



HOUSE OF LORDS

Economic Affairs Committee

Finance Bill Sub-Committee

Corrected oral evidence: Draft Finance Bill 2022-23

Monday 14 November 2022

4.45 pm

Watch the meeting

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

Evidence Session No. 5

Heard in Public

Questions 52 - 63

Witnesses

[I](#): Jenny Tragner, Director and Head of Policy, ForrestBrown; Nigel Holmes, Director of Tax, Catax.

Examination of witnesses

Jenny Tragner and Nigel Holmes.

Q52 The Chair: Welcome to this oral hearing of witnesses concerning the tax credit scheme for R&D. We are pleased to have representatives from the industry who help people with claims, and so on, and we look forward to hearing what you have to say about the current review.

First, perhaps you can tell us a little about your experience of the HMRC compliance activity to combat error and fraud on R&D claims and how it has impacted your clients. I also draw to the attention of Mr Holmes, in particular, what we have noted from the Catax website: the tremendously ambitious statement that something like £84 billion is owed by the British Government to small and medium-sized firms, as though it is waiting to be claimed. Is that not likely to generate lots of claims, many of them spurious? Mr Holmes, perhaps you will kick us off.

Nigel Holmes: Certainly. I do not know where that number comes from, to be honest; it is not one I have quoted.

At Catax, we have been involved in R&D claims for a number of years. I have been with Catax for five and a half years, but I have been doing R&D claims since they first came out in 2000. I am a chartered accountant and chartered tax adviser. I agree that there are definitely spurious claims being made. We see them being made by some of our competitors, but we have a very robust system in place so that we will never put in anything that we consider spurious. We take the view that, if we could not defend it in the event of an HMRC investigation, we do not submit it. I do not know where the figure of £84 billion came from.

The Chair: What about the £84 billion?

Nigel Holmes: I do not know where that came from.

The Chair: You do not know anything about it.

Nigel Holmes: I do not know anything about that.

Viscount Chandos: It comes from your website.

Nigel Holmes: I do not write our website. I do not know where that number came from.

Viscount Chandos: Surely you take responsibility for what your website carries.

Nigel Holmes: I do not operate our website. If that figure is there, I will have a word with our marketing team when I get back and we will get it removed. I do not know where it came from.

Viscount Chandos: It has been up there for nearly five years.

Nigel Holmes: Right, okay.

The Chair: It is some time since Philip Hammond was the Chancellor, and there has been no shortage of Chancellors ever since. He was described by Catax as sitting on an SME war chest of £84.5 billion—which is of course almost twice the budget of the Ministry of Defence and enough to run the NHS for eight months. That is one hell of a black hole we are talking about, if that is true. Is it true?

Nigel Holmes: I do not know. That number sounds very high. As I say, I have been at Catax for only five years, so that may predate my arrival. I do not check everything on our website. I am a technical person, not a marketer. I will look into that when I get back to the office.

The Chair: But it gives the impression that Catax—we will come to the other organisation in a minute—is looking to prompt lots of claims. There has been a big increase in claims recently, and I think this is causing some distress in Treasury circles. Is this not likely to encourage spurious claims as well as genuine ones?

Nigel Holmes: Obviously, Catax is in business to make good, robust claims, and a number of companies out there which could make claims are not. We would not make any spurious claims. By putting the message out there, some people get the wrong end of the stick, but we have very rigorous processes. We have seen some of the headlines in the *Times* from a couple of weeks ago about some people's ideas of what R&D is. We agree with the findings of those *Times* articles: the croissant, et cetera, that was cited in those articles is not R&D. We, the technical people at Catax, understand what R&D is.

The Chair: Okay, we might come back to that in a moment. Let me switch to our other witness. Mr Holmes introduced himself briefly; perhaps, Jenny, you would do the same thing.

Jenny Tragner: Absolutely. I am a director and head of policy at ForrestBrown. We are a specialist tax firm, and we specialise in providing R&D tax advice. I am a chartered accountant, and a member of ICAS and ATT. I have 20 years' experience in tax. I spent 10 of those at KPMG, and for the past 15 years, I have specialised solely in R&D tax advice. I am here today representing the range of clients that we work with at ForrestBrown.

The Chair: Thank you. Do you have any comment on the discussion we are having with Mr Holmes so far? Is your organisation promoting claims, many of which could be spurious?

Jenny Tragner: No; I am quite closely involved in the content on our website. It is fair to say that the R&D tax advice market has evolved over the past few years. Nigel has mentioned some examples of projects which we clearly do not want to direct R&D tax relief funding towards, and I suspect some questions today will come on where some behaviours in the market are happening and what recommendations we have to address them.

The Chair: What about errors and so on? We note that the Fraud Investigation Service has been quite busy sending out what many people would, I guess, regard as rather threatening letters to people who apply possibly—I say possibly—fraudulently or in an error-strewn way. What is the view of your organisations on that?

Jenny Tragner: I have seen examples of those letters. I would probably describe them as an accusation of fraud. Obviously, we have seen, with arrests this year and back in 2018, that fraudulent activity is certainly happening. I think most of the focus of these discussions has been more around abuse and boundary-pushing than outright fraud. I think the distinction was made earlier between entirely fabricated transactions and projects which do not meet the criteria but did happen.

I make the point that error and fraud are two different things. They are driven by different behaviours, and when we are looking at solutions to each, those solutions may be different. When it comes to erroneous claims, there is a lot that could be done around looking at the definition of R&D, improving guidance and educating businesses. That also speaks to some of the behaviours in the R&D agent market; when businesses are more well-informed and the relief is more accessible to them, they are less vulnerable to poor advice and rogue agents.

As for dealing with HMRC's compliance activity, which was the crux of the first question, activity directed at abuse and fraud must be incredibly well-targeted so as to protect legitimate businesses. We heard from the previous panel today of the importance of R&D tax credits to genuine R&D projects and businesses. We need to make sure that, in ramping up those efforts, we are doing that in a well-targeted way. Having seen an example of the Fraud Investigation Service letter, I think that if you had claimed in good faith, even if there may be some errors in your claim, an accusation of fraud is very likely to put you off accessing the incentive at all.

Nigel Holmes: I echo that. We saw five or six of these letters. We believe that more than 1,000 were issued, but each client who made that claim made it in good faith. If HMRC had an issue with any of those claims, it should have followed due process. Those fraud letters were very accusatory and did not follow the process. HMRC was not opening a formal fraud investigation. The letters appeared very threatening. Our few clients who received them were very frightened and thought they were going to go to prison over them. It was very heavy-handed, in our opinion.

The Chair: Turning back to the statement that you have no knowledge of, is it possible for you to let us have a note on the £84 billion claim that is on the website and whether it is true that that is the line pursued by your organisation? It is disappointing that you cannot give us an explanation today, but it would be most helpful for us to have a note.

Nigel Holmes: If it was written five years ago, I do not know who wrote it. I guess it was some type of press article. It obviously sounds

overinflated. When we realised that it was overinflated, it should have been taken down from our website. We certainly do not run by that principle every day and say that there is £84 billion unclaimed. It is an article from five years ago. You will not find anyone quoting that now and saying that this is something we are still pushing. Obviously, someone had a thought at the time that that was the number. It should have been pulled down when they realised it was not.

The Chair: Okay, but it would be helpful to have a note on the history of that statement.

Q53 Lord Turnbull: There is obviously some concern in the Treasury about the speed with which these grants and tax credits are growing—about 50% compound a year. The question is how far you think the measures in the finance Bill will target this relief better, exert some controls on it and generally give people more of a sense that the right money is going towards the right policy objectives. Do the finance Bill measures add up to that or not?

Nigel Holmes: In my opinion, some of them do and some do not. As the previous panel said, the inclusion of data and cloud computing and pure mathematics is a positive step because, as R&D moves on through time, the whole definition of R&D has to shift. That is good. Like the previous panel, I disagree with the exclusion of overseas activities. As you said earlier, where that R&D is exploited is more important than where it takes place. If you use overseas activity but it ends up benefiting the UK economy, to me that is more important.

Some of the anti-abuse measures are good. Although it has taken 22 years, making it compulsory to submit more detail on the R&D claim has to be a good thing. Catax submits a report with every single claim; I am sure ForrestBrown does as well. But the one we have all heard about in previous sittings is pre-notification; I just do not see what that achieves.

Lord Turnbull: It looks to me as if, rather than claims being spurious—people did not put in a claim knowing that this was not allowed or never even happened—it is more about what you can get away with. You put it in and you might get challenged by HMRC; if you are, you just drop the claim and carry on. Gradually, if HMRC is not challenging it, over time people will get away with more things that previously were not being allowed. Word will get round among your community—“Oh, do you realise that you can claim for that now?”—and it accumulates over time that the claims get softer and softer. The challenge presented is not keeping pace.

Jenny Tragner: I think the *Times* articles have been referred to and the projects cited there. In my experience of helping businesses that have found themselves with an HMRC enquiry, it is not the sense among the business community that it is pushing the boundaries to get away with it. Generally, the corporates' approach to corporate tax is now about getting it right and not abusing it or being seen to be aggressive in any way. Some of those behaviours might be more directed towards some of the agent community, which has had success in a particular type of claim and

then perhaps tried to roll that out across a sector. Some of that was potentially happening, but my experience with businesses is that they want to get it right, which is why a lot of our recommendations have been around making sure that the definition is accessible and that we are educating businesses. If the pubs, the blueberry muffin companies and the launderettes understand that this incentive is not directed at them, fewer of them will end up making claims.

Lord Turnbull: My father once told me that he was sitting by the doors that go in and out of the kitchen, and a guy came back from the restaurant into the kitchen and said to his mate, "He ate it". Do you ever get the same thing, where a claim is put in and you think, "Ooh, I didn't think that would get through"? Has that never happened to you?

Jenny Tragner: Do you mean claims that I have supported?

Lord Turnbull: You put something in and think, "Hmm, that might be a bit on the borderline", then later you say, "Ooh, they let it through".

Jenny Tragner: From a personal perspective, my role as a tax adviser is not so much to judge whether or not the project is R&D but to support my client's technical professionals. My background is in tax and accountancy, so my role is to educate my clients on what the criteria are and to speak to their technical professionals so that they can assess whether that project meets the criteria. There was discussion earlier about HMRC approving or accepting claims. The R&D tax incentives sit within corporation tax self-assessment, so these businesses are self-assessing what is due to them. It is about what we can do to support businesses to get it right and have confidence that when they self-assess they will meet HMRC's expectations if their claim is enquired into.

Lord Turnbull: So neither of you have ever, in conversation with a client, said, "Did you know that you could claim for that?"

Jenny Tragner: Absolutely. You would educate a client who was not aware of the definition or the criteria, and you would discuss the project. We have technologists on our team. I work with engineers and software developers, who are well placed to educate businesses on what they can claim. Conversely, I have a lot of conversations with clients about how projects do not meet the criteria. It is the application of the definition points—guiding clients through how you apply that definition to their project and how it might work.

Nigel Holmes: It is exactly the same at Catax; we have conversations with both. We have clients who either do not realise they are doing R&D or do not realise that one cost qualifies but another does not. Then there are those who think they are doing R&D, and you have to gently tell them that we cannot put that claim in because it does not meet the definition. It could be because, as we discussed earlier, it is an advancement to that company but not to the overall field of science and technology. That is where the definition lies. In my opinion it is a major problem in the industry that some people think it is about advancing just their own

knowledge, not industry-wide knowledge. But they have to follow the definition.

- Q54 **Viscount Chandos:** In the case of expenditure that has taken place with the company not knowing it was eligible for tax relief, from the point of view of the taxpayer, do you not feel that giving R&D tax credit for R&D that was taking place anyway does not represent very good value for money for the Exchequer?

Jenny Tragner: That is an interesting point. There has been a lot of discussion about dead weight in the system, directed to those examples, but in my experience of working with businesses that have accessed relief, it is not so much about whether that particular project would have taken place. If you are an inventor, you are carrying out that R&D project because you feel passionately about an idea and want to commercialise it. A tax incentive is designed to influence your behaviour. My clients would report accelerating that R&D investment or taking on slightly more risk than they would otherwise have been able to, because of the incentive. I am not sure it is necessarily about targeting only projects that would not otherwise have taken place. I am also not sure that we necessarily hold grant funding to that high an account. If 10 firms apply for a grant and one receives it, you would potentially expect all 10 of those R&D projects to go ahead. That is part of how the direct and indirect funding mechanisms work together.

- Q55 **Lord Palmer of Childs Hill:** Following on from that, how do you think HMRC can reduce error and abuse, particularly as so much of the claim is dealt with by filling things in on a computer and so is about knowing which button to press and which box to tick? If you get your claim through because you know the format, and so much of it is semi-automatic, what can HMRC do to cut down error and abuse?

Nigel Holmes: First, I think there are two separate areas there. There is abuse and there is error, and you have to look at them separately. From an abuse point of view, HMRC should be targeting the advisers who abuse the system rather than the claimants—the advisers are leading claimants up the garden path if they are saying, to take the example from the *Times*, that a blueberry croissant qualifies for R&D. It should focus on the adviser, rather than the claimant, who has probably gone into this quite innocently.

It is all about improving the guidance, making it clearer and simpler. When HMRC raises investigations—it is doing a lot more now than it was—it should tailor that to where it thinks the problem lies. At the moment, it seems very scattergun—cast the net wide and at least you will shrink the size of the pot—rather than focusing on where the real problems lie. It could be more focused.

A few years ago, HMRC used to run R&D units. They had officers who, although they were not scientists, engineers or chemists, had really good knowledge. You could pick up the phone and have conversations with them, and it worked. Now I just feel that it is lots of people pressing a

button to churn out a letter, without any attention given to whether it is the right company to target. It needs to focus its approach better.

Lord Palmer of Childs Hill: Do you think HMRC looks at particular advisers and marks them? You mentioned that you were at KPMG, probably dealing with larger claims. Would HMRC think that KPMG, PricewaterhouseCoopers or whoever might be more diligent than a smaller firm of advisers, or does it not look at it that way?

Jenny Tragner: I suspect it may do informally, although there is certainly no formal process there because of the regulatory framework in the tax advice market. We touched on the suite of measures coming in around the claims process next year. Companies providing the name of any agent who has supported the claim preparation will give HMRC a lot more data on where claims are coming from and who has supported them. We do not yet know how it will use that data, but one assumes it will enable it to target compliance activities or engage directly with agents and take action about behaviours, which in my experience they do very little of at the moment.

For a while now we have recommended compulsory professional body membership for those providing paid-for tax advisory services, so that businesses can be more confident that their advice is coming from a member of a professional body which has technical competence and some oversight over how they behave.

Q56 **Viscount Chandos:** You will both have heard Colin Hailey say that, from his and his organisation's perspective, HMRC is simply doing no checking or due diligence. Do you agree with that? Does that flow from inadequate resource within HMRC? If that is the case, would you both welcome those resources being increased to allow for the level of scrutiny that, for instance, Mr Hailey was advocating?

Jenny Tragner: Those resources within HMRC have been increased quite substantially over the past couple of years. Nigel mentioned the specialist R&D units, which were set up in 2006 specifically to recognise that this is a specialist area and to create consistency in a business's experience of HMRC. They have been disbanded more recently, but I think in 2020 HMRC got 100 new resources into R&D.

It is checking more claims, but there is more work to be done on the expertise available for HMRC to be able to target those activities, run those enquiries efficiently and review R&D projects—usually, a large part of reviewing an R&D claim is looking at the activities that take place and deciding whether they meet the criteria. With the exception of software, HMRC does not have its own in-house technical expertise to support that. BEIS does not have a role at the moment in supporting that application or in the interpretation of the definition. For me, it is not necessarily just about more resources but the right resources and expertise to focus those activities.

Nigel Holmes: Going back a few years, you used to get a letter from HMRC, after it had looked at the R&D report you submitted, saying, "Tell us more about this and explain that in a bit more detail". The letters we have been seeing recently come from a new R&D compliance team. There seem to be 12 standard questions, and they disregard everything we have already spent a lot of time on—telling HMRC what the R&D is and why we think it qualifies. It is just a standard template letter; in my opinion, that wastes both our time and HMRC's time.

We were talking before about quality not quantity. It should look at the reports that have been submitted; if it has questions, that is fine, but they should be specific. It should not waste its time and ours asking template questions on which, in the first instance, we will just point back to our report—we have a round of questions that could have been saved. The quality of the questions being asked needs to be improved.

Viscount Chandos: That may be like all of our experiences contacting our bank. You said there was an increase of 100 people but cuts to the specialised units. Is it feasible that there can be bespoke scrutiny by HMRC with its existing resources? If it has become standardised, that may be the result of the growth of claims over the last 10 years.

Jenny Tragner: I think it has. We should be mindful that the specialised units were formed in 2006, when the volume of claims was far smaller than now. Having said that, I believe the team at that time was smaller than the 100-odd it has now. That would need to be looked at.

There is another interesting point. When those units were set up, they had an enabling role as well as a compliance one. They were there to raise awareness of R&D tax reliefs and support and educate businesses in how to access the incentive. HMRC's activities are now very much focused on compliance, which I agree is in large part due to the volume of claims it has to deal with and the scrutiny it needs to place on that large population. However, there is an interesting question as to whether we should expect it to wear both hats and whether it is best placed to do that, particularly given that resources will be stretched even with those additional resources. That is more reason to be laser-focused in targeting those compliance activities where they will have most impact.

Q57 **The Chair:** You have thrown out one or two ideas for improvements already, but could you say a little more about the specific improvements you would like to see introduced by HMRC in relation to compliance? Do you have any extra thoughts you would like to share with us?

Nigel Holmes: I do not have anything extra to say but, to summarise, it has to be more focused. The skill set of the HMRC officers has to be increased so that they understand much better the definition in the rules and focus their attention on where they believe the problem lies rather than a more random, scattergun approach. My concern is that they will turn off genuine claimants who are doing good R&D, whether it is high-tech science or something that happens to meet the R&D definition in the BEIS guidelines. If claimants are doing R&D that qualifies, they will add

to the UK economy, but they are being penalised by receiving a random letter asking some very frustrating questions, when they have already delivered that information to HMRC. That policy must stop. It must be focused. That, in turn, would be helpful, because there would not be such stretched resources, as they would focus on where the problem lies.

Jenny Tragner: I would like to see us review the definition of R&D. Whether or not we change it, or its scope, there is work to be done to make it clearer and more accessible to businesses. Although that strays outside the remit of your question, it speaks to addressing errors and some of the behaviours in the agent market. Better guidance and examples will help educate businesses.

Anything we can do to simplify the incentive, while understanding that it still needs to be robust, will also help with that. As will everything we have said around targeted compliance activities and better awareness among businesses. We heard in the previous panel about how HMRC is not checking anything. We know that that has changed recently, but, for a business that is preparing its claim under self-assessment, are HMRC's expectations, and what might happen if HMRC checks the claim, well understood?

Q58 Lord Turnbull: We have seen two approaches from HMRC. One was based on the theory that the R&D tax credit system is complicated and needs to be dealt with by a specialist unit. That was in 2006. The other is that you need to bring dealing with claims closer to clients, so that you distribute support. That seems to be what has gone on more recently. Do you think it should go back to the 2006 methodology?

Nigel Holmes: In an ideal world, yes, if resource allows; I think that is a far better approach. Resource is the problem because, as Jenny says, the number of claims has gone up. Some of those may be the spurious ones that HMRC claws back, but they will be quite small in number compared to the total number of claims. As we are all aware, resource is tight at HM Revenue & Customs, but in an ideal world, that is what I would go back to.

Lord Turnbull: Taking account of the extra revenue—the reduction in credits given, because claims are better scrutinised—that would pay for itself, would it not?

Nigel Holmes: Exactly. Then the claims from the genuine claimants would be either not investigated or investigated and then approved. They will then continue to make claims in the future and that benefits the UK economy, so it makes absolute sense.

Q59 Lord Palmer of Childs Hill: Mr Holmes, I was a bit worried by your comment about real claims or those that are “within the guidelines”—I think those were the words you used. Are you saying that some people know what the guidelines are and use them, but that these are not real claims? I want to interpret exactly what you said because, in your comments, HMRC seems to operate on a “process now, check later”

basis. The genuine claim is fine, but with those that are found to be faulty, the problem comes later along the line. Have you any comments on that, particularly given your comment about claims that are real or within the guidelines, which worried me?

Nigel Holmes: “Process now, check later” is a general tax concept, not just an R&D concept. I apologise for not being clear. What I meant by that comment is that some people have an idea of what they consider R&D to be—chemicals, developing cures for cancer, et cetera—but the BEIS guidelines are very wide. The way it is defined—this is the legitimate definition—goes way beyond this being just for drugs or that type of R&D. It encapsulates industries such as manufacturing and engineering. What I meant by that comment is that sectors which are maybe not where you would expect to find R&D can still meet the guidelines.

Jenny Tragner: On your question on “process now, check later”, I agree that, if money has been paid out in error or in an abusive scenario, paying it out and then trying to get it back is obviously not ideal. That concept is baked into the tax self-assessment system.

There is a difference between risk-assessing and reviewing, but HMRC used to have a commitment or KPI that it would try to risk-assess a claim and decide whether it is likely to open an enquiry before processing the money. It recognised that, even if it ultimately finds nothing wrong with the claim, having the money and then having HMRC ask questions over the validity of the claim could be quite stressful for a business, and businesses need certainty so that they can reinvest that funding into more R&D.

I wonder if there is a balance to be struck over what we expect HMRC to do on risk-assessing claims when they are submitted and before it processes them, such that getting the money and then several months later having an enquiry that challenges the claim would be fairly rare. It used to be, but it is becoming more common as HMRC is enquiring into more claims.

Lord Palmer of Childs Hill: When claims are rejected later on, have you found that this has affected the viability or continuation of a business? Have businesses claimed, used the money and then found that HMRC wants it back, or do you never experience that?

Jenny Tragner: Certainly some of the businesses that have approached us have reached a point in an enquiry on a claim that we were not involved in preparing where there is just a stalemate and HMRC is not accepting that there is any R&D there. If the company received that money and reinvested it, there is every chance that this would cause some distress—potentially serious financial distress—particularly if it is a smaller business.

I think everyone would agree that it is not ideal for a business to be left in that situation. It is better if it has certainty that, when the claim is

processed, it has at least been risk-assessed. We perhaps cannot expect HMRC to review in detail claims and make a final decision about whether it needs to raise an enquiry in such a short timeframe—it has increased its KPI recently, but for a number of years it has been 28 days between submission and processing the claim—but certainly having a commitment that it would risk-assess, and therefore put as few businesses as possible in that situation, would be positive.

- Q60 **The Chair:** I invite both of you to comment on the following from your perspectives and what you do. Is there a chance that we could have a major financial problem with funding this scheme, if everybody who thinks they are eligible claims for it? We have talked about spurious claims, but let us assume that these are genuine claims. Could this cause such a demand on the public resources that we would be in quite serious trouble? Is this the kind of scheme that could run out of control as far as the Treasury and HMRC are concerned?

Jenny Tragner: This is probably a good moment to talk about the ONS measure of R&D and the recent revision it has made. That is our national measure of how much business R&D is happening in the UK. For a number of years it has been wildly out of kilter with the R&D expenditure on which relief is being claimed, and that has been part of the driver behind a lot of the discussions on value for money. It has recently revised that figure and brought it into line with HMRC's. To speak to your point about it not getting out of control, there is an opportunity to make sure that we are measuring the amount of R&D and measuring whether we are seeing the fruits of it within the UK. While they are subtly different, the two figures should align with each other and work closely together.

I reiterate, as I have mentioned a few times, that if we look at the definition of R&D and how we interpret it, we can be sure that we are targeting the incentive to the projects that we want to incentivise and that we have scope to evolve that over time. The Frascati Manual, which was mentioned earlier, keeps evolving; it keeps being revised, updated and iterated. The BEIS definition of R&D, which is what we use for tax credits, has not evolved since 2004—that is, until maths is included next year.

Nigel Holmes: We often survey our clients as to what they do when they get their R&D tax credits. We ask them what they use the money for and you could tick the answers off on about four or five boxes. They reinvest in R&D or working capital, spend it on capital expenditure or take on more staff. They all hope that this will grow their business and add something to the UK economy. I agree that it could spiral out of control, but we should not lose sight of the great good that the R&D tax credit system can benefit the UK economy. There is a risk that, if things do not go right, businesses will take their R&D abroad, as Mr Dyson did. We should not lose sight of the good the system does for the UK economy.

- Q61 **Viscount Chandos:** That leads well into the question I want to ask about the changes to restrict tax credits to R&D conducted in the UK. Can you comment on any possible further changes that you feel would be

beneficial?

Nigel Holmes: A company that uses overseas activities can do one of a few things. It can still use overseas activities, but cannot include them in a claim any more; it can go elsewhere in the UK and find the resource, but that may cost more, so it does not seem a very good commercial decision; or it can move its activities abroad. The big risk is that we lose all of that company's R&D.

There is one obvious exemption from the exclusion that seems to have been omitted. If you had a UK company with, say, a German parent, and the skill set lay in Germany, at the moment, unless it met one of the two very strict exemptions, it could not even include a parent company's cost in its R&D claim if that was recharged to the UK. It seems ridiculous that you could not tap into your own company group's employees or resource.

Personally, I would scrap the overseas activity rule and keep it as it is now. To me, the key is where the benefit lies. If that benefit is going to stimulate a UK company, it does not matter where the activities take place. That is my personal view.

Jenny Tragner: Overall, it feels like a fairly blunt instrument. There is no sense of scale there. Many of the comments are around the fact that we want global businesses to focus their investment in R&D here. We know that they have the flexibility to move it, and if we erode the attractiveness of the UK as a centre for R&D by limiting the value of the incentive they can access here, we might influence those decisions the other way, and that would not be advantageous. When you look internationally at how other countries have approached this, you see that a lot of them look at the ratio of investment within the country versus overseas. We are not doing that; we propose to restrict all costs.

Another point is that we are placing that administrative burden on all businesses, because they will all have to check, if they are using a subcontractor, where that activity is taking place. It might be obvious, but it is an additional check that all businesses will have to do, even if that expenditure is only a small proportion of their overall R&D investment. I agree with building a few more safeguards into that measure.

Q62 **Lord Turnbull:** We have had two proposals about professional conduct, professional standards and quoted advice. One is mandatory professional registration, which I think both of you are in favour of. The other is contingency fees. There are pros and cons to that; if someone takes on work that does not actually succeed in creating an acceptable application, they do not get paid as much, but it is also encouraging people to push out the boundaries all the time. Are you in favour of contingency fees or against them?

Nigel Holmes: I put my hands up and say that Catax charges contingency fees. We always have, since long before I started at Catax. That is the commercial model we choose, which is driven by the markets, because competitors are charging them as well.

As well as the fact that you do not pay anything if there is no claim, there is another thing to bear in mind. I used to work in accountancy practice. We made R&D claims, and we were charging on a time basis—the traditional structure of time. If you have quite a small claim, as an accountant you would be under quite a lot of pressure to get full recovery of your costs. The margin of what you charge your client on smaller claims compared to their benefit is shrunk. The advantage of the contingency fee is that you always share them in proportion. We have always advised that, if a claim is to be very substantial, we should make a commercial decision with the client; we are willing to charge a low percentage fee because we are trying to roughly measure a time basis, but we are also being fair by having a “no win, no fee” policy. In my opinion, contingency fees are not the horrible thing that people make them out to be.

Jenny Tragner: The concern comes from agent behaviour, which is more commonly linked to the contingency fee model, a “no win, no fee” model. Those fee bases are popular in the R&D market—I do not think tax is unique in that—but the type of agents we see behave poorly almost exclusively work on that fee basis. It obviously creates a threat to objectivity. As a professional body member, I have to make sure that my firm has safeguards in place to manage that threat. A non-professional body member obviously does not. For me, it is about the agent behaviour.

Lord Turnbull: Both of you want to retain this as an option, but are there any ways in which you could eliminate some of the more malign effects of it?

Jenny Tragner: I think there is a stronger role for the professional bodies to play. They have guidance on the objectivity threat of offering contingency fees and the safeguards to have in place. They have an oversight role over members, but obviously they can inform only the behaviour of their members, hence the recommendation that, if you are charging clients for tax advice, you should be a member of a professional body.

The Chair: Are there any further questions?

Q63 **Viscount Chandos:** What about the level of contingency fees paid compared to other areas of tax, such as VAT. For instance, I was on the board of a charity that had undertaken a major building project. I had my breath taken away by the level of contingency fee that a major firm of accountants was charging for VAT recovery—I think it was 30%. How would you position the fees either that your firms charge or that are charged in the industry compared to comparable areas of claim?

Jenny Tragner: I agree with the point Nigel made that a contingency fee is just a way of pricing for a piece of work. That starts with the time and expertise that we think we will need to deploy to the scope of work that we have agreed with the client, and that will then inform the contingency basis.

I guess the danger with contingency fees is that, because they are linked to the benefit of the claim, the amount of work that you need to put into support a client in preparing the claim robustly may mean that you are not making a profit but incurring a loss on that project. Do you balance out the other end of the portfolio and enjoy a huge profit margin if the numbers are bigger? That does not seem to be the way that things typically work. When used responsibly, a contingency fee is just a format for pricing work, and that fee basis must work for both the adviser and the client.

I do not feel as though I have addressed your question very directly, but I would not like to see the professional bodies or a regulator try to be prescriptive on the level of contingency fee that is acceptable. I would like more awareness among businesses that what they are paying for is advice, support and expertise.

Viscount Chandos: A contingency fee is normally set—whether it is in mergers and acquisitions or whatever—on the assumption that a significant proportion of transactions do not complete. Do you think the high level of acceptance actually means that advisers are, at least at the moment, doing unusually well because the contingency fee prices in a risk that does not really exist?

Jenny Tragner: Logically, a lack of scrutiny could create that environment. It is worth noting that it is a fiercely competitive market due to of the number of advisers and agents out there, because of the lack of any barrier to entry to become an R&D tax adviser. That in and of itself puts pressure on fee levels in the agent community.

Nigel Holmes: There is definitely a lot of competition. You often get companies trying to play you off against one another. To me, that is what a contingency fee is about: entering into an eyes-open contract with your client, saying this is what we are going to charge and these are the skills we bring. The firm down the road might be cheaper, and the firm up the road might be dearer, but do they do this or that? Clients should not base their decision on the size of the fee; it should be about the quality of the work. It is then up to them whether they want to accept that fee or negotiate it, as you would negotiate with an accountant on an hourly rate or fixed fee.

Jenny Tragner: If businesses assume that they are already operating in a regulated market, there can be a lack of due diligence and awareness on their part on how to choose and why the level of fees might differ. We have found that most businesses assume that they are dealing with a regulated market.

Nigel Holmes: Software systems where you just plug in a bit of data and out pops your R&D report have been briefly hinted at. They charge very small percentage fees but no one is spending a lot of time on it. The old expression is “Garbage in, garbage out.” If someone is not educated to know what to put into the system, how do you know that you are getting a good R&D report out of it?

The Chair: That concludes the question session. I remind Mr Holmes to let us have a note about the origin of that rumour that is going around about your firm at the moment. Thank you to both of you for coming along this afternoon and helping us with our inquiries. That formally ends the session today. Thank you again.