



HOUSE OF LORDS

Economic Affairs Committee

Finance Bill Sub-Committee

Corrected oral evidence: Draft Finance Bill 2022-23

Monday 14 November 2022

4 pm

Watch the meeting

Members present: Lord Monks (In the Chair); Viscount Chandos; Lord Palmer of Childs Hill; Lord Turnbull.

Evidence Session No. 4

Heard in Public

Questions 40 - 51

Witnesses

[I](#): Neil Ross, Associate Director, techUK; Colin Hailey, Chair, Finance and Tax Advisory Committee, BioIndustry Association (BIA); Dr Joe Marshall, CEO, National Centre for Universities and Business (NCUB).

Examination of witnesses

Neil Ross, Colin Hailey and Dr Joe Marshall.

Q40 The Chair: Welcome, everyone, to this oral evidence session before the Finance Bill Sub-Committee of the Economic Affairs Committee of the House of Lords. In formally opening the meeting, I welcome our guests. I would be grateful if you could give some very brief biographical details on what you do at the moment.

Colin Hailey: I am a partner at Confluence Tax and chair of the finance and tax committee of the UK BioIndustry Association, representing mainly SMEs doing drug development work in the UK.

Dr Joe Marshall: I am chief executive at the National Centre for Universities and Business, a representative body of universities and businesses across the UK, specialising in research and development and skills and talent.

Neil Ross: I am the associate director for policy at techUK, which is the UK's trade association for the technology sector, representing around 930 tech companies with operations in the UK, ranging from some of the very smallest to some of the very largest.

Q41 The Chair: Thank you very much. We have about 45 minutes, so if you can keep answers as concise as you can, we will try to keep questions as concise as we can, too. To kick off, how important is the whole system of R&D relief to businesses in your sector? This is particularly for Mr Ross and Mr Hailey.

Neil Ross: The R&D tax credit system is a very important part of the network of different incentives that attract tech companies to operate in the UK, even before the announced expansion to cover cloud data and computing costs, which was very welcome. When we have surveyed our members in the past, R&D has ranked very highly among some of their key business priorities.

When we have asked them what they would like to see the Government do to help them advance or expand their R&D operations, improving and expanding the incentives has usually been one of the top two or three asks of members over the past year and a half. This is borne out by the evidence; tech companies tend to be in the higher-claiming sector. They are very prevalent in professional technical and scientific areas as well as the information and communication sector, which, among the sectors claiming the R&D tax credit, are usually in the top three, so they have a very high use of the credit.

We are very keen on the expansion to cover cloud data and other computing costs, mainly because for a very long time the sector has had the ask that the expansion keeps up with modern R&D activities. Particularly in the way that it is claimed, it is very useful for the sector because, often, some of the biggest expenditure is the staff and talent costs of operating in that area, such as software development engineers

and other software engineers. Claiming the credit back against those costs is very important for the sector. We have been very supportive of the credits; they are very important for the sector's growth in the UK.

Colin Hailey: They are essential to UK biotechnology companies. Basically, most of these companies have no product until they have finished their R&D. It is an essential consideration for companies being founded and for companies growing in the UK. There is a competitive international landscape, so they have been very widely used by the sector, which has invested huge amounts in R&D since it was established in 2000.

The Chair: Does the UK get value for money out of this scheme?

Colin Hailey: Yes.

The Chair: Are you sure?

Colin Hailey: If you look at the scheme, the ability to claim R&D tax credits is one reason why people set up, found and grow companies here. It also helps to leverage in venture capital investment, delivering huge value for money. I am sure we will come on to some of the changes, but essentially as a trade body we are now in damage limitation mode to reassure people, including international investors, that the UK R&D tax credit system is not under threat, given the planned changes.

Neil Ross: Given the broader way government treats the R&D system—lengthening the point at which you hit the £22 billion/£25 billion target further down the line—the R&D tax credit system has been an important constant, and one that is seen as very attractive by our members compared to other schemes around the world.

The Chair: There has been a rapid increase in the amount paid out in recent years. People are asking serious questions about this budget line. Do you think they are justified in doing so, or do you refute anything other than that this is a good deal for the UK Government to spend quite a lot of money on?

Neil Ross: Scrutiny is always important. It is worth reviewing the system and looking at how it is working in practice, but it is very valuable to our sector. Our message is to reassure you that the system is effective and useful, but that it should be reviewed to make sure that its integrity is maintained. Ultimately, no one does well if the system falls into disrepute, but it is used very effectively by our sector, as I am sure others would agree.

Colin Hailey: We have a fantastic science base in this country. We are fantastic at life sciences. This is the industry that is trying to cure cancer, makes vaccines, tries to save lives and make people's lives better. The problem is not with drug development companies in bioindustry; the problem is spurious claims from no-win, no-fee and contingency fee claimants who do not deserve to claim and should be outlawed.

Q42 **Viscount Chandos:** Dr Marshall, on international comparisons, would you agree that other countries appear to be more successful than the UK in encouraging investment in R&D? What lessons can we learn from their tax systems and accompanying grant systems?

Dr Joe Marshall: How competitive the UK is relative to other countries is a really good question. To build a little on the first question, clearly the UK is in a global race to do more and more R&D activities and needs to be an attractive and competitive place for those activities. Under many reviews and observations on the UK economy, we are trying to stimulate more companies to do more R&D. Internationally, from a tax perspective, it is interesting what types and mechanisms are used and what is eligible and what is not for tax allowances. You can apply different weights and measures, but is the amount of tax relief available in the UK comparable? In many ways, it is.

Another interesting point is that Spain, I think, allows you to claim for the people element, so 17% can be taken off gross tax allowances made on payroll for the people doing the R&D activities. Looking at Canada, Spain and Germany, you start to see differentiations on the types of relief that you can claim against. The UK system is, effectively, focused only on large schemes and small schemes and against corporation tax allowances.

What is interesting when you look at the international comparisons is what else you might be able to do. As the debate and discussion goes on this afternoon, I am sure we will discuss broader complementarity to the grant scheme. It feels like we have a system in the UK focused on tax relief and a system about grants. What we do not have is a way to bring those discussions together so that we get the net benefits of both those schemes, rather than operating them in complete isolation.

Viscount Chandos: If we did that better, would the total cost rise, or would it be possible to target it better? The vice-chancellor of Swansea University has an article in today's *FT* quoting the international comparisons on public funding, which I suspect is grant funding, which shows the UK at 2.4%, the US at 3.4%, South Korea at 4.8%, and so on. Will there inevitably be a greater cost to having more impact?

Dr Joe Marshall: It depends whether you see this as a cost or an investment. The public investment is now close to £20 billion, which is kind of where Paul is making his point about the Government's commitments last year in the spending review on grant funding. If you take it in totality that the tax credit regime in R&D is equivalent to £9 billion, once you add in all the constituent parts, what impact does that have on the leverage rate? How much R&D activity is being done in the UK?

We are now at around 2.4%, because of an ONS reclassification. That was the Government's target against the OECD average of 2.4% as it was. The OECD average is now at 2.7%, and we should be trying to stimulate more and more R&D activities in the UK. If you see it as an

investment, is that public investment of £20 billion and the utilisation of the tax credit regime an enabler and leveraging to achieve an even greater level of private investment? When we were doing major work in this space, we were looking at £17 billion or £20 billion additional private investment required to get to 2.4%. That is the sort of quantum that we are talking about. If you see it at an investment, this could have quite significant leveraging impact on the UK economy.

Colin Hailey: Just one point on that. You have the R&D tax credit system and the grant system, but they talk to each other, in that if you have spend on which you have a grant, you cannot claim an R&D tax credit on the same spend, so the systems talk to each other in that sense; you do not get double claiming.

Dr Joe Marshall: No.

The Chair: You cannot get two.

Colin Hailey: No, you get one, and you take the grant because it is usually at a higher rate than the R&D tax credit.

The other point is that a grant is always a lottery. You apply for a grant, you might write a good application or you might not, you might hit favour with what the call for applications is addressed to. The great thing about R&D tax credits is that if you meet the criteria, you will get the R&D tax credit. That is very valuable for companies, rather than spending money on grants report writers, hoping that you will be one of the successful applicants.

Q43 **Lord Turnbull:** As major players in this space, I would expect you to be on the generous side of wanting to increase expenditure. If you are looking at it from where I have come from, you might say, "Are we getting value for money?" Are claims sometimes allowed through, some expenditure, that could be pruned and redistributed into other areas where you get more bang for your buck, more ground-breaking research than you would get elsewhere, or have we by and large got the distribution between the things we are paying for about right?

Colin Hailey: I would say that it is very far from right at the moment. Essentially, the Revenue guidance says that if you are doing drug development, up to and including phase 3 of a clinical trial, it is probably R&D, so you know you are doing R&D. The kind of claims from SMEs that are going through are from companies charging contingent fees that do not know the rules. There are claims going in for all sorts of things that should not qualify, but they are simply not being looked at by HMRC. During Covid, no inquiries were running at all; HMRC just let everything through. You are just asking for a refund on your tax return, you get it. We are only just starting to see inquiry activity coming back in. The measures in the Finance Bill, from my point of view, do not go anywhere near far enough to clamp down on spurious claims.

Lord Turnbull: But in this review, and in the material in the Finance Bill, which is basically what we are looking at, I cannot see anything that will bring this correction about.

Colin Hailey: I completely agree. We, as the Bioindustry Association, have raised this with the Treasury a number of times, using the DOTAS—disclosure of tax avoidance scheme—rules, which are already on the statute book and which say that where you have mass-marketed schemes with contingent premium fees, you have to give a disclosure number and notify the Revenue: “I’m doing a tax avoidance product”.

Lord Turnbull: I notice that you mentioned drugs, because that is the area you are working in, but is that true of other sectors of research: that there is a core of good projects and quite a long tail of less worthy projects that are getting ticked through by HMRC?

Colin Hailey: In general, my experience is that almost everything is not even getting ticked through by HMRC. No one picks up the pen at HMRC; they just go through and get picked up at random. The measures in the Finance Bill are trying to deal with spurious claims without incurring more headcount in HMRC.

Lord Turnbull: Maybe we will come to the method, but the only one I have seen is this pre-registration, and I do not know anyone who really thinks that is the most effective tool for dealing with this.

Colin Hailey: I completely agree. There are already software products out there that will write your R&D claim for you. You put in a few words, and it will generate the report for you to send into HMRC. It will not take those firms long to work out how to write an automatic notification piece of software. It will not address the problem at all.

Q44 **Lord Palmer of Childs Hill:** To all the guests, Dr Marshall talked about eligible and ineligible, and that really is. Do you think the changes to the definition of research and development have modernised it or made it worse? What items of expenditure should be included? Another comment was made, I think by Dr Marshall, about R&D in the UK. Is that R&D that starts in the UK, or is the asset just as good to use R&D from outside the UK?

Dr Joe Marshall: I am happy to start, and I am sure colleagues will join me. It is clear that the Bill is putting a spotlight on what we are talking about when we talk about R&D. Are we talking about the OECD’s Frascati definition? We have already mentioned the OECD average of 2.4%, which is now 2.7%. That is based on a common and consistent definition of R&D, and colleagues in the arts, humanities and social sciences may, in another hearing, talk about whether that Frascati definition in itself is broad enough, but that is for a different discussion.

In this context, the Frascati definition is commonly used and has very good working definitions of what is and is not included. There seems to be an interesting disconnect between the R&D definition and what the R&D tax relief enables, which Colin just described. Are we talking about

new-to-world innovation-type activities—what we would consider to be R&D activities, hence the Frascati definition—or are we talking about improving new-to-firm innovation? Are we thinking about broader innovation adoption?

Both those things have a place. I was perhaps remiss in my comments. Some countries will reward tax reliefs at a higher level for companies that do genuinely new-to-world R&D activities, but still put some premium, but at a much lower level, on companies that do new-to-firm activities.

Part of the challenge is definitional. What are we talking about and what, ultimately, are the Government trying to achieve? Are they trying to enable more R&D activities based on the Frascati definition? There is then the broader point about where that R&D activity is taking place. The UK, by lots of measures, is a very attractive place on a global stage to do R&D, but that is not just because of the tax relief system; it is also because of access to talent, access to world-class facilities and access to the science base. This becomes part of a mix. We should recognise that the UK punches well above its weight against a whole raft of measures in its attractiveness to do R&D, but we then get into the question of whether the R&D is actually being done here. This Bill is trying to tighten up on R&D actually being done in the UK while recognising—I am sure Colin will talk about this—that there are obvious things about clinical trials and other things that we need to be mindful of.

Colin Hailey: Yes. I think the main thing exercising BioIndustry Association members at the moment is the exclusion of overseas expenditure. We have had very constructive engagement with the Treasury and the Revenue on an exemption to that, for circumstances where you just have to use people based outside the UK.

For example, if you are in a new area of medicine and there are a handful of subject matter experts worldwide but none of them are in the UK, why should you be precluded from putting the cost of engaging that person in your R&D tax credit wherever they are in the world? If you are running a clinical trial in multiple sites around the world and struggling to recruit patients, or if it is very hard to manage a multiple-site clinical trial, you should be able to include that cost in your R&D tax credit because, to your point, the asset you are building is in a UK company; when the drug is developed, the UK will benefit from increased corporation tax receipts and we should not prejudice that.

Furthermore, I deal with companies every day that have already signed up a clinical trial provider on a three or five-year deal. They are now worrying, saying “We’ve already signed up a supplier outside the UK. Are we going to get R&D tax credits? Can we have some measure that says that if we have already signed the contract, we’re not caught by the new rules, because we entered into it before the Treasury moved the goalposts?”

Lord Palmer of Childs Hill: Obviously there is a quantum of how much is done and whether it can be done in the UK or not. Would you say that the balance is on whether the UK company has benefited from it?

Colin Hailey: The test in the law, that it would be wholly unreasonable to replicate it in the UK, is fair. This is not cost driven in drug development. If you can use people in the UK, you do; they are based where your people are based, they are in the right time zone, they speak the same language and you can drive down the road to see them. You use people overseas, because they are the worldwide experts you need to do what you need to do. That is why you need that ability to use people overseas. Does that answer your questions?

Lord Palmer of Childs Hill: Yes, that is fine.

Q45 **Lord Turnbull:** I am puzzled that if, on the one hand, a company buys some super-duper piece of kit—a machine of some kind—brings it to the UK and uses it to drive up productivity, it gets all the tax allowances that the system allows. If, on the other hand, it develops some intellectual property, which is on its balance sheet as an asset and has the same feature of spending money now to get benefits over time, it does not. We are trying to make a distinction that you get this relief if the research was done in the UK, but not if you bought that research for your company and added it to your company's knowledge base. I really do not understand why we are making this distinction.

Colin Hailey: I do not know if anyone else has a view, but I think you would have to ask the Treasury. It is probably to do with concerns on cost grounds. My understanding from the Treasury is that this is not about the UK life sciences industry, which is not cost driven. It is more about companies saying, on purely cost grounds, that it is expensive to do it in the UK.

Lord Turnbull: You say cost, but you should be looking at the quality of the research being done and cutting out the long tail that you referred to. If that research will advance knowledge worldwide, it seems to me that it should be allowed. If it will not, it should not, whether it happens in the UK or elsewhere.

The Chair: Mr Ross, would you like a crack at that?

Neil Ross: There is a scheme in the Netherlands called the innovation box which our members often point to—I am sure the committee is relatively familiar with it. It provides discounts at payroll level for more intangible, non-patented innovations, so a broader range of IP rights are encompassed. It is seen as a particularly good model for the tech sector, where innovation is a lot more iterative.

For example, if you build a very good machine-learning algorithm or AI system, the benefits of that accrue over time, as it learns and develops. It is not a one-off cost, like buying a piece of fancy kit. It gets more advanced and smarter, and delivers better benefits over time, particularly as it is trained. The innovation box allows you to continue to claim a

discount on payroll as that innovation is used, rather than just at the point where it is purchased.

Colin Hailey: I think we are conflating two things. First, is the company doing R&D or not? From my point of view, drug development is clearly R&D all day long, but some claims out there are not. Secondly, if it is doing R&D, which of its costs can it put in a claim for and get credit on? That is where we say that the proposed new law that will be introduced in the finance Bill says that if you are doing the work in the UK, you can include it, but if you are doing it outside the UK, you have to meet a very tightly drawn exemption to include it. They are two slightly different things.

Lord Turnbull: That “we” is a tricky word in the language. Who does it refer to? I suspect that the people doing the conflating are HMRC. As Dr Marshall was indicating, it should be separating out research in the sense of developing new knowledge and activity that is trying to drive the application of knowledge. We have a scheme that just throws the two things together and it is causing a mess.

Colin Hailey: I do not think that trying to split different types of R&D is the issue. The issue is claims that are simply not being looked at by HMRC, where companies are not doing R&D under any definition but are getting claims through because they do not get looked at.

Viscount Chandos: Do you think that, at a policy level, the Government should be trying to kill two birds with one stone? Should they support research to stimulate growth in productivity in the company that benefits from that research, or should they do that and try to stimulate research within the UK as an end in itself?

Colin Hailey: I have no issue with the definition of R&D as it stands. I can see why, to cut costs, the Treasury is suggesting that we should exclude overseas expenditure.

Lord Palmer of Childs Hill: In your view, if companies were not getting tax credits or grants for work done overseas, would most of them carry on buying that product?

Colin Hailey: They might not set up in the UK in the first place or they might grow outside the UK.

Lord Palmer of Childs Hill: So that would be the danger.

Colin Hailey: Yes.

Q46 **The Chair:** Let us turn to the review of the tax credit system that is being undertaken. I address this question to Mr Hailey particularly. The Government pitched this as a comprehensive review of the R&D relief. Are you satisfied with the scope of the review? What additional changes would you like to see as it continues, and why? There are hints that it is only one stage in some further work that the Treasury is doing on the tax credits. Can I have your views on those points, please?

Colin Hailey: Of course. The extension to include cloud computing and data costs is very welcome. It is long overdue, so it is good news. I would always welcome it being an ongoing review, because most tax systems around the world have some form of R&D tax credit and we need to remain internationally competitive. So that is a welcome measure. Speaking purely for the BioIndustry Association, we do not like the overseas expenditure restriction because of the nature of the industry we are in.

Neil Ross: The cloud computing and data cost element is very welcome. It is something that our industry has argued for for a long time. Some of our companies that are engaged in very high-end software development continue to raise concerns that the threshold for a claim for any kind of software development is still very high. The review pushes things in the right direction, but ultimately it is an ongoing conversation that we need to continue to have.

The Chair: Do you detect subjects that might be the subject of the next review after the current one?

Neil Ross: I am not sure what is in the Treasury's mind at the moment. I suspect it is being driven mainly by saving costs.

The Chair: Can you guess?

Neil Ross: I think cost saving will be what is driving it at the moment, but certainly we are always engaged in how we ensure that the definition of R&D keeps up particularly with intangible asset and data-driven developments in our sector.

Q47 **Viscount Chandos:** I have one question on the scope of the relief and one on process.

On scope, we have heard from other witnesses about the desirability, in their view, of giving relief on new-to-firm R&D, not just new-to-market R&D. Can any of you comment on that?

Looking at the process in general, what are your views on the proposed changes? If they are not covered, how would you make the process of claiming more streamlined without sacrificing proper due diligence?

Dr Joe Marshall: I think we have rehearsed some of the points already. Certainly in the previous committee hearing you heard about new to world versus new to firm.

Picking up on the Chair's question about the Treasury's thinking on this, clearly from an R&D perspective the world is continuing to move. We continue to operate in the UK in an ever more competitive global environment in which the boundaries between R&D are being pushed and there is a blurring of activities, which are increasingly overlapping and pushing against each other. It is right, therefore, that the Treasury—and, ultimately, HMRC—tries at best to keep pace with that and thinks about the definitions.

On the tech side, cloud computing issues have as much of an impact on my colleague on the right in the bioindustry. We can sometimes pigeonhole these discussions and say, "Oh, this is good for the tech sector and we're pushing boundaries". Actually, in the biocentre, we could have the automotive and creative industries. Those sectors are pushing boundaries all the time.

Although we as an organisation are incredibly sensitive to the fact that the cost to the taxpayer and UK plc is clearly going up, we also have to remember that the Government set very ambitious targets to do more R&D activities, particularly to stimulate business R&D. There are various stats around—for example, that 400 companies in the UK do 75% of all R&D. We need to push at the boundaries. What are the levers, incentives, encouragements, environment, ecosystem that encourage more genuine R&D activity to take place? If there are problems on definition and on process, hopefully it is within the Government's gift both to tighten up the definitions and their eligibility and to put the resources in to monitor and process this more effectively. But we should not lose sight of the fact that the UK wants to do, and should be doing, more business-led R&D. That is the big driver.

Colin Hailey: I certainly cannot see any Treasury signing up to expanding the definition to include new to firm, because the cost would be enormous. It is already unhappy with the level of cost. The issue is process. The issue is the claims that should not be allowed through. That is where the problem is. The concern we at the BioIndustry Association have is that, if this carries on as it is, at some point the Treasury will say, "This is just too expensive. We're going to scale the scheme back". Then everyone, including companies trying to develop new drugs, will suffer because of people who should not be claiming in the first place.

Viscount Chandos: Do you think that means that we should be concentrating on deepening, and possibly therefore narrowing, the scope—we have used this phraseology in other sessions—rather than broadening it?

Colin Hailey: This is an operational matter for HMRC. It should be looking at claims, but it is not looking at enough claims. It is not a policy matter; it is an operational matter.

Q48 **Lord Turnbull:** This is the thing that is coming out most clearly: the review is not reviewing the right thing. What needs to be reviewed is the way in which HMRC reviews claims. It is a tax authority. What locus does it have to make judgments about whether this R&D is ground-breaking, or whatever? The big question, which is not being reviewed, is whether it is really within HMRC's capability to do this work. What I am getting from you is that it probably is not.

Colin Hailey: I think that HMRC is perfectly able to ask the questions and understand what it gets told by companies, but it is not asking the questions and reviewing enough claims.

Lord Turnbull: That ought to be the central question. It is really for the Treasury to ask HMRC, "Are you fit for purpose? Do you have the right people and resources? If not, can you get them from elsewhere in government, like BEIS, to answer the questions that are being put before you?" The answer may be no, and some big changes may be needed in the organisation.

Colin Hailey: Just to reflect the scale of the problem, let us say that you are a spurious tax adviser and charge your 20% contingent fee, so you take £20 of £100 of tax credit as your fee. If you do not think that HMRC is going to look at your claim—the chances are that it will not—there is no limit on how much you put into that claim. You will convince yourself, as a company doing R&D, that costs that should not be in the claim should go in there.

Lord Turnbull: Can HMRC not see what is going on? Instead, it just comes up with this scheme for pre-application.

Colin Hailey: I agree. I do not understand what the notification process is trying to address.

Q49 **Lord Palmer of Childs Hill:** We have touched on this already, but it is the interpretation of R&D that seems to be the point. In the view of you all, could HMRC or BEIS do a better job of working out what the interpretation is so that there are fewer spurious claims and people really know what they are claiming?

Colin Hailey: My personal view—the others can come in on this—is that, when HMRC looks at claims, it is able to ask perfectly intelligent questions and understand what it is being told. It then says, "Yes, that is R&D", or "No, it's not". Obviously, in the industry I work in, it is pretty obvious: if it is drug development, it is R&D. We then have debates about whether certain costs qualify.

Dr Joe Marshall: It feels to me that, in a joined-up Government, you have BEIS, which is ultimately the department responsible for delivering on the 2.4% target for R&D, and perhaps gives advice as part of its sponsorship of and relationship with HMRC. However, HMRC has a different definition of R&D, so it immediately asks a series of questions.

On this question of depth versus breadth and narrow versus broad, in the OECD's *Frascati Manual*, it is very clear and is continuously under review. While Governments around the world are striving to do more and more R&D as a percentage of their GDP, it feels at odds to me to have an HMRC department that effectively has on one level a very broad definition of R&D in which lots of things can be included.

Some companies might not realise that they can claim for R&D tax credits. If you are not sure about the HMRC definition that is being used, it is unsurprising that two things happen. One is that we are not getting full value for money from this. The second, as a result, is that we are also getting into a whole set of questions about whether a claim is legitimate or not when, in the case of effective versus efficient—or, perhaps,

reliability versus validity—you actually have a safe scheme. The definition on the HMRC side is very broad. Therefore, lots of things could be included.

Neil Ross: I echo the points made by my fellow panellists. The only thing I would say, again, is that some of our members, particularly in the software development space, keep running up against HMRC when it comes to making claims. Clearer guidance and a better approach would probably be welcome on their side.

Q50 **Lord Turnbull:** We have this question about whether a claim is spurious. If it is put into HMRC and it approves it, it is not spurious; it has accepted it. There are claims that really are spurious, where the company does not even exist or the money was not actually spent. I think people are tackling some cases of that kind. The problem is that the claims are being accepted. By being accepted and paid out on, they are being legitimised. People can say, "I'm acting within the law. I put my claim in. They accepted it". That is fair enough. If they did actually spend that money, they can say that they are acting within the law, but from a policy point of view it may make a difference whether that claim really meets the definitions that we are after and the policy ends that we are pursuing. That is the bit that needs to be looked at more carefully.

Colin Hailey: I am not quite clear when you say that claims are being accepted by HMRC.

Lord Turnbull: If someone puts in an application, it just checks it through and sends it.

Colin Hailey: It goes through by computer.

Lord Turnbull: That is what I mean.

Colin Hailey: You put in the box, "I'm claiming this much R&D relief. I'm owed a refund of this much. Here are my bank details". The computer says yes and pays you the money.

Lord Turnbull: Once that has happened, if they did actually spend that money, you cannot turn round to someone and say, "You acted illegally".

Colin Hailey: You can if you were not doing R&D in the first place or you are including costs that should never be included. If you rang up an inspector—you can do this—and said, "I'm doing this kind of activity. Do you think it qualifies and I can include these costs?", and the inspector said no, surely ignorance is no defence.

Lord Turnbull: By having this computer the system is set up to cut out the "talking to the inspector" phase so that HMRC can reduce its costs. It basically wants people to do it by computer. The problem then is that you miss out the chance to bring any challenge into it.

Colin Hailey: The challenge is really not there.

Lord Palmer of Childs Hill: On the computer side, is the advantage of having an outside adviser that they know how the computer is going to

answer?

Colin Hailey: It is literally all automated: you put some numbers in and get a repayment. There is no review going on. Outside advisers cold-call companies all the time saying, "We have a special relationship with HMRC. Some 99% of our claims are accepted by HMRC. It's free money from HMRC". The Treasury has said to me that it is very frustrating that, if you google "R&D tax credits", you go through four pages of R&D tax credit firms before you get to anything from GOV.UK. It is an absolute wild west out there.

Q51 The Chair: The final question is for Mr Hailey and Mr Ross in particular. The changes are designed to come in in less than six months, in 2023. Are businesses ready for the new rules? What more can HMRC do to ensure an orderly transition?

Colin Hailey: As I say, the big concern for bioindustry companies is overseas expenditure. We understand that the Treasury and the Revenue are looking at whether we can do more on the definition in the law, and the Revenue is looking at some new and improved guidance to explain when overseas expenditure can and cannot be included. We think that that is under way, but the sooner we see something, the better, because, as we have already talked about, this is internationally competitive. Some people, from the US or wherever, are already saying to me, "I understand that R&D tax credits are going to be much reduced in the UK". So the sooner we see something, the better. Waiting for the Finance Bill is too long, really.

Neil Ross: I would agree on the points about overseas expenditure. It is a concern raised by our companies as well, particularly in the deep tech sectors where, as Colin mentioned, you are dealing with subject-specialist experts from around the world in small teams. The broadening of the definition for cloud computing and data costs is very welcome. Companies are prepared to take advantage of it, but we will wait and see how the initial round of applications goes.

The Chair: Thank you very much. That concludes today's hearing. We shall now suspend it while we rearrange the team who are going to talk to us next. Thanks again for coming along and giving us the benefit of your views.