agents who do that kind of work, but, to my mind, you are just moving the goalposts a little, and they will just be making sure that they can get into the pre-notification deadlines as well.

Q17 **Viscount Chandos:** If pre-notification was high on the list of HMRC's proposed changes to improve compliance, it sounds as though you are all pretty sceptical about that, so how do you feel about other measures that could be introduced to tackle the level of abuse you heard us express concern about in the earlier panel?

Adam Harper: Clearly, as a representative body, we welcome any and all measures that HMRC looks to implement that would genuinely address the issues around spurious claims being made. Certainly, we recognise that the other measures identified are likely to enhance HMRC's ability to target its compliance activities. Our assessment is that there perhaps needs to be greater clarity about how each of those measures will specifically reduce erroneous claims; we are not sure that they would necessarily deliver that.

Emma Rawson: We at ATT agree with that. Measures such as naming the adviser associated with the claim and providing more information should not massively inconvenience genuine claimants, and if HMRC makes full use of that information it could be very helpful to it in risk profiling. We would like to see it go a little beyond that to try to target the problem areas, which to our mind are the minority of advisers pushing people into making inappropriate claims or marketing for them. In the past, we have suggested having some way for regular tax advisers—people such as our members—to report when they come across clients being sold that by a firm or see promotional material that they think is not quite right. There should be somewhere they can go to take those concerns, to tip off HMRC.

Jason Piper: Many of our members advise overseas as well, because, obviously, research and development is an international enterprise these days. They have given the example of a couple of overseas tax authorities, in the Netherlands and France, where they operate a sort of voluntary pre-approval process under which the taxpayer claimant firm can go to the authorities, set out what they are doing and get pre-approval, in the case of the Netherlands Enterprise Agency, if they qualify for the wage tax incentive. Similarly, the French Government allow companies to make a request up to six months before the claim is submitted for pre-approval of the activities to ensure that they apply the rules correctly.

Viscount Chandos: That would be a parallel of what in this country is done for the EIS—is that right?

Jason Piper: Yes, there is already the advanced assurance programme in the UK. It is not very well known or understood, and the problem is that you can engage with it only once, so it does not help a lot for repeat claims and so on. The big benefit to having a pre-assurance programme that operates effectively is that if a taxpayer has engaged with it in good faith—HMRC should be able to assess that—it takes them out of the bucket of a potentially fraudulent claim. Early, genuine engagement between taxpayer and tax authority enables the tax authority to understand better what a good claim looks like and give the taxpayer more confidence that they will get their claim.

Viscount Chandos: The distinction is that it would be voluntary, whereas pre-notification is proposed as being compulsory for you.

Jason Piper: Yes. Obviously, as an assurance programme it would probably involve more information coming across than the notification does.

Baroness Noakes: Ms Rawson, you talked about members reporting to HMRC activities of agents that did not look quite right, or something. Are there any barriers to that happening at the moment?

Emma Rawson: It happens informally already. For example, when a member comes to me and says, "I've seen this article from a firm that looks a bit suspect", or, "One of my clients received this through the post or had a phone call telling them they can claim for this", I have used HMRC contacts that I have through my work to forward it to HMRC. It is happening informally, but there is no formal process for everybody else.

Baroness Noakes: Have you discussed with HMRC whether that should be made more of a formal process?

Emma Rawson: We have suggested it, but we have not had any response.

Q18 **The Chair:** It is clear that spurious claims will lead to a loss of tax for the Exchequer. Have you any experience of actions of agents making spurious claims or, on a wider basis, having an impact on your members, particularly your clients?

Emma Rawson: Yes. It puts our members in a difficult position. They have a set of rules and professional standards that they abide by, and there are agents who do not have those. For them, it sometimes feels a bit like they are doing everything right but there is still a problem that is not being addressed. It also makes for difficult discussions with clients if they have engaged an R&D specialist who has prepared an inappropriate claim. If one of our members is then asked to reflect it in the company's tax return, they have to talk to them about it.

The regular agents often act as a sort of second line of defence, because they will know the clients inside out and sometimes they will be able to tell that the R&D claim being put forward does not reflect reality. It puts them in difficult positions with clients, having to have that discussion, to tell them why they cannot reflect it and even, if pushed far enough, no longer to work with that client, because they think it is an unsubstantiated claim.

There are clients who come to members and say, "Why didn't you tell me I could claim?" The answer might quite honestly be, "You can't. You're not eligible", but they will have been told by somebody else that they can, or they know somebody who works in a similar field who has claimed and it has been successful. It puts a wedge between the client and the agent.

Adam Harper: I echo those sentiments. One of the wider risks is that if a business encounters bad advice—for want of a better way of putting it—it will impact on its perception of the general market of tax advisers and accountants. I do not think that there is necessarily sufficient awareness that individuals practising tax advisory services do not have to be a member of a recognised professional body. To some extent, there is an assumption that it is already a regulated profession, whereas clearly it is not.

Similarly to some of the points that Emma has already made, the feedback we have had from our members is that they often find themselves in the situation of having to pick up the pieces after the damage has already been wrought on those businesses, not exclusively from the point of view of R&D, but fundamentally from a broader perspective. They then have to have some very difficult and uncomfortable conversations with the businesses, explaining to them the impact of the advice that they have had previously. That plays back and we are then put under pressure from our members, who say, "What is being done to protect the reputation of the profession more broadly?"

We have been very active in lobbying on the basis of our Accountable campaign, which looks to put pressure on HMRC, particularly around the recommendation that anybody providing tax advisory or accountancy services should be mandated to be a member of a professional body. The fundamental reason behind that is not driven by self-interest; it is actually about consumer protection. As I have mentioned, some of the experiences we have had fed back to us by our members clearly point to the damaging impact that bad advice can have. The advantage that we are able to offer is that there are avenues for recourse, but, more importantly, we are able to put measures in place either to raise the standards of members who fall short of what is expected of them or take action against them should they persist with their failure to meet those professional standards.

Jason Piper: The example that we have had is in some ways the opposite extreme: clients who have been cold-called by some of the unregulated boutiques and offered thousands of pounds of free cash in return for very little exercise. That can put them off. In a modern conservative environment, they are very concerned that if it sounds too good to be true it must be. When the regular agent then brings up the topic of R&D tax credits, they say, "Well no, surely that's all a scam, isn't it?" It defeats the whole object of having the incentive there in the first place to try to encourage those behaviours.

The Chair: Do you and your other professional bodies' members always charge on a time basis, and do agents always charge on a no-win no-fee basis? What is your view of no-win no-fee?

Jason Piper: It is impossible to give an absolute blanket assurance one way or the other, and there will be a blend of both in each, but, as a general rule, time-charged is less likely to be linked to speculative claims, whereas no-win no-fee can perhaps be seen as more of a warning sign. It is not necessarily always totally inappropriate, but it will tend to sit more on the claims factory side of things than for a larger or more regular business.

Adam Harper: I echo those views. I would not necessarily go as far as suggesting that it would be appropriate to prohibit no-win no-fee types of models, because I think they can be useful, particularly in affording businesses the opportunity to establish whether they can benefit from R&D relief without necessarily incurring any cost. But I recognise exactly what Jason said about how it might typically be perceived. To some extent, because it has been tainted by the way no-win no-fee models have been utilised and pushed so heavily in other sectors, there is inevitably that association. One of the particular risks with the model is that it presents the opportunity for undercutting, and that then plays back into what we said previously about the way in which the unregulated sector might well look to exploit that as a mechanism to capture business. Again, if it looks too good to be true, maybe it is.

Emma Rawson: Yes. We would agree with that as well. There is an obvious risk to objectivity when there is a contingent or results-based fee involved, but that is not to say that they are not appropriate in some circumstances. I do not think we would support an outright blanket ban either. From a purely practical perspective, it is hard to see how HMRC would police that in practice, and there are question marks over whether HMRC should be treading into commercial practices to that extent.

An alternative to banning them would be that, if we are asking for extra information about agents advising on R&D relief claims, we could ask them to declare where there has been a contingent-fee basis. If that could feed into HMRC's risking, it might give some interesting data about the connection between incorrect or fraudulent claims and contingent fees, and help with its risk profiling.

Q19 **Lord Turnbull:** Can I explore the pause in processing claims over the spring, and what has happened now? One possibility is that instead of being processed in 28 days it is now 40, but by and large you have got the claim through that you would have got through before. Have any of your clients reported that it has got a bit tougher, the challenge is greater, and they are not getting things approved that, back in the spring, they might well have done?

Adam Harper: We have not heard that specifically from feedback from our members, but, by the same token, we have not gone out and sought specifically to canvass opinion on it. If it would be helpful to ask that as a direct question from our members, we can certainly do so.

Lord Turnbull: It would. One issue is simply a cash-flow effect; you eventually get your money, but three weeks later than it would have been. The other is that you do not get as much of your claim approved as you might have expected a few months ago.

Emma Rawson: We have had members contact us about delays in payment. It comes down partly to HMRC resourcing, but also the prevalence of suspected fraud. HMRC is having to pause compliance work or processing of genuine claims because it has to focus on fraudulent claims and stop those getting through. When it comes to that, the messaging is very important. To its credit, HMRC has been quite open and said, "Look, we are experiencing these delays, and we're having to put a pause on because we are trying to stop these claims getting through". Keeping that up is important, because people are more likely to be patient with delays in getting their repayments when they know that it is for a good reason, which is to stop taxpayer cash getting into the wrong hands. That is quite good, but at heart it also comes down to resourcing. There is a question mark as to whether HMRC is adequately resourced to deal with the volume of claims it has, as well as the compliance checks and the anti-fraud work.

Jason Piper: There is probably not a lot to add. Likewise, we have not yet done a specific time change in terms of attitude. Some of our members have reported that HMRC is generally very reluctant to agree claims. There have been some very poor experiences where claims that the adviser clearly thought were 100% legitimate took three years and alternative dispute resolution for the client to get 80%, at which point they just gave up and could not even face trying to go for the last 20% they thought they were owed.

Lord Turnbull: The issue is whether people are beginning to feel that there is tightening or whether it was always happening. Some claims are always challenged.

Q20 **Lord Palmer of Childs Hill:** You have given us your views on pre-approval, but I understand that HMRC has a target of 28 days—we are told—to turn around claims. I do not know whether that is sufficient to deal with the claims, and whether it keeps to that target and there is enough time for genuine claims to be expedited. Following some of your previous answers, HMRC has numerous offices. Is there consistency across those offices? It does not put all the claims through one office, or does it?

Emma Rawson: I believe they go through a certain business unit. I do not think there are people sitting in, say, Wolverhampton, and people sitting in Glasgow. There may be people around the country, but I think they report to one unit that processes the claims. Obviously, HMRC will have more insight into that. On the question of whether it is keeping to the 28 days, again, we get anecdotal evidence. People come to us and say, "Look, this isn't getting turned around as quickly as before", but we do not have a view of the overall service level agreement and how it is hitting that.

Lord Palmer of Childs Hill: A claim may go to Glasgow, but it will be dealt with—

Emma Rawson: I am not sure, to be honest. I would not like to say.

Lord Palmer of Childs Hill: We do not know, so we need to follow that up with HMRC.

Emma Rawson: Possibly, yes.

Adam Harper: To pick up the point you mentioned about a target, targets can work both ways. A target helps to manage expectations of likely timeframes, but by the same token it means that you are giving others a stick with which to beat you, because, ultimately, if you do not manage to hit that target, having publicly made that commitment, it will be followed up. One of the particular challenges that throws up is that claims vary widely in their levels of complexity. In that sense, one assumes that the target may well be set in some form of average. I do not know that for certain, but clearly there will be some claims for which that will be comfortably adequate, and there may well be others for which it will not be.

The other factors that Emma mentioned in response to the previous question are relevant too, from the point of view of resources. There will be seasonal variations in HMRC's resource availability that might well have an impact. For example, around year-end or holiday periods, its resources may be a little more stretched. We would always advocate taking a slightly broader perspective, saying that it is guidance but not necessarily something over which we would explicitly hold it to account.

The Chair: Thank you very much indeed for coming to appear in front of us. That was very helpful.