



HOUSE OF LORDS

Economic Affairs Committee

2nd Report of Session 2023–24

**Research and
development tax
relief, HMRC data
requirements, promoters
of tax avoidance and
sentencing for tax fraud**

Ordered to be printed 25 January 2024 and published 1 February 2024

Published by the Authority of the House of Lords

Select Committee on Economic Affairs Finance Bill Sub Committee

The Economic Affairs Finance Bill Sub Committee was appointed this session “to consider the draft finance bill 2023–24”.

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See Appendix 1.

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Evidence is published online at <https://committees.parliament.uk/work/7923/draft-finance-bill-202324/publications/> and available for inspection at the Parliamentary Archives (020 7219 3074).

Q in footnotes refers to a question in oral evidence.

SUMMARY

This inquiry covered four measures within the draft Finance Bill 2023–24: reform of Research and Development (R&D) tax relief, including a merger of the two R&D schemes and the introduction of a new scheme providing tax relief for R&D intensive small and medium sized enterprises (SMEs); a requirement for certain businesses to provide additional data to HMRC; measures dealing with promoters of tax avoidance; and an increase in the maximum prison term for tax fraud.

R&D Reform

The R&D reforms addressed within this report mark the conclusion of an R&D review launched by the Government in March 2021. R&D tax relief is seen by businesses as crucial for supporting and promoting R&D activity in the UK. We therefore welcome the Government's commitment to simplifying R&D tax relief and continuing to support business investment in R&D. However, we are concerned that the scale and rate of change to R&D tax relief over the last five years has created uncertainty and a lack of understanding about the UK's R&D tax relief regime, which risks undermining its incentive effect.

While we welcome confirmation from the Government that the R&D tax relief review is now complete, there remain a number of issues that require further clarity from the Government, particularly with respect to subcontracted R&D and subsidised R&D expenditure. It was clear throughout our inquiry that the issue of subcontracted R&D generated the most concern for businesses in a number of sectors. It is important that the Government commits to evaluating the effectiveness of these reforms, especially their impact on incentivising R&D investment.

We make strong recommendations regarding the scale and pace of change in the area of R&D relief over the last few years, as well as the ways in which the Government consults with stakeholders.

HMRC Data Requirements

The draft Finance Bill sets out a new power for HMRC to require additional data from employers and individual taxpayers, in line with the Government's 10-year tax administration strategy, published in July 2020. It was evident from the start of the inquiry that there was a lack of clarity regarding this requirement. We are concerned at the length of time it took for the Government to clarify to businesses what was required, despite the consultation on this measure going on for more than a year.

We welcome the Government's clarification that the data required for employees will be the number of hours paid rather than hours worked, as originally stated. However, additional burdens should not be placed on businesses unless there is a compelling reason to do so. HMRC should publish guidance as early as possible in 2024 to help employers and businesses understand the exact data that they will be required to provide, and what this data will be used for.

We consider that the case for requiring employers to provide employee hours data to HMRC has not been made out. We also have particular concerns about the legal basis underpinning these additional data requirements and how the data will be used and have asked the Government for clear explanations on these points.

Tax Avoidance and Tax Fraud

The draft legislation dealing with promoters of tax avoidance contains two measures, one creating a criminal offence where promoters fail to comply with a 'stop notice' from HMRC, and the other granting HMRC a new power to apply to the court directly to disqualify directors of a company involved in promoting tax avoidance. There are also provisions doubling the maximum prison term for tax fraud to 14 years.

Promoters

We are pleased to see the Government's commitment to cracking down on promoters, and it was clear from our evidence that witnesses were generally supportive of the draft legislation on the introduction of a new criminal offence for promoters. Nevertheless, we are particularly concerned about how the legislation aimed at dealing with promoters of tax avoidance schemes can be applied to offshore promoters.

For these measures to prove effective, promoters must perceive that prosecutions, even when conducted against those operating offshore, are plausible and credible. We are also concerned about the lack of independent oversight of the issuing of stop notices and of decisions to prosecute, and we recommend that this be put in place. We make recommendations about wider publicity and communications about this issue to ensure that vulnerable groups are not duped into acting as 'stooge directors' for promoters.

Sentencing

The measure increasing the maximum prison term for tax fraud is derived from the 2019 Conservative election manifesto. The Government told us that this measure would send a signal to anyone considering committing tax fraud. However, we remain sceptical that increasing the maximum prison term is the most effective deterrent against tax fraud and consider that HMRC should review its strategy for the prosecution of tax fraud.

Whistleblowers

HMRC operates a whistleblower scheme to encourage and reward whistleblowers to supply information about tax fraud, yet our inquiry highlighted the lack of awareness of this scheme, as well as the lack of incentives for whistleblowers to report this information. For the whistleblower scheme to have an impact, HMRC should publicise it more widely, including on social media platforms, and consider how it might better incentivise whistleblowers to come forward.

Cross-Cutting Issues

Looking ahead, we are pleased to see the amount of consultation the Government has undertaken on the measures discussed in this report. However, we consider that the nature and quality of consultations need to be improved in order to ensure that they are as effective as they should be. In addition, despite the issue of HMRC resourcing being raised in previous Finance Bill Sub-Committee reports, it has become apparent that the situation has continued to deteriorate. If the Government is to continue introducing new legislation that places additional burdens on HMRC, it must ensure that HMRC is adequately resourced in order to fulfil its role and provide taxpayers with the level of service that they expect.

Research and development tax relief, HMRC data requirements, promoters of tax avoidance and sentencing for tax fraud

CHAPTER 1: INTRODUCTION

1. The Finance Bill Sub-Committee is appointed by the Economic Affairs Committee on an annual basis to consider the technical issues of tax administration, clarification and simplification arising from the draft Finance Bill. In recognition of the House of Commons' financial privilege, the Sub-Committee does not inquire into rates or incidence of tax.
2. This year our inquiry covered four measures within the draft Finance Bill 23–24, published on 18 July 2023. They are:
 - The reforms that merge the two existing Research and Development (R&D) schemes as well as providing tax relief for R&D intensive Small and Medium-sized Enterprises (SMEs);
 - A requirement for certain businesses to provide additional data to HMRC;
 - The measures dealing with promoters of tax avoidance; and
 - An increase in the maximum prison term for tax fraud.
3. The R&D reforms, which involve the merger of the two existing R&D schemes, as well as the introduction of a scheme for R&D intensive SMEs, follow an R&D review launched by the Government in March 2021. The draft Finance Bill proposes an additional tax relief for the most R&D intensive loss-making SMEs. It also proposes combining the current SME R&D and Research and Development Expenditure Credit (RDEC) schemes into a single, simplified scheme providing an above the line¹ tax credit—which we refer to in this report as the ‘merged scheme’.
4. On 22 November 2023, the Autumn Statement announced that the merged R&D scheme would be applied to accounting periods starting on or after 1 April 2024. The Economic Affairs Committee usually publishes the report prepared by the Finance Bill Sub-Committee shortly before the Autumn Statement and the publication of the Finance Bill itself. However, the Finance Bill 2023–24, which was expected in the Spring, was published on 29 November 2023.
5. The measure requiring certain taxpayers to provide additional data to HMRC follows a consultation, launched in July 2022, which proposed a number of different options for improving the range of data that HMRC collects and uses. Under the draft legislation, employers, owner-managers, and the self-employed will be required to provide additional information. This will

1 See Box 1.

include the submission of employee hours paid via Real Time Information PAYE reporting, as well as showing dividend income received by owner managers from their own companies separately in their Self-Assessment return and the percentage share they hold in their companies.

6. The measures dealing with promoters of tax avoidance aim to counter and penalise the activities of promoters, and build on anti-avoidance measures introduced in the Finance Act 2021 and Finance Act 2022.²

Box 1: 'Above and below the line'

In simple terms, above the line costs are the standard routine costs a business incurs in its normal operations. They are subtracted from revenue to calculate gross profit. Below the line costs, on the other hand, are unexpected or non-repeated costs not included in the above the line calculation. These are deducted from gross profits to calculate the net profit. In the context of the subject matter of this report, RDEC tax relief for larger companies is an above the line credit, meaning that it is applied to the company's profit before that profit is taxed. This can then be shown as income, increasing the company's stated profitability. It also increases predictability (as it excludes one-off or unexpected costs from the calculation) enabling the company to forecast its cashflow more effectively.

By contrast, tax relief and tax credits under the current SME scheme are applied below the line. This means that they are not taxable (as they are applied after tax), thus providing a better representation of the core operating performance of the business (by not inflating income).

7. We took written and oral evidence from business organisations, tax professionals, professional advisory firms, law societies, academics, and individuals. We also heard evidence from His Majesty's Revenue and Customs (HMRC), His Majesty's Treasury (HM Treasury) officials, and the Financial Secretary to the Treasury, Nigel Huddleston MP. We are grateful to all those who provided evidence and would like to thank them for their time. We would also like to thank our two specialist advisers, Sarah Squires and Robina Dyall for their invaluable advice, insight, and support throughout the inquiry.

This report

8. The first part of this report covers the reforms to the R&D tax relief regimes; Chapter 2 discusses the background, Chapter 3 the introduction of the R&D intensive scheme for SMEs, Chapter 4, the introduction of the R&D merged scheme, and Chapter 5, the subcontracting and subsidy arrangements under the merged scheme. We then turn to the three other measures: Chapter 6 covers HMRC's new data requirements for employers, Chapter 7 explores the measure dealing with promoters of tax avoidance, and Chapter 8 deals with the proposed doubling of the maximum prison term for tax fraud. Finally, in Chapter 9, we discuss the common themes that have emerged across the four measures.

2 Finance Act 2021, [section 121](#); [Finance Act 2022](#)

CHAPTER 2: GOVERNMENT REVIEW OF RESEARCH AND DEVELOPMENT TAX RELIEF

Background

9. Research and development tax relief (R&D relief) was first introduced in 2000 in response to evidence that the UK's R&D spend was falling behind that of its competitors.³ Its purpose was to incentivise companies to undertake innovative R&D—R&D that seeks to advance overall knowledge or capability in a field of science or technology⁴—by providing further tax relief, over and above the normal corporation tax relief available for business expenses.
10. Initially only available to small and medium sized enterprises (SMEs),⁵ the Government extended R&D relief to larger companies in 2002, providing relief on the same basis, albeit at a lower rate.⁶ Since then, there have been a number of changes to R&D relief, particularly in relation to the rate at which relief is granted for qualifying R&D.⁷ However, one of the more significant changes was the replacement of the large company scheme by the RDEC scheme in 2013. Under RDEC, large companies obtained relief by way of an 'above the line'⁸ credit instead of through additional tax relief.⁹
11. The effectiveness of R&D was not considered during this year's inquiry. However, last year's Finance Bill Sub-Committee report, published in January 2023¹⁰, concluded that R&D relief is perceived by business as important for supporting and promoting R&D activity in the UK. The report also concluded that data from HMRC indicates that the reliefs do promote spending on R&D, but that the return on the SME relief was disappointing.

The Research & Development Review

12. In March 2021, the Government announced it was carrying out a review of R&D relief, the first in the history of R&D relief.¹¹ It said it wanted to: "consider all elements of the two R&D tax relief schemes, with the objective

3 HM Treasury, *Stability and steady growth for Britain: Pre Budget Report* (November 1999), pp 34, 37: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/260769/cm4479.pdf [accessed 3 January 2024]

4 HM Treasury and HMRC, *R&D Tax Reliefs: consultation* (March 2021), p 8: https://assets.publishing.service.gov.uk/media/603cc357d3bf7f03985e12b5/Condoc_-_RD_review_.pdf [accessed 3 January 2024]

5 HM Treasury, *Budget 2000* (21 March 2000), p 40: <https://www.gov.uk/government/publications/budget-march-2000> [accessed 3 January 2024]

6 HM Treasury, *Budget 2013* (20 March 2013), p 78: <https://www.gov.uk/government/publications/budget-2013-documents> [accessed 3 January 2024]

7 HMRC 'Internal Manual, Corporate Intangibles Research and Development Manual' (28 December 2023): <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird98900> [accessed 3 January 2024]

8 See Box 1.

9 HM Treasury, *Autumn Statement 2011* (November 2011), p 40: <https://assets.publishing.service.gov.uk/media/5a7c0151e5274a7202e18f39/8231.pdf> [accessed 3 January 2024]. Although RDEC was introduced in 2013, there was a transitional period of 3 years in which large companies could choose to continue claiming R&D relief by way of an additional tax deduction under the original scheme or instead claim the new credit under RDEC. From 1 April 2016, however, a large company could only claim under RDEC.

10 Economic Affairs Committee, *Research and Development Tax Relief and Expenditure Credit* (3rd Report, Session 2022–23, HL Paper 137)

11 HM Treasury, *Budget 2021 Protecting The Jobs and Livelihoods Of The British People* (3 March 2021), p 64: https://assets.publishing.service.gov.uk/media/60411da7e90e077dcdd752ce/BUDGET_2021_-_web.pdf [accessed 3 January 2024]

of ensuring that the UK remains a competitive location for cutting edge research, that the reliefs continue to be fit for purpose and that taxpayer money is effectively targeted”.¹²

13. The Government launched a consultation seeking views on the efficacy of the two R&D relief schemes and on possible changes to the regime.¹³ The consultation said that the UK was: “unusual internationally in having two different schemes” and questioned whether there was a case for consolidating the SME and RDEC schemes. It also asked how the availability of R&D relief impacted investment decisions and what could be done to improve the claims process.¹⁴
14. The Government noted that: “the rate of relief provided by the SME scheme is significantly more generous than that provided by RDEC” and wanted to understand why, despite this, recent evaluations of the two schemes suggested that RDEC was more successful in promoting additional R&D investment than the SME scheme.¹⁵
15. At the time of the review, the additional tax relief under the SME scheme was provided at a rate of 130 per cent. As R&D tax relief is an additional relief, the SME first deducts 100 per cent of its qualifying R&D expenditure from its income under normal corporation tax rules and then claims an additional deduction/payable tax credit under the SME scheme. For an SME spending £1,000 on qualifying R&D, this would mean a deduction of £1,300 which, when combined with the normal tax relief for that expenditure, would translate into total relief of £2,300—230 per cent. This had the effect of reducing the SME’s overall taxable profits, resulting in a lower corporation tax bill. Under the SME scheme, SMEs who carried out R&D but made a loss in the relevant year could claim a payable tax credit worth (in broad terms) 14.5 per cent of the surrenderable loss.¹⁶
16. In contrast, under RDEC, R&D tax relief is provided to larger companies by way of a (taxable) credit which, at the time of the review, was set at 13 per cent of qualifying R&D spend—referred to as above the line credit¹⁷. This means that, in addition to the tax relief for that R&D expenditure under normal corporation tax rules, the company’s R&D expenditure of £1,000 would result in a credit of £130. A company that receives RDEC credit will generally use it to offset its tax bill, reducing the amount of corporation tax it would otherwise pay but, in some circumstances, such as where the company makes a loss, the credit can be paid in cash.¹⁸

12 HM Treasury, *Budget 2021: Protecting The Jobs and Livelihoods Of The British People* (March 2021), p 64: https://assets.publishing.service.gov.uk/media/60411da7e90e077dcdd752ce/BUDGET_2021_-_web.pdf [accessed 03 January 2024]

13 HM Treasury and HMRC ‘R&D Tax Reliefs: consultation’: <https://www.gov.uk/government/consultations/rd-tax-reliefs-consultation> [accessed 3 January 2023]

14 HM Treasury and HMRC, *R&D Tax Reliefs: consultation* (3 March 2021), p 14: https://assets.publishing.service.gov.uk/media/603cc357d3bf7f03985e12b5/Condoc_-_RD_review_.pdf [accessed 3 January 2024]

15 Additionality—the investment that would not happen but for the relief—is the way in which the Government looks to measure the impact of R&D tax relief.

16 The SME tax credit scheme allows SMEs to exchange their losses for cash credit: the 14.5 per cent rate applied until 31 March 2023.

17 See Box 1.

18 Although the RDEC mechanism for relief is primarily targeted at large companies, there can be circumstances in which an SME is required to claim relief under RDEC (and not the SME scheme). In particular, an SME must use RDEC if it is carrying out R&D activities as a subcontractor to a large company or if its R&D expenditure has been subsidised.

Initial reforms—Finance (No 2) Act 2023

17. In November 2021, HM Treasury published the *R&D Tax Reliefs Report* which set out the Government’s proposals for specific changes to R&D relief.¹⁹ These included a number of compliance-related changes primarily designed to help counter error and fraud, and a proposed restriction on R&D relief for certain overseas R&D expenditure.²⁰ These proposals, which the Government said were: “initial reforms”²¹, were examined by last year’s Finance Bill Sub-Committee.²² Other than the proposals relating to R&D relief for overseas expenditure, these proposals were legislated for in *Finance (No 2) Act 2023*.²³

“Rebalancing the reliefs”

18. In the Spring Statement on 23 March 2022, the Government said that it was continuing its review of R&D relief and that it was considering a possible increase to the rate of relief under RDEC to: “rebalance the schemes and make RDEC more internationally competitive”.²⁴ In the Autumn Statement on 17 November 2022 (Autumn Statement 2022), the Government confirmed that the rate of relief under RDEC would increase from 13 per cent to 20 per cent from 1 April 2024, while the SME deduction rate would be reduced from 130 per cent to 86 per cent, and the rate of the SME payable credit which could be claimed for surrenderable losses would be decreased from 14.5 per cent to 10 per cent.²⁵
19. The Government described this rebalancing of the reliefs as bringing: “the generosity of the two schemes closer together” and as: “a step towards a simplified, single RDEC-like scheme for all”, about which it would be launching a consultation. It also committed to work with industry ahead of the 2023 Spring Budget: “to understand whether and how to provide further support to R&D intensive SMEs”.²⁶
20. Less than two months later, on 13 January 2023, the promised consultation on the design of a single R&D relief scheme was launched.²⁷ Although the Government maintained that no final decision to merge the schemes had

19 HM Treasury, ‘R&D Tax Reliefs: Report’ (30 November 2021): <https://www.gov.uk/government/publications/rd-tax-reliefs-report> [accessed 3 January 2024]

20 HMRC, ‘Research and Development Tax Relief reform (21 July 2022): <https://www.gov.uk/government/publications/research-and-development-tax-relief-changes/research-and-development-tax-relief-reform> accessed 3 January 2024]

21 HM Treasury, *Spring Statement 2022: documents* (23 March 2022), p 31, 40, 41: https://assets.publishing.service.gov.uk/media/623b313ed3bf7f6ac2de7557/Spring_Statement_2022_Print.pdf [accessed 3 January 2024]

22 Economic Affairs Committee, *Research and Development Tax Relief and Expenditure Credit* (3rd Report, Session 2022–23, HL Paper 137)

23 The legislation for the restriction on overseas R&D expenditure is instead in Finance Bill 2023–24, due to come into effect for accounting periods beginning on or after 1 April 2024.

24 HM Treasury, *Spring Statement 2022*: (23 March 2022), p 41, 42: https://assets.publishing.service.gov.uk/media/623b313ed3bf7f6ac2de7557/Spring_Statement_2022_Print.pdf [accessed 3 January 2023]

25 HMRC, ‘Research and Development Tax Reliefs–Reform’ (21 November 2022): <https://www.gov.uk/government/publications/research-and-development-rd-tax-reliefs-reform> [accessed 3 January 2023]. The SME additional deduction rate was reduced from 130 per cent to 86 per cent, with the SME credit rate also reducing from 14.5 per cent to 10 per cent.

26 HMRC, ‘Research and Development Tax Reliefs–Reform’ (21 November 2022): <https://www.gov.uk/government/publications/research-and-development-rd-tax-reliefs-reform> [accessed 3 January 2023]

27 HM Treasury and HMRC, *R&D Tax Reliefs Review: Consultation on a single scheme* (13 January 2023), p 11: https://assets.publishing.service.gov.uk/media/63c51fc08fa8f572a9a36f33/20230113_R_D_Consultation.pdf [accessed 3 Jan 2024]

been made, it stated that, if the ultimate decision was indeed to merge the schemes, this new merged scheme would be introduced on 1 April 2024.²⁸

Budget 2023—a new R&D intensive scheme

21. As the consultation period expired two days before the 2023 Spring Budget, no announcement about whether the two schemes would be merged was made at that stage. The Government did say, however, that it would publish draft legislation on a merged scheme in July 2023 for consultation: “to keep open the option of implementing ... [a merged scheme] ... from April 2024”.²⁹ It also confirmed that the restriction on R&D relief for overseas expenditure would come into effect from April 2024, a year later than originally proposed, to allow time to assess this restriction’s interaction with any merged scheme.³⁰
22. The Government made an additional announcement that, with effect from 1 April 2023, it would introduce a new scheme for loss-making SMEs that invested heavily in R&D—companies it referred to as ‘R&D intensive SMEs’. Under this scheme, qualifying SMEs would be able to continue to claim tax credit under the SME scheme at the previous rate of 14.5 per cent instead of the new lower 10 per cent rate that would otherwise apply.³¹

Autumn Statement 2023—the end of the review

23. In the Autumn Statement on 22 November 2023 (Autumn Statement 2023), the Government confirmed that it would be proceeding with the merger of the two existing R&D schemes into a single scheme broadly based on the existing RDEC scheme, and that this would come into effect for accounting periods beginning on or after 1 April 2024.³² This announcement marked the conclusion of the R&D Review started in March 2021.³³
24. At the same time, the Government announced some changes to the new R&D intensive scheme, to take effect from the start of the claimant company’s first accounting period beginning on or after 1 April 2024. These changes included amendments to the test for R&D intensity—which we discuss in Chapter 3—as well as changes to ensure greater consistency between the rules in the existing SME scheme (under which R&D intensive relief is given) and the proposed merged scheme, in certain areas.³⁴ The Government also said that it would be continuing to work with industry on developing this particular relief.

28 HM Treasury and HMRC, *R&D Tax Reliefs Review: Consultation on a single scheme* (13 January 2023), p 12: https://assets.publishing.service.gov.uk/media/63c51fc08fa8f572a9a36f33/20230113_R_D_Consultation.pdf [accessed 25 January 2024]

29 HM Treasury, *Spring Budget 2023* (15 March 2023), p 87: https://assets.publishing.service.gov.uk/media/6419c8dde90e0769ea4a4eb6/Print_Budget_2023.pdf [accessed 03 January 2024]

30 HM Treasury, *Spring Budget 2023* (15 March 2024), p 88: https://assets.publishing.service.gov.uk/media/6419c8dde90e0769ea4a4eb6/Print_Budget_2023.pdf [accessed 25 January 2024]

31 HMRC, ‘Technical Note Additional tax relief for Research and Development intensive small and medium enterprises’ (15 March 2023): <https://www.gov.uk/government/publications/additional-tax-relief-for-research-and-development-intensive-small-and-medium-sized-enterprises> [accessed 3 January 2024]

32 HMRC, ‘Research & Development (R&D) tax relief reforms’ (22 November 2023): <https://www.gov.uk/government/publications/research-development-rd-tax-relief-reforms> [accessed 3 January 2024]

33 HM Treasury, *Autumn Statement 2023* (22 November 2023), p 94: https://assets.publishing.service.gov.uk/media/6568909c5936bb00133167cc/E02982473_Autumn_Statement_Nov_23_Accessible_Final.pdf [accessed 3 January 2024]

34 HM Treasury, ‘Autumn Statement 2023 Research and Development Tax Reliefs Reform’: <https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform> [accessed 3 January 2024]

25. Legislation to implement the merger and to enact the R&D intensive scheme was subsequently published as part of Finance Bill 2023–2024.³⁵ We consider the R&D intensive scheme in Chapter 3 of this report, and the merged scheme in Chapters 4 and 5.

General reaction to the R&D reforms

26. Our witnesses generally supported the Government in its efforts to simplify R&D tax relief. Ela8 Limited (ela8) said that, overall, it welcomed: “any move to simplify the R&D tax relief regime as it is clear that the complexity of the current arrangements is causing difficulties for claimants, R&D practitioners and HMRC alike”.³⁶
27. This general support for the reforms notwithstanding, several of our witnesses expressed concerns about the number and scale of the changes to R&D relief in recent years.³⁷ Ayming UK Limited (Ayming) told us: “R&D schemes are most effective when there is stability and predictability, because businesses can factor that into their decision-making processes ... [but] ... companies ... cannot take R&D relief into account when it is in such a state of flux”.³⁸ ForrestBrown Limited (ForrestBrown) agreed, saying that: “the current extended reform period ... has been piecemeal in nature, leading to uncertainties that have undermined the effectiveness of the incentive as a driver of R&D investment.”³⁹
28. Referring to the reduction in the rate of relief under the SME scheme announced at Autumn Statement 2022, Michael Moore of British Venture Capital Association (BVCA) told us that: “the scale of the prospective change was a shock”.⁴⁰ Nonetheless, he was: “pleased about how some of the thinking has evolved”.⁴¹ However, Dr Roger Barker of the Institute of Directors (IoD) said the last year: “had not been a productive way forward” with both new proposed regimes creating: “a lot of uncertainty and disruption”.⁴²
29. There was also a sense that the current proposals—the introduction of an R&D intensive scheme and the possible merger—were being: “rushed”.⁴³ Mace said that the timeline: “risks the R&D tax scheme being no longer considered as a stable and reliable incentive for future R&D investment decisions”.⁴⁴
30. The Financial Secretary, Nigel Huddleston MP, told us that the changes to R&D relief now being taken forward—namely, the R&D intensive scheme and the merger—would: “obviously be beneficial overall” and, in particular, meant there was: “more money going into investing and encouraging investment in R&D”.⁴⁵ He also told us that the changes were: “the

35 [Finance Bill](#), Schedule 1 [Bill 14 (2023–24)]

36 Written evidence from ela8 limited ([DFH0015](#)), BIA ([DFH0013](#)) and ICAS ([DFH0018](#))

37 Written evidence from Ayming UK ([DFH0014](#)), BIA ([DFH0013](#)) and ForrestBrown ([DFH0016](#))

38 [Q 41](#) (Benjamin Craig) and written evidence from Ayming UK ([DFH0014](#))

39 Written evidence from ForrestBrown ([DFH0016](#)). See also written evidence from BIA ([DFH0013](#)) and [Q 42](#) (Mark Davis).

40 [Q 56](#) (Michael Moore) and written evidence from National Centre for Universities and Business (NCUB) ([DFH0009](#))

41 [Q 56](#) (Michael Moore)

42 [Q 57](#) (Dr Roger Barker)

43 [Q 8](#) (Richard Jones) and written evidence from Ayming UK ([DFH0014](#)), CAI ([DFH001](#)), CIOT ([DFH0006](#)), ICAS ([DFH0018](#)) and Skanska ([DFH0010](#))

44 Written evidence from Mace ([DFH0007](#)). See also written evidence from CIOT ([DFH0006](#)).

45 [Q 81](#) (Nigel Huddleston MP, FST)

measures that we have been hearing industries say they want, and on the government side we do not want to drag our feet in any way.” He reiterated the Government’s view that R&D relief was: “an important element” of its: “overall push for growth”.⁴⁶

31. Matt Henty, Deputy Director, Enterprise and Property Tax, at HM Treasury acknowledged that companies would need to adjust to the new R&D relief rules but considered that the changes overall were: “very worthwhile”, resulting in an increase in the support the Government would be providing to R&D activity.⁴⁷
32. **While it is right for the Government to keep the R&D relief scheme under review to ensure that it meets the needs of a modern economy and provides value for money for the taxpayer, too much change over too short a period can create uncertainty. We are concerned that the number of significant R&D changes made in the last 5 years has led to a perception of instability in the UK’s R&D tax relief regime and undermined the intended incentive effect of the relief.**
33. **The Government’s postponement of a final decision on creating a single merged scheme of R&D relief added to the uncertainty around R&D relief. Businesses can only start to prepare in earnest once a change is confirmed. The Government’s announcement of a prospective commencement date of an unconfirmed measure did not give businesses sufficient certainty to be able to plan effectively.**
34. *We welcome the announcement at Autumn Statement 2023 that the R&D review is now complete. Businesses need time to adjust to all the recent changes to R&D relief. We recommend that, over the medium term, the Government does not make further changes to R&D tax relief, other than to simplify the relief as set out in this report.*

⁴⁶ [Q 84](#) (Nigel Huddleston MP, FST)

⁴⁷ [Q 87](#) (Matt Henty, HM Treasury). For information as to total Exchequer costs of the two schemes (for 2023/24 to 2028/29). See also Letter from Nigel Huddleston MP Financial Secretary to the Treasury to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (7 December 2023): committees.parliament.uk/publications/42711/documents/212323/default/ and Letter from Nigel Huddleston MP Financial Secretary to the Treasury to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (12 December 2023): committees.parliament.uk/publications/42711/documents/212323/default/.

CHAPTER 3: THE RESEARCH & DEVELOPMENT INTENSIVE SCHEME FOR SMALL AND MEDIUM ENTERPRISES

Background

35. The introduction of an additional tax relief aimed specifically at SMEs that heavily invest in R&D, was first mooted at Autumn Statement 2022.⁴⁸ The Institute of Chartered Accountants in England and Wales (ICAEW) told us that it was: “announced unexpectedly ... without any prior public consultation”⁴⁹. It was not until Budget 2023 that details about the scheme were provided.
36. The Government said that this scheme was aimed at channelling further support to those R&D intensive companies that generally obtained relief under the existing SME scheme through a cash payment (rather than as an additional tax deduction)⁵⁰ and for whom the reduction in the rate of relief under the SME scheme from 1 April 2023 was: “creating challenges”.⁵¹ At that time, HMRC estimated that around 20,000 SMEs, out of a total of 39,000 loss-making SMEs, should be able to claim under the R&D intensive scheme—although that number has now increased to 25,000 as a result of changes to the scheme announced at Autumn Statement 2023.⁵² Draft legislation for the R&D intensive scheme followed in July 2023.⁵³
37. Under the R&D intensive scheme, a loss-making SME that qualifies as R&D intensive⁵⁴ will claim under the existing SME scheme, but a higher rate of 14.5 per cent (in most cases) will be used to calculate the cash payment due, rather than the 10 per cent rate that now applies under the SME scheme more generally. The additional tax deduction rate, however, will remain at the new 86 per cent level.⁵⁵
38. The R&D intensive scheme took effect from 1 April 2023⁵⁶, the same date on which the payable tax credit under the existing SME scheme was reduced to 10 per cent. This meant that SMEs eligible to claim under the R&D intensive scheme would be effectively protected from the reduction in the SME rates that took effect on the same date. However, companies will only

48 HMRC, ‘Policy paper, Research and Development Tax Reliefs—Reform’ (21 November 2022): <https://www.gov.uk/government/publications/research-and-development-rd-tax-reliefs-reform> [accessed 3 January 2024]. See Chapter 2 above.

49 Written evidence from ICAEW (DFH0005)

50 Q 80 (Matt Henty). The option of obtaining R&D relief by way of cash payment under the SME scheme is only available to a company that is loss-making.

51 HMRC, ‘Technical Note Additional tax relief for Research and Development intensive small and medium enterprises’ (15 March 2023): <https://www.gov.uk/government/publications/additional-tax-relief-for-research-and-development-intensive-small-and-medium-sized-enterprises> [accessed 4 January 2023]

52 Q 80 (Matt Henty) and written evidence from HMRC (DFH0020). By way of comparison, the Government estimates that the proposed merged scheme will apply to 50,000 to 60,000 companies.

53 HMRC and HM Treasury: ‘Consultation on draft legislation published for Finance Bill 2023–24’ (18 July 2023): <https://www.gov.uk/government/collections/finance-bill-2023-24> [accessed 4 January 2024]

54 We discuss the definition of R&D intensive below but in broad terms the test of R&D intensity is by reference to the proportion of a company’s (tax deductible) expenditure that is on R&D.

55 HM Treasury, *Spring Budget 2023* (15 March 2023), p 61: <https://www.gov.uk/government/publications/spring-budget-2023> [accessed 4 January 2024]. The additional deduction rate applies in working out the loss that the SME would have made had it claimed the additional tax relief—and so determines the amount of the cash payable credit. The Government said this meant that eligible companies would receive £27 from HMRC for every £100 of R&D investment.

56 *Finance Bill*, Schedule 1 [Bill 14 (2023–24)]

be able to claim for the higher relief under the R&D intensive scheme once the Finance Bill 2023–2024 has been enacted.⁵⁷

39. Moreover, ForrestBrown told us, despite this being described as a higher rate of relief for qualifying SMEs: “relief will still decrease for these SMEs, just by a smaller amount than for others”⁵⁸ and, as ela8 noted: “it is still lower than the benefit available up to 31 March 2023”.⁵⁹
40. The UK BioIndustry Association (BIA), representing business in the life sciences sector, was concerned about the impact of this reduction in R&D relief on R&D intensive businesses but generally welcomed the new scheme, saying: “the sooner this comes in the better, because we get back to a rate of credit more like the old scheme”.⁶⁰ It told us that the Chancellor had: “rightly recognised that the cut to the SME scheme announced at Autumn Statement 2022 would damage the UK’s life sciences sector”.⁶¹ The National Centre for Universities and Business (NCUB) agreed, describing the new scheme as: “a significant relief for those operating in sectors heavily dependent on research and development, particularly the life sciences sector”.⁶²

Consultation process

41. Although the Government had said it would work with industry on the development of a targeted relief for R&D intensive businesses, there was no formal consultation on the scheme.⁶³ The Institute of Chartered Accountants of Scotland (ICAS) described the scheme as a: “rushed response” to concerns about the reduction in the rate of relief under the SME scheme announced at Autumn Statement 2022,⁶⁴ with Susan Cattell telling us that: “there was a government announcement ... [and then] ... nothing until the publication of the draft legislation.”⁶⁵
42. The consultation on the merger of the two R&D tax relief schemes—RDEC and the SME scheme—did not discuss the details of an R&D intensive scheme, although it did include two questions on whether (and how) the Government should provide a targeted relief to particular businesses under a merged scheme.⁶⁶
43. Despite the lack of a formal consultation process, BIA told us that it had: “engaged closely with Ministers and officials after the cut [to the SME rate] was announced at the Autumn Statement ... [and had been] ... consulted in detail on the R&D-intensive scheme, which is very welcome.”⁶⁷ Nevertheless,

57 HMRC, ‘Technical note: Additional tax relief for Research and Development intensive small and medium enterprise’ (15 March 2023): <https://www.gov.uk/government/publications/additional-tax-relief-for-research-and-development-intensive-small-and-medium-sized-enterprises> [accessed 4 January 2024]. At the date of this Report, Finance Bill 2023–24 has reached Committee Stage.

58 Written evidence from ForrestBrown (DFH0016)

59 Written evidence from ela8 limited (DFH0015) and written evidence from BIA (DFH0013)

60 *QQ 55–56* (Colin Hailey). The BIA contrasted the £27 cash credit (per £100 investment) under the R&D intensive scheme with the £33 that had applied under the SME scheme until 31 March 2023.

61 Written evidence from BIA (DFH0013)

62 Written evidence from NCUB (DFH0009)

63 Written evidence from ICAS (DFH0018)

64 Written evidence from ICAS (DFH0018) and written evidence from ForrestBrown (DFH00016)

65 *Q 8* (Susan Cattell). See also *Q 54* (Dr Roger Barker) and written evidence from ForrestBrown (DFH00016).

66 HM Treasury, *R&D Tax Reliefs Review: Consultation on a single scheme* (13 January 2023), p 20–21: https://assets.publishing.service.gov.uk/media/63c51fc08fa8f572a9a36f33/20230113_R_D_Consultation.pdf [accessed 4 January 2024]

67 Written evidence from the BIA (DFH0013)

referring to the speed at which the scheme had been put together, it was concerned that those: “companies at which the policy is aimed may not be appropriately targeted”, particularly given the lack of time for: “proper testing [of the 40 per cent threshold for R&D intensity]”.⁶⁸ Similarly, the Chartered Institute of Taxation (CIOT) confirmed that HMRC had engaged with stakeholders on the changes: for it, the issue was more that: “we do not have the detail ... [as] ... it has gone very quickly from one step to the next” rather than a lack of engagement per se.⁶⁹

44. Information about how the R&D intensive scheme was intended to work was initially provided in an HMRC technical note published at the time of the Budget in March 2023. ICAS told us that the scheme: “took effect without any legislation, or details of the qualifying conditions, being available”.⁷⁰ Draft legislation only followed four months later—more than three months after the scheme technically started to apply—providing stakeholders with their first formal opportunity to comment on the detail of the proposed scheme. In light of feedback on that draft legislation, various changes to the R&D intensive scheme were announced at Autumn Statement 2023. These included significant changes to the qualifying criteria for R&D intensity—to apply from April 2024—which we discuss below.⁷¹
45. The Financial Secretary told us that there had been extensive consultation, and that the Government was: “largely implementing what industry has asked for”.⁷² The Government has said it will continue to engage with industry on developing the scheme further.⁷³ The Financial Secretary told us that the: “SME loss-making R&D niche area is unique, which gives us the ability to target ... [relief] ... in a very specific way for an area where we see great things in the future for the UK economy.”⁷⁴ Mr Henty of HM Treasury told us that the Government would be continuing to engage with industry on the new scheme: “because obviously it is new”.⁷⁵ The Government has said that this continuing engagement would in particular consider further simplifications.⁷⁶
46. As we discuss in Chapter 4, a number of our witnesses suggested that one possible further simplification would be to bring R&D intensive relief into the merged scheme, resulting in a single scheme for R&D relief, albeit one with a different rate of relief for R&D intensive companies.⁷⁷ Although incorporating R&D intensive relief into the merged scheme would mean that R&D intensive SMEs would have to adjust to a different mechanism for

68 Written evidence from BIA (DFH0013)

69 Q 8 (Ellen Milner)

70 Written evidence from ICAS (DFH0018)

71 HM Treasury, ‘Autumn Statement 2023 Research and Development Tax Reliefs Reform’ (22 November 2023): <https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform> [accessed 4 January 2024]. In summary the relevant changes are lowering the threshold of R&D intensity from 40 per cent to 30 per cent, and incorporating a one year grace period.

72 QQ 81–82 (Nigel Huddleston MP, FST)

73 HM Treasury, ‘Autumn Statement 2023 Research and Development Tax Reliefs Reform’ (22 November 2023): <https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform> [accessed 4 January 2024]

74 Q 83 (Nigel Huddleston MP, FST)

75 Q 80 (Matt Henty)

76 HM Treasury, ‘Autumn Statement 2023 Research and Development Tax Reliefs Reform’ (22 November 2023): <https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform> [accessed 4 January 2024]

77 Cross ref paras re discussion on simplification in Chap 4 which link to R&D intensive scheme.

receiving R&D relief,⁷⁸ Ayming told us that there was: “no reason for the intensive scheme to remain a ‘below the line’⁷⁹ super-deduction, as opposed to an ‘above the line’⁸⁰ credit in the manner of the merged scheme”.⁸¹

47. **We acknowledge that the Government responded promptly to concerns about the impact of the reduction in the rate of R&D relief for SMEs following its announcement in November 2022. However, the development of the R&D intensive scheme over only a few months, and without the benefit of formal consultation, was not an example of good policy-making.**
48. **It is disappointing that the Government did not carry out a public consultation on the R&D intensive scheme, but instead appears to have chosen to consult on a confidential basis with selected stakeholders. We acknowledge that a formal consultation would have taken more time, but this might have avoided the need to make significant changes to the scheme in November 2023, only a few months after first announcing it.**
49. **We welcome the Government’s continued commitment to work with businesses on possible further improvements to the scheme. It is important that the Government is as transparent as possible about its further engagement with stakeholders on this measure.**

What is an R&D Intensive business?

50. The new scheme assesses R&D intensity by calculating the ratio of a company’s qualifying R&D spend to its total expenditure in a given accounting period. The qualifying ratio was initially set, at the Budget on 15 March 2023, at 40 per cent. This dropped to 30 per cent as part of the changes announced at Autumn Statement 2023.⁸² Mr Henty explained that these thresholds were designed to enable the Government to target additional relief at those companies that the scheme was specifically created to help.⁸³
51. BIA considered that: “the overall policy is sound because R&D intensity correlates with SMEs bringing innovative new products to market or innovating internal processes”.⁸⁴ CIOT told us this approach to defining R&D intensity seemed: “pragmatic”.⁸⁵
52. Many other witnesses were rather less enthused about the policy. ICAEW told us that it did not see: “the level of R&D intensity of a company ... [as] ... a good measure of whether it deserves more support from the government or not”.⁸⁶ It suggested extra support should instead be directed at early-

78 Although non-R&D intensive SMEs will only be able to claim an above the line credit under the merged scheme going forward, relief under the R&D intensive scheme is to continue to be provided under the SME scheme model: we discuss this in Chapter 4.

79 See Box 1.

80 See Box 1.

81 Written evidence from Ayming UK ([DFH0014](#)). Relief under the R&D intensive scheme is given using the SME scheme model—in the form of an additional tax deduction—whereas the merged scheme confers relief by way of an (RDEC-like) above the line credit.

82 [Finance Bill](#), Schedule 1 [Bill 14 (2023–24)]. For these total expenditure is limited to expenditure that is deductible for corporation tax purposes.

83 [Q 80](#) (Matt Henty)

84 Written evidence from BIA ([DFH0013](#))

85 Written evidence from CIOT ([DFH0006](#))

86 Written evidence from ICAEW ([DFH0005](#))

stage companies that: “may or may not be R&D intensive”.⁸⁷ ForrestBrown noted that: “a monetary threshold does not in itself target any given type of innovation.”⁸⁸ The Association of Taxation Technicians (ATT) had concerns that the R&D intensive scheme might send the message that: “R&D carried out by, for example, an engineering company is less valuable than that carried out by a more R&D intensive business”.⁸⁹ Ayming queried how providing additional support to R&D intensive SMEs fitted with other policy aims of the Government, for example in relation to net zero, noting the lack of evidence of a: “correlation between either intensity of R&D or size of company, and investments in ‘net zero’ R&D.”⁹⁰ ICAS said the test was: “a very blunt instrument” given that, as any R&D could qualify (so long as the threshold was crossed): “it might not be the best R&D for generating economic growth.”⁹¹ Ms Cattell questioned whether an approach that targeted specific sectors, or specific types of R&D, should have been taken, remarking that it: “might have been sensible to have a proper consultation on the best way of incentivising the type of R&D that would promote the most economic growth.”⁹²

53. For IoD, a focus on R&D intensity was wrong in principle. Dr Barker told us that his members: “are very much of the view that the R&D regime should be encouraging R&D across the economy as a whole, not in certain sectors or certain types of company.”⁹³
54. For BIA, the question was whether the threshold was set at the correct rate, having been developed: “at speed” using: “imperfect data”⁹⁴. The Government therefore needed to monitor use of the scheme to: “evaluate whether it is appropriately targeting the relief to companies as intended by the policy”.⁹⁵ Ela8 feared that the threshold might: “disadvantage companies that are R&D intensive with respect to their science or engineering teams but incur unavoidable overheads on sales and operations personnel”⁹⁶, reducing the ratio to the extent that they would not qualify.
55. For many witnesses, a significant concern was the need for companies to: “have to look year on year at whether they fall into that category [of an R&D intensive business]” which risked creating uncertainty as to future eligibility for some companies.⁹⁷ Mr Moore said that, because of the 40 per cent threshold: “there is the possibility of a cliff-edge” given the potential to fall within the scheme one year and out of it the next.⁹⁸ Of further concern, CIOT told us, were the differences between the R&D intensive scheme and the merged scheme, which an SME would need to adjust to each time it moved from one to the other. This contrasted with the pre-merger position, where movement from the SME scheme to RDEC was likely to be: “a one-

87 Written evidence from ICAEW ([DFH0005](#))

88 Written evidence from ForrestBrown ([DFH0016](#))

89 Written evidence from ATT ([DFH0002](#))

90 Written evidence from Ayming UK ([DFH0014](#))

91 [Q 8](#) (Susan Cattell)

92 [Q 8](#) (Susan Cattell)

93 [Q 54](#) (Dr Roger Barker,) and written evidence from the FSB ([DFH00019](#)) and ForrestBrown ([DFH0016](#))

94 Written evidence from BIA ([DFH0013](#))

95 Written evidence from BIA ([DFH0013](#))

96 Written evidence from ela8 limited ([DFH0012](#)) and [Q 55](#) (Colin Hailey)

97 [Q 14](#) (Dr Emma Rawson). See also [Q 47](#) (Michael Moore), [Q 41](#) (Benjamin Craig) and written evidence from Ayming UK ([DFH0014](#)), ela8 limited ([DFH0015](#)) and ForrestBrown ([DFH0016](#)).

98 [Q 47](#) (Michael Moore)

time only, one-way movement” when an SME became a large business—businesses generally growing rather than shrinking over time.⁹⁹

56. Ayming suggested that a possible solution might be to allow a grace period so that: “loss of R&D intensive status would only occur if a company fails to meet the criterion for two successive accounting periods”¹⁰⁰—something other witnesses also suggested.¹⁰¹ An alternative approach, proposed by BVCA, was to allow a company to assess: “percentage expenditure on R&D over a period of several years, in circumstances where the threshold might be breached in a single year.”¹⁰²
57. Mr Henty accepted that setting a specific threshold created a: “boundary issue” and that: “there will always be people nearer that boundary who will need to plan quite carefully.”¹⁰³ However, he considered that alternative approaches could add complexity.¹⁰⁴
58. Mr Henty told us that the lower threshold that would apply for accounting periods on or after 1 April 2024, announced at Autumn Statement 2023, and the targeting of the R&D intensive scheme at: “the most intensive companies... [would ensure that] ... many companies will very clearly know what their plans and financial flows are and what they are expecting.”¹⁰⁵ He told us that lowering the threshold to 30 per cent would bring: “about 5,000 additional companies” within the scope of the R&D intensive scheme. The reduction of the threshold to 30 per cent announced at Autumn Statement 2023 was coupled with a one-year grace period, which Mr Henty said would help businesses manage the boundary issue as it should avoid: “one-off events [of] dropping people out, in, out, in” and mean: “that people have more certainty year to year. If they know that they are in it this year, they will know that they are in it next year”.¹⁰⁶
59. **A scheme based on R&D intensity is agnostic as to the type of R&D that a company is undertaking. We note that a number of our witnesses did not understand why this approach had been taken, rather than targeting specific policy objectives, such as providing tax credits for activities that support the Government’s net zero commitments.**
60. *The Government should explain why it considers this approach to be the best way of incentivising the types of innovation that will support economic growth.*
61. **We acknowledge that the threshold test for R&D intensity creates a cliff-edge, but we recognise that many alternative approaches, such as tapering relief as R&D intensity decreases, could create more complexity. However, we welcome the announcement at Autumn Statement 2023 of a grace period to help mitigate this.**
62. **It is important that modelling of the threshold for R&D intensity is based on accurate data, is properly tested, and can be justified**

99 Written evidence from CIOT ([DFH0006](#)) and ICAEW ([DFH0005](#))

100 Written evidence from Ayming UK ([DFH0014](#))

101 [Q 54](#) (Colin Hailey) and written evidence from ATT ([DFH0002](#)) and ela8 limited ([DFH0015](#))

102 Written evidence from BVCA ([DFH0017](#)) and [QQ 48, 54](#) (Colin Hailey)

103 [Q 81](#) (Matt Henty)

104 [Q 81](#) (Matt Henty)

105 [Q 81](#) (Matt Henty)

106 [Q 80](#) (Matt Henty)

objectively by reference to the policy aim. We are concerned that this appears not to have been the case with the original proposed 40 per cent threshold—and this may also be true of the new 30 per cent threshold.

63. *We recommend that the Government monitors the operation of the R&D intensive scheme and, in particular, keeps the threshold for R&D intensity under review to ensure that the scheme is appropriately targeted and effective in achieving its policy objectives.*

Calculating R&D intensity

64. As explained above, the test of R&D intensity requires a company to compare its qualifying R&D expenditure in a particular accounting period with the total amount of expenditure that it is able to deduct for corporation tax purposes in that period.¹⁰⁷ ATT told us: “to identify total deductible expenses, companies will have to go quite a long way down the route of preparing their tax computation, or perform significant amounts of work in-year”, meaning that:
- “If you do not know until perhaps after the year-end whether you will fall into the R&D intensive category, it makes it hard to plan for that. In our view, for R&D relief to act as an incentive to investment and innovation, it needs to be something that you can factor in and plan for, not something that is nice to have that you end up with at the end of the year.”¹⁰⁸
65. Other witnesses agreed, with Ayming telling us that businesses: “will have to work on the worst-case assumption that they are not going to be eligible”, with the result that the relief: “is a less effective incentive than it could be”.¹⁰⁹
66. In addition, as Colin Hailey of BIA explained, although the test appeared easy to apply, this was not likely to be the case in practice given uncertainty about what could (or could not) be taken into account as qualifying R&D spend and/or total expenditure. He told us of particular concerns about how the new restriction on overseas R&D expenditure would interact with the test for R&D intensity, explaining that some HMRC inspectors: “say that they will have a light touch with this rule and that you can include overseas expenditure in your R&D as long as it would derail your business plan to have done that work in the UK”, while others have told him that: “the bar is set incredibly high. You’ll need a letter from the US drug regulator, the FDA, proving that it asked you to do your clinical trial work in the US before we’ll let you include it”. The result of this is that: “there is a swirling mass of uncertainty about what the HMRC’s view will be”.¹¹⁰
67. At the time it announced the R&D intensive scheme in March 2023, the Government referenced guidance being published later in 2023 but—as yet—

107 [Finance Bill](#), Schedule 1 [Bill 14 (2023–24)] and written evidence from Ayming UK ([DFH0014](#)). A company’s qualifying R&D expenditure is the expenditure on R&D for which it can claim relief under the SME scheme—which, by definition, also deductible for general corporation tax purposes.

108 [Q 14](#) (Dr Emma Rawson)

109 [Q 41](#) (Mark Davis). See also written evidence from Ayming UK ([DFH00014](#)) and ForrestBrown ([DFH0016](#)).

110 [Q 50](#) (Colin Hailey)

none has been published.¹¹¹ Mr Hailey urged HMRC to publish guidance on applying the R&D intensity test: “rapidly” to give businesses clarity.

68. Mr Henty told us he recognised our witnesses’ concerns about the retrospective nature of the R&D intensive test but that this was not significantly different from the position under the current SME scheme, where companies only knew the amount (and type) of relief they could claim at the end of an accounting period. This had: “been a feature of the SME scheme throughout its history”.¹¹² However, in his view, the lower threshold of 30 per cent should make it easier for many companies to know whether they are R&D intensive upfront. He gave the example of a bio-tech company undertaking a drug-discovery programme being able to know it was: “very much higher than [30 per cent]” because: “that is [its] entire purpose”.¹¹³
69. **It is disappointing that, although the R&D intensive scheme has applied since April 2023, HMRC has not yet published any guidance—including draft guidance—on how the scheme will work in practice. Businesses need to know whether they are R&D intensive in advance of April 2024, when they will be able to make their first claims under the new scheme, so they can plan accordingly.**
70. **We are concerned that the incentive effect of R&D intensive relief will be weakened because SMEs have no certainty about whether they are R&D intensive, and so eligible for additional relief, until after they have invested in R&D.**
71. **We acknowledge that the lower R&D intensity threshold should mean that more companies will have confidence that they qualify as R&D intensive in a given period. However, a lower threshold is no substitute for clear rules that businesses can readily understand.**
72. *We recommend that HMRC publishes draft guidance on applying the R&D intensity test as a matter of urgency.*

Possibility of spurious claims

73. The previous Finance Bill Sub-Committee’s inquiry in 2022–23¹¹⁴ looked at the steps being taken by HMRC to try to reduce the high level of error and fraud in the R&D claims.¹¹⁵ In its response to the report of that inquiry, the Government stated that: “the SME scheme’s generosity had been a target

111 HMRC, ‘Technical note: Additional tax relief for Research and Development intensive small and medium enterprise’ (15 March 2023): <https://www.gov.uk/government/publications/additional-tax-relief-for-research-and-development-intensive-small-and-medium-sized-enterprises> [accessed 4 January 2024]

112 **Q 81** (Matt Henty). This is because, under the SME scheme, the (effective) rate of relief is dependent on the company’s overall profitability in the relevant period, which can only be known at the end of that period—see written advice from Ayming UK (**DFH0014**) which includes an example at footnote 11.

113 **Q 81** (Matt Henty)

114 Economic Affairs Committee, *Research and Development tax relief and Expenditure Credit* (3rd Report, Session 2022–23, HL Paper 137)

115 Economic Affairs Committee, *Research and development tax relief and expenditure credit* (3rd Report, Session 2022–23, HL Paper 137). We note that, for the fourth year, the NAO qualified HMRC’s annual accounts for 2022.23. See National Audit Office, ‘Report—HM Revenue & Customs 2022–23 Accounts’ (7 July 2023): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1179615/HMRC_annual_report_and_accounts_2022_to_2023.pdf#page=293 [accessed 4 January 2024].

for fraud”.¹¹⁶ The rebalancing of the R&D reliefs at Autumn Statement 2022 reduced that generosity, with the Government saying that the reduction was: “expected to reduce levels of non-compliance”.¹¹⁷ However, the R&D intensive scheme reinstates some of that generosity, albeit only for companies that satisfy the definition of R&D intensity.¹¹⁸

74. ATT was concerned that:

“the definition of ‘R&D intensive’ could lead to boundary pushing, manipulation or even abuse by unscrupulous claimants and advisers. In particular, where a company is just below the ... threshold, there could be the temptation to increase the amount of expenditure allocated to R&D, or even disclaim other expenses to ensure the test is met.”¹¹⁹

75. For BVCA, the:

“definition of ‘relevant R&D expenditure’ in the R&D intensity condition ... lacks precision and could be open to abuse. The accounting treatment is not set in stone and there are instances in which, entirely legitimately within acceptable accounting standards, the same costs or income could be classified in two alternative ways, which would result in two very different figures for R&D expenditure.”¹²⁰

76. The Government said it was aware that the R&D intensive scheme would bring: “compliance risks ... [including] ... the risk that there are those who will seek to take advantage or abuse the higher rate of support who are not eligible for the relief.” In recognition of this, HMRC would deploy 82 additional staff: “in operational compliance teams to mitigate the additional compliance risks ... from July 2023.”¹²¹

77. **We are concerned about the abuse of R&D relief, which has increased due to exploitation of the tax repayment available under the SME scheme. We note the Government’s commitment to tackling this abuse but we agree with our witnesses that there is a risk that, with the creation of the R&D intensive scheme, new opportunities for spurious claims could be created.**

78. **We welcome the Government’s announcement that HMRC will be funded to deploy additional officers to manage the compliance risks relating to the new scheme.**

116 HM Government, *House of Lords Economic Affairs Finance Bill Sub Committee : Research and Development Tax Relief and Expenditure Credit (HL Paper 137): Government Response*: <https://committees.parliament.uk/publications/38977/documents/191609/default> [accessed 4 January 2024]

117 HMRC, ‘HMRC’s approach to Research and Development tax reliefs’ (17 July 2023): <https://www.gov.uk/government/publications/compliance-approach-to-research-and-development-tax-reliefs/hmrcs-approach-to-research-and-development-tax-reliefs> [accessed 4 January 2024]

118 HMRC, ‘Technical note: Additional tax relief for Research and Development intensive small and medium enterprise’ (15 March 2023): <https://www.gov.uk/government/publications/additional-tax-relief-for-research-and-development-intensive-small-and-medium-sized-enterprises> [accessed 4 January 2024]

119 Written evidence from ATT (DFH0002), ICAS (DFH0018), Evelyn Partners LLP (DFH0012) and ela8 limited (DFH0015) and Q 44 (Mark Davies)

120 Written evidence from BVCA (DFH0017)

121 Written evidence from HMRC (DFH0020)

CHAPTER 4: A NEW MERGED RESEARCH & DEVELOPMENT TAX RELIEF SCHEME

Background

79. The Government first raised the possibility of merging the two existing R&D tax relief schemes in its consultation, *R&D tax reliefs*, published in March 2021.¹²² The summary of responses to that consultation noted the differing views about the proposed merger.¹²³ Then, at Autumn Statement 2022, the Government announced that it would be consulting on the design of a single R&D tax relief scheme.¹²⁴ Although that announcement—and the consultation itself¹²⁵—came too late to be considered as part of last year’s Finance Bill Sub-Committee inquiry into Finance Bill 2022–23, witnesses submitted mixed evidence about the putative concept of merging the two schemes.¹²⁶
80. Given the lack of consensus among stakeholders, the report by last year’s Finance Bill Sub-Committee reflected disappointment that the consultation on the design of a merged scheme, launched in January 2023, was limited to the design and implementation of the new scheme rather than whether the merger of the two schemes was desirable.¹²⁷
81. The Government published a summary of responses to this consultation in July 2023, together with draft legislation implementing a merger: “to keep open the option of implementing a merged scheme from April 2024”.¹²⁸ While the Government said that it had not yet decided whether to go ahead with the merger, it noted that they would do so at the next fiscal event.
82. The next fiscal event was Autumn Statement 2023: the Government announced that it had decided to proceed with merging the SME and RDEC schemes and that, as trailed, the merger would take effect from 1 April 2024.¹²⁹ Revised legislation was published as part of Finance Bill 2023–2024.¹³⁰ This meant that, at the time our witnesses gave their evidence, they still did not know whether the merged scheme would be introduced, and it is important to take this into account when reading their evidence.

122 HM Treasury and HMRC, ‘R&D Tax Reliefs: consultation’ (3 March 2021): <https://www.gov.uk/government/consultations/rd-tax-reliefs-consultation> [accessed 4 January 2024]

123 HM Treasury, ‘R&D Tax Reliefs Report’ (30 November 2021): <https://www.gov.uk/government/publications/rd-tax-reliefs-report> [accessed 4 January 2024]

124 HMRC, ‘Reforms to R&D tax reliefs’ (21 November 2022): <https://www.gov.uk/government/publications/research-and-development-rd-tax-reliefs-reform/reforms-to-rd-tax-reliefs> [accessed 4 January 2024]

125 HM Treasury, ‘R&D Tax Reliefs Review: Consultation on a single scheme’ (13 January 2023): <https://www.gov.uk/government/consultations/rd-tax-reliefs-review-consultation-on-a-single-scheme> [accessed 04 January 2024]. Our call for evidence had expired on 2 November 2022.

126 Economic Affairs Committee, *Research and development tax relief and expenditure credit* (3rd Report, Session 2022–23, HL Paper 137)

127 Economic Affairs Committee, *Research and development tax relief and expenditure credit* (3rd Report, Session 2022–23, HL Paper 137), p 61, para 260

128 HMRC and HM Treasury: ‘Consultation on draft legislation published for Finance Bill 2023–24’ (18 July 2023) <https://www.gov.uk/government/collections/finance-bill-2023-24> and HM Treasury, ‘R&D Tax Reliefs Review: Consultation on a single scheme—summary of responses’ (18 July 2023): <https://www.gov.uk/government/consultations/rd-tax-reliefs-review-consultation-on-a-single-scheme> [both accessed 4 January 2024].

129 HMRC, ‘Research & Development (R&D) tax relief reforms’ (22 November 2023): <https://www.gov.uk/government/publications/research-development-rd-tax-relief-reforms> [accessed 4 January 2024]

130 HMRC, ‘Research & Development (R&D) tax relief reforms’ (22 November 2023): <https://www.gov.uk/government/publications/research-development-rd-tax-relief-reforms> [accessed 4 January 2024]

83. The merged scheme is broadly based on RDEC, with relief provided by way of an above the line¹³¹ credit which the Government said made: “the benefit more visible ... and easier to factor into R&D investment decisions”.¹³² However, it also has certain elements—such as in relation to subcontracted R&D, which we discuss in Chapter 5—that are based on the SME scheme, as well as some new features. As Richard Jones of ICAEW told us, this means that both larger companies and SMEs: “will be used to some of [the merged scheme] because it is based ... partly on their [current] scheme[s].”¹³³ Mr Henty told us that: “this is taking the best of both schemes into the merged design”.¹³⁴ Some of our witnesses disagreed. In particular, Benjamin Craig of Ayming felt that many of the: “complexities and challenges of having two schemes are still there.”¹³⁵
84. **We recognise that the Government has sought to engage with stakeholders on merging the two existing R&D tax relief schemes since January 2023. However, given the significance of this change, the consultation in January 2023 should not have been limited to the design and implementation of the scheme; it should also have considered the fundamental question of whether a single scheme was desirable.**

A simplification of R&D tax relief?

85. Throughout the consultation process, the Government presented the merger of the two schemes as a means of simplifying R&D tax relief.¹³⁶ Mr Hailey welcomed this simplification: “if you are not R&D intensive, you have one set of rules for every project”.¹³⁷ NCUB agreed that a merged scheme: “removes the intricacies of choosing between two differing schemes” for SMEs.¹³⁸
86. Both Evelyn Partners LLP (Evelyn Partners) and Ayming welcomed the decision to provide relief by way of an above the line credit.¹³⁹ Evelyn Partners said that an RDEC-like credit would be: “simpler and more predictable than the current SME relief (where the benefit can vary dependent on final tax position)”.¹⁴⁰ Ayming told us that an above the line credit makes it: “much easier to calculate” how much relief is available. It added that: “for the majority of SME claimants, the merger will represent a simplification to the existing [SME and large company] schemes.”¹⁴¹

131 See Box 1.

132 HM Treasury, *R&D Tax Reliefs Review: Consultation on a single scheme—summary of responses* (18 July 2023), p 17: https://assets.publishing.service.gov.uk/media/64b65ec90ea2cb001315e470/Summary_of_Responses_-_RD.pdf [accessed 4 January 2024]

133 [Q 7](#) (Richard Jones)

134 [Q 84](#) (Matt Henty)

135 [Q 39](#) (Mark Davies, Benjamin Craig) and also see Chapter 5 in which we discuss the concerns of witnesses about the adoption of the SME scheme model for subcontracting within the merged scheme.

136 HM Treasury, ‘R&D Tax Reliefs Review: Consultation on a single scheme’ (13 January 2023): <https://www.gov.uk/government/consultations/rd-tax-reliefs-review-consultation-on-a-single-scheme>. [accessed 4 January 2024]

137 [Q 47](#) (Colin Hailey), written evidence from BIA ([DFH0013](#)). We note that Mr Hailey caveated his view saying his welcome was dependent on relief being available under the merged scheme for subsidised expenditure—which following Autumn Statement 2023 will be the case: we discuss the treatment of subsidised expenditure in Chapter 5.

138 Written evidence from NCUB ([DFH0009](#))

139 See Box 1.

140 Written evidence from Evelyn Partners ([DFH0012](#))

141 Written evidence from Ayming UK ([DFH0014](#))

87. ForrestBrown agreed that a single scheme would present: “an important opportunity to ... offer SMEs access to ... a more consistent effective rate of relief, making forecasting easier, more visibility to decision makers and other stakeholders.”¹⁴² Evelyn Partners told us that another benefit was that the merged scheme means: “there will be less of a requirement to ascertain whether or not a business ... meets the current SME thresholds.”¹⁴³
88. On a less positive note, ATT told us that, while: “a single R&D scheme would be a simplification ... new rules to define R&D intensive SMEs and the possibility of companies moving in and out of the two regimes ... will result in an overall increase in the complexity of the R&D relief regime, rather than simplification.”¹⁴⁴ Many of our witnesses shared ATT’s view.¹⁴⁵ Mr Hailey pointed to the introduction of the R&D intensive scheme, meaning that there would still be two schemes and: “In that sense, this is not a simplification.”¹⁴⁶
89. For CIOT, the Government’s proposals represented: “a huge, missed opportunity” as, by retaining the SME scheme for R&D intensive companies: “most of the benefits of a simplification that would come from having a single scheme in the UK will not be realised”.¹⁴⁷ Ela8 agreed: it generally welcomed the move to simplify R&D tax relief by merging the schemes, but retaining:
- “the SME scheme for ... [R&D intensive] businesses means that the current complexities of these arrangements (including the definition of an SME itself) are retained and there is potential confusion for claimants not fully understanding the differences or when to claim under each regime.”¹⁴⁸
90. For Ayming, the fact that there will continue to be two distinct schemes means that the Government has not introduced a complete merger: “[it] just changes the balance of the number of claimants between schemes. There will remain the differentiation for R&D intensive loss-making SMEs and therefore the complexity of the [SME] scheme will remain.”¹⁴⁹ In this regard, ATT did not see why enhanced relief for SMEs: “could not be delivered as part of the proposed, merged scheme”.¹⁵⁰
91. CIOT accepted the need for the SME scheme to be used to deliver relief under the R&D intensive scheme in 2023/24, but remarked that:
- “this does not seem to preclude the additional relief from being amalgamated into a single scheme when the relief being given to SMEs more generally changes, with a different (higher) rate being available to R&D intensive SMEs. Although having different rates would add some

142 Written evidence from Forest Brown ([DFH0016](#))

143 Written evidence from Evelyn Partners ([DFH0012](#))

144 Written evidence from ATT ([DFH0002](#))

145 Written evidence from Ayming UK ([DFH0014](#)), BVCA ([DFH0017](#)) CAI ([DFH0001](#)), CIOT ([DFH0006](#)), ela8 limited ([DFH00015](#)), ICAEW ([DFH0005](#)) and ICAS ([DFH0018](#)), [Q 38](#) (Mark Davis, Justin Arnesen), [Q 6](#) (Susan Cattell).

146 [Q 47](#) Colin Hailey

147 Written evidence from CIOT ([DFH0006](#))

148 Written evidence from ela8 limited ([DFH0015](#)). This is because the R&D intensive scheme follows the SME model (while RDEC is the model for how relief is given under the merged scheme). Written evidence from Ayming UK ([DFH0014](#))

149 Written evidence from Ayming UK ([DFH0014](#))

150 Written evidence from ATT ([DFH0002](#)), [Q 6](#) (Susan Cattell) and written evidence from ela8 limited ([DFH0015](#)).

complexity into the new scheme, in our view it would be less complicated overall than continuing to have two schemes.”¹⁵¹

92. Bringing relief for R&D intensive businesses into the merged scheme would mean a change in the mechanism by which relief is provided to R&D intensive SMEs—namely by way of above the line credit, rather than additional tax relief. However, both Ayming and ForrestBrown told us this would have been their recommendation in any event.¹⁵² Ayming said that, by continuing to provide relief under the SME scheme model, the R&D intensive scheme retained: “a critical flaw” of the SME scheme: “as the amount by which an SME can benefit [under the SME scheme]... is dependent on the wider tax position of the company, and not merely on the level of R&D it undertakes”¹⁵³ and so varies depending on the SME’s profitability.¹⁵⁴ ForrestBrown considered that, by continuing with the SME model for R&D intensive relief, R&D intensive companies were being denied access to: “the benefits of RDEC—a more consistent effective rate of relief.”¹⁵⁵
93. Mr Henty told us that the: “vast majority of businesses now have just one scheme to think about ... [so] it is definitively simpler than it was before.”¹⁵⁶ He told us that the Government had sought to align the schemes in relation to subcontracting and certain other aspects of the relief: “the rules of the game would be very similar but the mechanism [for relief under the two new schemes] would still be different, so there is potentially an option to simplify in the future”.¹⁵⁷
94. **We welcome the Government’s acknowledgement that having one scheme, instead of the proposed two, would be simpler and its apparent willingness to consider further simplification in the future.**
95. **We agree that providing relief under the merged scheme by way of an above the line credit to all companies, whatever their size, is the right decision.**
96. **We acknowledge that, for those companies that are not R&D intensive, having just one scheme for R&D tax relief will be a simplification. However, we agree with many of our witnesses that retaining the existing SME scheme for R&D intensive businesses is a missed opportunity in terms of the Government’s tax simplification agenda.**
97. ***We recommend that the Government consult in the near term on bringing the R&D intensive scheme within the new merged scheme to create a fully merged and simplified scheme.***

Timetable for merged scheme

98. The Government confirmed in July 2023 when it published the draft legislation that, if the merger took place, it still intended that the merged

151 Written evidence from CIOT ([DFH0006](#)), BVCA ([DFH0017](#)) and ela8 limited ([DFH0015](#))

152 Written evidence from Ayming UK ([DFH0014](#)) and ForrestBrown ([DFH0016](#))

153 Written evidence from Ayming UK ([DFH0014](#)), which includes an example explaining the impact of profitability on R&D relief under the SME scheme.

154 Written evidence from Ayming UK ([DFH0014](#)), which includes an example explaining the impact of profitability on R&D relief under the SME scheme.

155 Written evidence from ForrestBrown ([DFH0016](#))

156 [Q 83](#) (Matt Henty)

157 [Q 80](#) (Matt Henty)

scheme would take effect from 1 April 2024.¹⁵⁸ This was despite only a third of respondents to the consultation being in favour of that date.¹⁵⁹ ICAS told us that this was not: “a realistic timetable. ... Until the legislation is enacted, it is impossible for businesses to prepare”.¹⁶⁰ ForrestBrown said that: “it is important to allow companies sufficient preparation time” but that the proposed timetable meant that the time available for preparation was: “negligible”.¹⁶¹ BVCA agreed—in its view April 2024 was: “overly ambitious ... Businesses will need more time to prepare.”¹⁶²

99. In addition to the impact on the ability of businesses to prepare for the merger, there was also concern about the lack of time for effective consultation, scrutiny, and revision of the proposed scheme. Ayming saw it as: “unnecessarily hasty to push for implementation this rapidly, since it gives relatively little time to effectively scrutinise and revise the proposals to ensure their effectiveness”.¹⁶³ ICAEW felt that: “further consultation is required to ensure that any difficulties or complexities involved in merging the two schemes are considered properly”¹⁶⁴ and ForrestBrown told us that a rushed implementation: “leading to further piecemeal changes to address unintended consequences”, risked eroding business confidence in the new scheme.¹⁶⁵
100. BIA considered that the Government should: “just get on with [the merger]” as otherwise: “we are just prolonging the uncertainty”¹⁶⁶ but there was otherwise general consensus that the start date should be deferred until at least until 1 April 2025.¹⁶⁷ Kevin Hart of Business Application Software Developers Association (BASDA) told us that April 2025 was achievable—in terms of making the relevant changes to tax software—but only: “on the basis that sufficient information is declared early ... [in 2024]”.¹⁶⁸
101. Some witnesses suggested that a delay of 2–3 years was needed.¹⁶⁹ These included Chartered Accountants Ireland, which said that deferring the start date would: “enable the changes taking effect from 1 April 2023 to bed down and their impact ... to be assessed before future changes are considered for introduction.”¹⁷⁰
102. At Autumn Statement 2023, the Government announced a change to the proposed start date. Rather than applying to R&D spending on or after 1

158 HMRC and HM Treasury: ‘Consultation on draft legislation published for Finance Bill 2023–24’ (18 July 2023): <https://www.gov.uk/government/collections/finance-bill-2023-24> [accessed 4 January 2024]

159 HM Treasury, ‘R&D Tax Reliefs Review: Consultation on a single scheme—Summary of Responses’ (18 July 2023): <https://www.gov.uk/government/consultations/rd-tax-reliefs-review-consultation-on-a-single-scheme> [accessed 4 January 2024]. In contrast, 0 per cent of respondents were against 1 April 2024 as start date and 30 per cent neutral.

160 Written evidence from ICAS (DFH0018)

161 Written evidence from ForrestBrown (DFH0016)

162 Written evidence from BVCA (DFH0017) and Evelyn Partners (DFH0012)

163 Written evidence from Ayming UK (DFH0014)

164 Written evidence from ICAEW (DFH0005) and Forest Brown (DFH0016), Q 16 (Dr Emma Rawson) and written evidence from CIOT (DFH0006)

165 Written evidence from ForrestBrown (DFH0016)

166 Q 59 (Colin Hailey)

167 Q 9 (Susan Cattell), Q 15 (Andrew Harding, Dr Emma Rawson), written evidence from CIMA (DFH0008), ela8 limited (DFH0015), Evelyn Partners (DFH0012), ForrestBrown (DFH0016) and Skanska (DFH0010)

168 Q 69 (Kevin Hart)

169 Q 7 (Richard Jones)

170 Written evidence from CAI (DFH0001)

April 2024 as originally proposed, the merged regime would instead apply to a company from the first accounting period to start on or after that date. This meant that, for a company whose accounting year ends with the calendar year, the merged scheme will not apply to R&D expenditure until 1 January 2025.¹⁷¹

103. The Financial Secretary hoped that: “the accounting period element will provide some assurance to most businesses. Many of them will have an accounting period that will be late 2024 or 2025, so they have until then to work practically on this.”¹⁷² Mr Henty said that he had received feedback that this change to the commencement date for the new regime had made: “a big difference to the big companies that are facing the most change through the merged scheme because of the subcontracting rules”.¹⁷³
104. **We acknowledge that the change to the start date announced at Autumn Statement 2023 will mean that the merged scheme may not apply to some businesses until 1 January 2025. For some companies, however, it will be much earlier.**
105. **We remain concerned that, even with the latest possible start date under the revised timetable, businesses will not have enough time to prepare for the new scheme.**
106. ***We recommend that the start date for the new scheme be delayed until a company’s first accounting period to start on or after 1 April 2025.***

Awareness of the changes to R&D relief

107. A pressing concern raised by witnesses to our inquiry was the lack of awareness about the changes. Ayming said that awareness of the changes was: “poor”¹⁷⁴—Mr Craig told us:

“Virtually every business that I have spoken to, with very few exceptions, had not heard about changes until we spoke to them about it. ... It is potentially quite concerning that changes are going through and there is a real risk that businesses, through no fault of their own, will get things wrong simply because they do not know that changes are happening.”¹⁷⁵

By way of illustration, he told us that his firm had recently hosted a roundtable for clients, including 8 of the UK’s top 12 construction companies and: “not one of them had heard of these changes until we reached out to them”.¹⁷⁶

108. Mark Davis of ela8 said that awareness of the merged scheme among businesses tended to be linked to whether the business had a professional adviser. Without an adviser: “there is a very strong chance that [the business] will not know that any of this is happening or understand the consequences ...”.¹⁷⁷

171 [Finance Bill](#), Schedule 1 [Bill 14 (2023–24)]. The Finance Bill does not contain a specific commencement date but instead provides for a day to be appointed by regulations.

172 [Q 84](#) (Nigel Huddleston MP, FST)

173 [Q 84](#) (Matt Henty, HM Treasury)

174 Written evidence from Ayming UK ([DFH0014](#))

175 [Q 41](#) (Benjamin Craig)

176 [Q 41](#) (Benjamin Craig)

177 [Q 41](#) (Mark Davis)

109. The Financial Secretary promised that there was: “a plan to communicate” and that HMRC had a: “small paid-for marketing budget” of £20,000 allocated specifically for R&D.¹⁷⁸ He also told us that: “many of the industry bodies and groups have done a very good job of publicising [the changes] themselves.” Mr Henty added that:

“Industry bodies, business representation groups, agents, accountants, accountancy bodies, and many businesses have been actively engaged throughout the process ... All want to make sure that the information gets out so that people know what they are doing. A large number of people are involved in making that happen rather than it just being an exercise from the agency or the Treasury.”¹⁷⁹

110. **Given the significance of these changes, it is critical that businesses that could be affected know that they are happening sooner rather than later. We welcome the work of representative bodies and advisers in raising awareness of the changes among the business community. However, the primary responsibility for informing taxpayers of changes to tax regimes lies with the Government. We welcome the Minister’s confirmation that there is a communication plan and a specific budget allocated to HMRC for this purpose.**
111. *We recommend that, as a priority, HMRC should implement an education campaign about what the merged scheme will mean for businesses investing in R&D.*

Adjusting to the merged scheme

112. The decision by the Government to incorporate elements of both RDEC and the SME scheme into the merged scheme means that both SMEs and larger businesses will need to adjust. ForrestBrown noted that: “the proposals potentially disrupt both SMEs and large companies”.¹⁸⁰ For large companies, the most significant change, as compared to RDEC, is likely to be the treatment of subcontracting arrangements under the merged scheme¹⁸¹—we discuss this in Chapter 5.
113. In relation to SMEs, Dr Barker told us that while: “in principle the single scheme is more straightforward ... the fact that it is new and will be set up on a completely different basis will create uncertainty for SMEs”.¹⁸² The main change for many SMEs will be the move to an above the line¹⁸³ credit. CIOT pointed out that, in addition to the new tax rules, SMEs would need to get to grips with the accounting treatment of the R&D credit as: “accounting for RDEC is more complex” than is the case for relief under the SME scheme.¹⁸⁴
114. Ela8 contrasted the proposed: “overnight move to a different regime”, with the situation in 2013, when: “the transition to the RDEC scheme for large

178 **Q 88** (Nigel Huddleston MP, FST) and written evidence from HMRC ([DFH0020](#)), letters from Nigel Huddleston MP Financial Secretary to the Treasury to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (7 December 2023 and 12 December 2023): [committees.parliament.uk/publications/42723/documents/212469/default/](#) and [committees.parliament.uk/publications/42711/documents/212323/default/](#)

179 **Q 88** (Matt Henty)

180 Written evidence from ForrestBrown ([DFH0016](#))

181 Written evidence from CIOT ([DFH0006](#))

182 **Q 48** (Dr Roger Barker)

183 See Box 1.

184 Written evidence from CIOT ([DFH0006](#))

companies was phased.”¹⁸⁵ The rapid introduction of the merged scheme led ATT to question whether HMRC would be able to provide the: “significant amounts of education, guidance and support ahead of any new scheme launching”.¹⁸⁶ Witnesses emphasised that the guidance needed to be clear and contain relevant examples of common scenarios.¹⁸⁷ In this regard, ela8 stressed the need for HMRC: “helplines where claimants/potential claimants could access real-time technical support”.¹⁸⁸

115. Some witnesses were also concerned that the changes—in particular the reduction in the rate of relief available under the merged scheme (at 20 per cent) when compared with that previously available under the SME scheme—could reduce the willingness of SMEs to claim R&D relief.¹⁸⁹ Mr Davis told us:

“The benefit levels have been cut once, and this proposal [for a merged scheme] would cut them again. There is a potential risk of firms in the UK, particularly SMEs, looking at this and starting to debate whether, in the context of the benefit available, ... along with a fear of the compliance environment, they want to make a claim for relief”.¹⁹⁰

116. Similarly, CIOT told us that:

“It seems likely that the effect of the merged scheme will be to reduce the number of claims overall, ... with mid-sized businesses in particular being less likely to be able to claim relief ... We recognise that this might be an intentional policy outcome, as the reduction in rate to the relief available to SMEs will cause many SMEs to have to re-evaluate the economic viability of their businesses and R&D projects. ... [If] the government wishes to focus R&D tax relief more on larger companies, it should be more open and transparent about these policy aims.”¹⁹¹

117. Dr Barker said that, for IoD members: “the key fact behind whether the new regime will be successful will not be the format of the scheme but how generous the final scheme is in incentivising R&D expenditure”.¹⁹² In a survey of IoD members, 47 per cent of those who responded said that they thought the merged scheme: “could result in them spending less on R&D than in the past.”¹⁹³
118. The Federation of Small Businesses (FSB) suggested that if the merged scheme goes ahead: “a higher rate of relief could be set for SMEs”.¹⁹⁴ ForrestBrown told us that providing a higher rate of relief for SMEs was justified as: “access to finance for risky endeavours such as R&D is more limited [for SMEs] than for larger businesses.”¹⁹⁵

185 Written evidence from ela8 limited ([DFH0015](#))

186 Written evidence from ATT ([DFH0002](#))

187 Written evidence from ela8 limited ([DFH0015](#)), Evelyn Partners ([DFH0012](#)), and ForrestBrown ([DFH0016](#))

188 Written evidence from ela8 limited ([DFH0015](#))

189 Written evidence from CIMA ([DFH0008](#)), CIOT ([DFH0006](#)), ForrestBrown ([DFH0016](#)) and FSB ([DFH0019](#))

190 [Q 42](#) (Mark Davis) and written evidence from ela8 limited ([DFH0015](#))

191 Written evidence from CIOT ([DFH0006](#))

192 [Q 47](#) (Dr Roger Barker)

193 [Q 47](#) (Dr Roger Barker)

194 Written evidence from FSB ([DFH0019](#))

195 Written evidence from ForrestBrown ([DFH0016](#))

119. The Financial Secretary told us that, overall, the changes—both the merged scheme and the relief for R&D intensive businesses—were: “adding hundreds of millions more into the R&D system”:

“The reality is that we have fallen behind in overall investment in business and R&D compared to many other countries around the world. ... We need to focus on growth and to enhance our productivity ... R&D benefits the UK economy. There is a lot of economic analysis looking at the previous systems and seeing what worked and what did not work. We are very confident that this will lead to positive outcomes”.¹⁹⁶

120. In addition, HMRC said that it will be monitoring the measure through information collected from claims and that, after 5 years of monitoring in this way: “Consideration will be given to evaluating the policy”.¹⁹⁷
121. **We are doubtful that final guidance of the quality needed to support businesses as they adjust to the merged scheme can be put in place by 1 April 2024. Without final detailed guidance, well in advance of the start date, it is not sensible or appropriate to bring the merged scheme into effect.**
122. **We are concerned that the introduction of the merged scheme will impact investment in R&D by SMEs, and subsequently impact UK productivity and growth. We note the concerns raised by witnesses that the reduction in the rate of the relief may deter SMEs from submitting future claims. If it is the Government’s intention to reduce the number of claims from SMEs and focus the relief on larger companies, then it should make this clear.**
123. *We recommend that the Government commits now to evaluating the effectiveness of the merged scheme in incentivising investment in R&D by large and small businesses in three years’ time.*
124. *We ask the Government to provide evidence of the economic impact of the merged scheme and the R&D intensive scheme and, in particular of the additional monies they have injected into the UK’s R&D systems.*

Costs

125. The Government first produced an estimate of the costs for business of adapting to the new R&D scheme when it announced its decision to proceed with the merger at Autumn Statement 2023. One-off costs for businesses were estimated at a total of £7 million and on-going costs at £300,000—with the Government saying it expected approximately 87,000 businesses to be impacted by the change.¹⁹⁸ Mr Henty told us that this was: “based on established methodology for business-customer costs”. He said that that one-off costs were expected to be about: “familiarising yourself with new

¹⁹⁶ Q 82 (Nigel Huddleston MP,FST)

¹⁹⁷ HMRC, ‘Policy paper, Research and Development reform—Consultation on a single scheme’ (18 July 2023): <https://www.gov.uk/government/publications/research-and-development-reform-additional-tax-relief-and-potential-merger/research-and-development-reform-consultation-on-a-single-scheme> [accessed 4 January 2024]

¹⁹⁸ HMRC, ‘Merger of current small or medium enterprise (SME) and Research and Development Expenditure Credit (RDEC) schemes’ (23 November 2023): <https://www.gov.uk/government/publications/research-development-rd-tax-relief-reforms> [accessed 4 January 2024]

rules” and were therefore: “a forecast based on a set of assumptions about the time taken to look at the rules of the new scheme”.¹⁹⁹

126. Our witnesses provided their evidence before the Government published its costings.²⁰⁰ ICAEW said it was: “unacceptable” that potential costings had not been provided earlier as businesses: “need time to assess the final design and the likely cost impact to advise the government on whether the scheme is good value for money.”²⁰¹ ATT agreed: it described the Government’s failure to quantify these costs in July as: “disappointing”, leading ATT to conclude that: “the cost to business will not be considered as part of the final policy decision.”²⁰²
127. Ela8 told us that, although the costs of adjusting: “should be manageable for most businesses with a realistic timetable and appropriate support”, SMEs could face particular issues as: “sourcing quality, professional support at reasonable cost is becoming difficult for SMEs due to rising complexity and compliance costs”.²⁰³
128. Mr Henty told us that the new scheme would give additional support to businesses and that the Government therefore judged the one-off transition costs to be: “very worthwhile”.²⁰⁴
129. **The cost to taxpayers of implementing new tax rules is an important consideration when developing new policies. While not confirming whether the merged scheme would go ahead, the Government has been clear since January 2023 that, if it did, it would take effect from April 2024. Changing the way in which R&D relief is given is a major change and we see no reason why indicative cost estimates could not have been provided in July 2023. By only publishing its costings in late November 2023, the Government left it too late for stakeholders to engage on whether its estimates accurately capture those costs.**
130. *Where the Government is proposing a major change to how businesses are taxed, we recommend that costs are modelled at an earlier stage in the consultation process to allow for stakeholder engagement, even where some details have not yet been finalised.*

199 [Q 87](#) (Matt Henty) and written evidence from HMRC ([DFH0020](#))

200 Written evidence from ICAS ([DFH00018](#))

201 Written evidence from ICAEW ([DFH0005](#))

202 Written evidence from ATT ([DFH0002](#))

203 Written evidence from ela8 limited ([DFH0015](#))

204 [Q 87](#) (Matt Henty)

CHAPTER 5: SUBCONTRACTING ARRANGEMENTS

131. A company embarking on an R&D project may outsource to another company part of the R&D activity—for example, where the other company has particular specialist experience.²⁰⁵ The existing schemes contain specific rules that set out who can claim relief for R&D that is subcontracted to another person. This is because, as Mace told us, the: “treatment of subcontracted R&D in a merged R&D relief scheme is critical for preventing ‘double counting’ in a supply chain, where one entity performs R&D but then contracts out those activities to another entity, and they are both able to claim the cost as qualifying.”²⁰⁶ However, the existing SME and RDEC schemes differ in how they deal with subcontracted R&D—which we summarise in the next section. The treatment of subcontracted R&D generally generated the most concern from our witnesses.²⁰⁷
132. A company intending to carry out R&D activity may also seek funding from a third party for its work, including grant funding or another form of subsidy. The existing SME and RDEC schemes also treat subsidised expenditure differently.

Treatment of subcontracted R&D and subsidised expenditure under the existing R&D relief schemes

133. Under the existing SME scheme, where one company (the customer) outsources R&D to another company (the provider), it is the customer (and not the provider) who claims R&D tax.²⁰⁸ Conversely, under RDEC, only the provider is generally entitled to claim R&D relief.²⁰⁹ If one company in a subcontracting arrangement is a large company, and the other an SME, then the question of who can claim R&D relief—and on what basis—is, in effect, determined by the scheme that applies to the customer. For example, where a large company subcontracts R&D to an SME, the SME would claim R&D relief under RDEC.²¹⁰
134. Under the current SME scheme, where a company’s expenditure on R&D is ‘subsidised’ (in that it is met by someone else)²¹¹, that company cannot claim relief in relation to that subsidised expenditure. No such restriction, however, applies to RDEC. It is the case, however, that an SME prevented

205 Written evidence from CIMA (DFH0008), ICAS (DFH0018) and FSB (DFH0019)

206 Written evidence from Mace (DFH007)

207 One of our witnesses contacted us about this issue before the call for evidences launched.

208 Corporation Tax Act 2009, [section 1053](#). HMRC, ‘Corporate Intangibles Research and Development Manual’ (22 September 2023): <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird84200> [accessed 4 January 2024]

209 Corporation Tax Act 2009, [section 1049](#) and HMRC, ‘Corporate Intangibles Research and Development Manual’ (22 September 2023): <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird84200> [accessed 4 January 2024]. See also Table 1 below.

210 HMRC, ‘REVENUE 16: Research and Development (R&D) Tax Credit’ (April 2002): <https://webarchive.nationalarchives.gov.uk/ukgwa/20060719075948/http://www.hmrc.gov.uk/budget2002/revbn16.htm> [accessed 4 January 2024]

211 For the meaning of “subsidised expenditure”, see Corporation Tax Act 2009, [section 1138](#) and HMRC ‘Corporate Intangibles Research and Development Manual’ (22 September 2023) at CIRD81650: <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird81650> [accessed 4 January 2024]. It includes, but is not limited, to grant funding.

from claiming under the SME scheme because of a subsidy should be able to claim R&D relief under RDEC.²¹²

Different interpretations of subcontracted R&D and subsidised expenditure?

135. Last year's Finance Bill Sub-Committee report, *Research and Development tax relief and Expenditure Credit*,²¹³ found a difference in view between HMRC and most advisers on how the SME scheme rules relating to subcontracted R&D and 'subsidised expenditure' applied in practice, and that this was creating uncertainty for businesses and advisers.
136. In this year's inquiry, our witnesses explained that the difference in view mainly concerned contracts under which the customer outsourced work to the provider under contract and the provider subsequently found that, to do that work, it needed to carry out R&D.²¹⁴ We were told that HMRC's current view was that: "any activities carried out in order to fulfil the terms of a contract are deemed to be subcontracted".²¹⁵ Ayming told us that if a civil engineering firm were hired to build a stadium for a football club and, after starting work, found a problem that it needed to undertake R&D to resolve: "it would not be the civil engineers making the claim but ... a premiership football club."²¹⁶
137. In addition, we were told that HMRC's view of when expenditure is subsidised could also prevent a company claiming R&D relief for activity they are paid to do under a contract. Mace explained: "if a company secures a contract up front with a customer to undertake a project, any activity that takes place thereafter will be deemed as fulfilling the terms of a contract. HMRC would therefore treat any R&D expenditure on a commercial project as subsidised by the customer".²¹⁷ Ela8 summarised: "subsidised R&D continues to be a difficult area for companies and advisers alike".²¹⁸
138. The previous Finance Bill Sub-Committee's report into R&D tax relief,²¹⁹ asked HMRC to consider what steps it could take to resolve uncertainty around the meaning of 'subsidised expenditure'. However, in its evidence for the current inquiry, CIOT told us that HMRC was: "permitting a situation of uncertainty to continue" in relation to this issue.²²⁰
139. ***We recommend that in 2024 HMRC work closely with members of its Research and Development Communication Forum in order to***

212 Corporation Tax Act 2009, [sections 1052](#) and [1053](#) and HMRC, 'Corporate Intangibles Research and Development Manual' (22 September 2023) at CIRD81650: <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird81650> [accessed 4 January 2024]

213 Economic Affairs Committee, *Research and development tax relief and expenditure* (3rd report, Session 2023–23, HL Paper 137)

214 Written evidence from ela8 limited ([DFH0015](#)). This is in contrast to the position where a subcontracted task is recognised as being R&D ab initio.

215 [Q 39](#) (Benjamin Craig), Letter from Ayming UK to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (16 August 2023): <https://committees.parliament.uk/publications/42719/documents/212447/default/> and written evidence from Ayming UK ([DFH0014](#))

216 [Q 39](#) (Benjamin Craig), written evidence from Mace ([DFH0007](#))

217 Written evidence from Mace ([DFH0007](#))

218 Written evidence from ela8 limited ([DFH0015](#))

219 Economic Affairs Committee, *Research and development tax relief and expenditure credit* (3rd Report, Session 2022–23, HL Paper 137)

220 Written evidence from CIOT ([DFH0006](#)) and see also written evidence from Ayming UK ([DFH0014](#)).

clarify the treatment of both ‘contracted out R&D’ and subsidised expenditure.

Who should claim relief for subcontracted R&D and subsidised expenditure?

140. In its consultation on a single scheme, the Government said that the new scheme would contain only one rule for subcontracted R&D and asked for views on: “which set of rules would best support companies”—the SME scheme rules, RDEC or a different approach.²²¹ Given the significant differences in the treatment of subcontracted R&D and subsidised expenditure between the two existing schemes, ICAEW said: “some people will win and some people will lose ... it will be impossible to find a solution that suits everyone affected”.²²² Indeed, some witnesses favoured the RDEC model and others the approach of the SME scheme.²²³ Justin Arnesen of Evelyn Partners told us that this issue, which he described as: “ultimately who was eligible to claim” between customer and provider, was a: “major point of debate”.²²⁴
141. When it published draft legislation in July 2023, the Government said that it had decided to adopt the SME approach, with the customer being entitled to claim R&D relief (subject to an exception where the customer was outside the UK).²²⁵ Mr Henty told us that: “there is a strong economic case for giving R&D relief to the decision-making body, the company that has the project to resolve a scientific or technological uncertainty”.²²⁶ CIOT told us that this was a: “significant change for large companies”.²²⁷
142. To illustrate this, Table 1 below summarises who can claim R&D relief under each of the existing SME and RDEC schemes where R&D has been subcontracted. Table 2 summarises the effect of adopting the SME model for the merged scheme, highlighting the changes from the current schemes.

Table 1: Subcontracting: who can claim under the existing schemes

	Customer	R&D Claim	Provider	R&D Claim
1	Large company	None	Large company	RDEC
2	Large company	None	SME	RDEC
3	SME	SME relief	SME	None
4	SME	SME relief	Large company	None

Source: Written evidence from ForrestBrown (DFH0016)

221 HM Treasury, *R&D Tax Reliefs Review, Consultation on single merged scheme* (January 2023), p 17: https://assets.publishing.service.gov.uk/media/63c51fc08fa8f572a9a36f33/20230113_R_D_Consultation.pdf [accessed 4 January 2024]

222 Q 9 (Richard Jones)

223 We summarise the different views below—but as a general, larger companies favoured following the RDEC approach on this, while bodies representing SMEs preferred the SME model.

224 Q 39 (Justin Arnesen)

225 HM Treasury, *R&D Tax Reliefs Review: Consultation on a single scheme—summary of responses* (July 2023), p 17: https://assets.publishing.service.gov.uk/media/64b65ec90ea2cb001315e470/Summary_of_Responses_-_RD.pdf [accessed 25 January 2024]. The Government said that this was preferred approach of the majority of respondents to the consultation and that, of the options, this had the greatest spillover benefits for the broader economy.

226 Q 86 (Matt Henty, HM Treasury)

227 Written evidence from CIOT (DFH0006)

Table 2: Subcontracting: who will be able to claim under the merged scheme

	Customer	R&D Claim	Provider	R&D claim
1	Large company	Merged Scheme	Large company	None
2	Large company	Merged Scheme	SME	None
3	SME	Merged Scheme	SME	None
4	SME	Merged Scheme	Large company	None

The text highlighted in bold in Table 2 shows the differences for large companies under the merged scheme.

Source: Written Evidence from ForrestBrown (DFH0016)

143. FSB supported the Government's decision to adopt the SME scheme's approach to subcontracting in the merged scheme, given that, for SMEs: "the practicalities ... mean [that R&D] will need to be outsourced from time to time".²²⁸ IoD also saw this as: "the right approach".²²⁹ NCUB was similarly in favour and told us that this was: "the most common approach internationally."²³⁰
144. BIA saw the SME approach as working: "perfectly from a life sciences point of view". However, while it recognised that it: "was very hard to fix" all the issues, it had some reservations about this being a blanket rule, given issues around fragmented R&D.²³¹
145. Many of the witnesses who, conversely, sought a replication of the RDEC approach to subcontracting, highlighted the uncertainty surrounding the interpretation of the rules on subcontracted R&D and subsidised expenditure under the current SME scheme²³². Mr Craig said that, in adopting the SME model, the Government had: "picked up one of the most problematic, and currently most controversial, aspects of the SME scheme".²³³ Even though ATT thought the SME model was both: "reasonable" and "sensible", it nevertheless felt that: "one drawback is that consideration as to whether R&D has been contracted into a claimant company or subsidised by customers will continue to be important."²³⁴ According to ForrestBrown: "Adopting the SME approach to contracting out could cause major disruption for large companies if the recent uncertainty regarding the interpretation of 'contracted out' continues",²³⁵ and ela8 told us that the proposed restriction for subsidised R&D should be removed as it is: "not appropriate within the merged scheme".²³⁶
146. Ayming's view was that the merged scheme should: "parallel the current RDEC scheme ... as this would bring the benefit [through R&D relief] of providing relief to the company actually undertaking the R&D ... as well as ensuring the company claiming had the competence to prepare the claim

228 Written evidence from FSB (DFH0019) and AICPA-CIMA (DFH0008)

229 Q 52 (Dr Roger Barker)

230 Written evidence from NCUB (DFH0009)

231 Q 52 (Colin Hailey). Fragmented R&D is where one company plans a project and outsources particular aspects of the R&D activity to other companies that have the specialist skills and experience for that R&D.

232 See footnotes 228–239 above.

233 Q 39 (Benjamin Craig)

234 Written evidence from ATT (DFH0002)

235 Written evidence from ForrestBrown (DFH0016) and Q 51 (Gillian Thomson)

236 Written evidence from ela8 ltd (DFH0015)

accurately.”²³⁷ Mace and Morgan Sindall Group (Morgan Sindall), each of which currently claims R&D relief under RDEC, agreed²³⁸—Mace told us that RDEC credit: “provides vital support and investment in construction ... allowing the sector to take financial risks on innovation and modern methods of construction”, and that, if the merged scheme followed the SME model: “a significant proportion of R&D tax credits are set to be directed away from construction companies”²³⁹—which, Morgan Sindall pointed out, would be: “with only a few months’ notice”.²⁴⁰

147. Mr Davies explained that another issue with the SME model was that many companies will be unaware that: “R&D is taking place as part of an arrangement they have with someone else. They suddenly become eligible claimant organisations but will have no understanding of R&D ... so you will end up with the ironic situation of R&D taking place but nobody being able to access relief.”²⁴¹
148. Mr Arnesen of argued that: “the entity that should be claiming is the entity that has the technical know-how in that particular area, as opposed to a funder who is ultimately paying for an activity but does not necessarily understand the scientific baseline”.²⁴²
149. Some witnesses who favoured the RDEC approach to subcontracting questioned whether the Government properly understood how subcontracting worked in different industries. For Skanska UK plc (Skanska), issues around subcontracting and subsidised expenditure were the main issues relating to the merged scheme. Gillian Thomson told us that:

“when the Government talked about merging the scheme there was talk about a lot of it falling with the large scheme, so it was not something that we [in]tended to consult on at that point. When the draft legislation came out ... we found it was a complete change We do not feel the Government have looked at what they really mean by ‘subcontracted’.”²⁴³

She also said that Skanska believed that: “the subsidy part should be taken out altogether There should not be a penalty for us for being able to claim the R&D part purely because we are getting some income towards the project as a whole rather than the R&D specifically”.²⁴⁴ ICAS was also concerned that the Government had not taken: “sufficient account of the range of commercial arrangements and allocation of economic risk” relating to R&D activity.²⁴⁵

150. Mr Henty told us that there had been: “a lot of discussion” since the publication of the draft legislation in July.²⁴⁶ Referring to those discussions, HMRC said

237 Written evidence from Ayming UK (DFH0014)

238 Written evidence from Mace (DFH0007) and Morgan Sindall (DFH0003)

239 Written evidence from Mace (DFH007). Mace said that in 2021/22 the construction sector received £480 million in RDEC credits.

240 Written evidence from Morgan Sindall (DFH0003)

241 Q 40 (Mark Davis) and see written evidence from BVCA (DFH0017).

242 Q 39 (Justin Arnesen). See also written evidence from Mace (DFH0007).

243 Q 51 (Gillian Thomson)

244 Q 53 (Gillian Thomson) and written evidence from Mace (DFH0007), Morgan Sindall (DFH0003), BIA (DFH0013), and BVCA (DFH0017)

245 Written evidence from ICAS (DFH0018)

246 Q 85 (Matt Henty)

that the: “main topics of conversation have been around subcontracting and subsidised expenditure rules”.²⁴⁷

151. CIOT and BIA both told us that, in those discussions, the Government had proposed two different solutions to deal with subcontracting.²⁴⁸ The first was to define ‘subcontracted R&D’ by: “distinguishing in the legislation an R&D contract (only the customer can claim) from a non-R&D contract (the subcontractor may be able to claim).”²⁴⁹ The second was a system of notification by the customer: “whereby a party initiating a contract notifies the subcontractor, ahead of payment, that the subcontractor cannot claim R&D relief.”²⁵⁰
152. ICAEW and Ayming preferred the notification system option, while recognising that: “there are practical steps to get over to make that work.”²⁵¹ On the other hand, Ellen Milner said that CIOT’s preference was for the first approach as it felt that a notification system would mean that parties: “potentially start to get wrapped up in contract negotiations”.²⁵² In any event, it felt that: “the outcome of the Government’s deliberation following these discussions and the proposed way forward should be the subject of further consultation.”²⁵³

The Government’s preferred approach: defining subcontracted R&D

153. In its summary of consultation responses, the Government said it would like: “further discussions to understand how a potential merged scheme could distinguish between ‘normal’ (non-R&D) contracts and ‘subcontracted out R&D’ so that those undertaking qualifying R&D are enabled to claim relief, whilst avoiding double claims.” The Government also said that it was still considering whether the merged scheme should contain a restriction on relief for subsidised expenditure.
154. HMRC told us that in its discussions with stakeholders over summer 2023, it had been: “working with industry to get the detail right” in relation to how the new scheme dealt with subcontracting arrangements.²⁵⁴ The draft Finance Bill clauses did not distinguish between the two types of subcontracting arrangements identified by the Government—non-R&D and subcontracted R&D—which CIOT described as a: “huge omission”.²⁵⁵ However, HMRC told us that it would be informally consulting on any further draft legislation on this aspect of the scheme before finalising the next Finance Bill.²⁵⁶ Although the Government did not say what it meant by this distinction, Ms Thomson told us that there were two main types of subcontracting: the first, where: “there is the subcontracting of an R&D project”—for example, outsourcing a drug trial—and the second where R&D is: “embedded in a wider commercial project”, as is usually the case under a construction contract.²⁵⁷

247 Written evidence from HMRC (DFH0020)

248 Written evidence from ICAS (DFH0018)

249 Written evidence from CIOT (DFH0006)

250 Written evidence from CIOT (DFH0006) and BIA (DFH0013)

251 Q 9 (Richard Jones, ICAEW) and written evidence from ICAEW (DFH0005), Ayming UK (DFH0014), and BVCA (DFH0017)

252 Q 9 (Ellen Milner)

253 Written evidence from CIOT (DFH0006)

254 Written evidence from HMRC (DFH0020)

255 Written evidence from CIOT (DFH0006)

256 Written evidence from HMRC (DFH0020)

257 Q 51: (Gillian Thomson)

155. At Autumn Statement 2023, after our non-government witnesses had given evidence, the Government confirmed that it intended to pursue the option of defining a ‘subcontract’ for R&D purposes in the legislation. Where a contract met that definition, the customer would be the person entitled to claim R&D relief (as per the SME model). For other contracts, it would be the provider that could claim relief—so that: “if a company is contracted to provide a product or service which is not R&D ... [but undertakes] R&D in delivering that product or service, they would be able to claim relief even though they are undertaking R&D on an activity contracted to them”.²⁵⁸
156. The Government also announced that, because of how it planned to treat subcontracted R&D: “the rules relating to subsidised expenditure in the existing SME scheme are no longer relevant”, meaning that: “if a company receives a grant that covers part of the cost of its R&D, or if the cost of the R&D is otherwise met by another person, then (subject to the contracting out rules ...) this will not reduce the amount of support available under the merged scheme”. The Government also announced that it would be making equivalent changes to the R&D intensive scheme (which, as discussed in Chapter 3 above, is based on the existing SME scheme²⁵⁹) in the interests of: “consistency across the regime” once the merged scheme was in place.²⁶⁰
157. Mr Henty told us that these rules were designed: “to ensure that we pick up all the R&D and do it at the level of the decision-making body that is trying to resolve a scientific uncertainty” and that, both in principle and from an economic perspective: “it is better to have the rules that we are proposing”. He said the Government was not in favour of a notification system as it would mean that R&D relief was granted on the basis of: “bargaining power ... [rather than] following the substance”. He accepted that there would need to be: “a lot of guidance and clarity from HMRC so that people know exactly what needs to be done” when working out whether their contractual arrangements were caught by the legislation or not, and that HMRC’s: “focus over the next few months will be to make sure that that is right.”²⁶¹
158. **It is clear that changing the rules on subcontracted R&D would always result in winners and losers. The Government should have been more transparent in July about its reasons for its chosen approach so that those businesses at risk of losing out could at least understand the policy rationale for this.**
159. **We consider that there should have been a wider, and more formal, consultation on the treatment of subcontracting arrangements at an earlier stage. It is particularly disappointing that the new Finance Bill provisions on subcontracting were not themselves subject to formal consultation before being laid before Parliament.**

258 HM Treasury, ‘Technical note on changes to research and development tax reliefs at Autumn Statement 2023’ (22 November 2023): <https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform/technical-note-on-changes-to-research-and-development-tax-reliefs-at-autumn-statement-2023> [accessed 5 January 2024]

259 As a result, the draft legislation for the R&D intensive scheme did not allow an eligible SME to claim for subsidised expenditure and, where R&D was subcontracted, only allowed a claim for relief by the customer.

260 HM Treasury, ‘Technical note on changes to research and development tax reliefs at Autumn Statement 2023’ (22 November 2023): <https://www.gov.uk/government/publications/autumn-statement-2023-research-and-development-tax-reliefs-reform/technical-note-on-changes-to-research-and-development-tax-reliefs-at-autumn-statement-2023> [accessed 5 January 2024]

261 [Q 85](#) (Matt Henty, HM Treasury)

160. **Given the range of commercial arrangements relating to R&D activity, we consider that defining ‘subcontracted R&D’ to exclude what the Government calls a ‘normal’ contract may be very challenging, if not impossible. We therefore agree that it is vital that detailed guidance on the meaning of ‘subcontracted R&D’ is made available as soon as possible. We are concerned, however, that there is insufficient time for such guidance to be developed prior to the legislation coming into force from April 2024.**
161. **We welcome the Government’s decision to remove the restriction on relief for subsidised expenditure under each of the merged and R&D intensive schemes.**
162. *Detailed guidance on subcontracted R&D, including realistic examples, must be available to businesses in advance of 1 April 2024 when some businesses will have to apply the new rules. HMRC needs to assure businesses that final guidance will be available before the start date of the merged scheme.*

A need for transitional provisions?

163. CIOT told us that, whichever route the Government took in relation to subcontracted R&D: “April 2024 is too soon for businesses to organise their contracts and businesses arrangements to reflect the new rules, particularly when much of the detail remains outstanding”.²⁶² Given that many R&D projects: “involve long-term contracts, spanning several years”, ICAEW told us there could be projects that: “span an existing R&D tax relief scheme and the merged scheme”. The difference between the treatment of subcontracting under the merged scheme and the current RDEC scheme meant that: “the entity entitled to relief under the contract concerned will change [mid-contract], especially where R&D work is subcontracted.”²⁶³
164. ICAEW argued for existing contracts to: “continue to be dealt with under existing rules, or [for] the entity currently entitled to the relief ... [to] continue to do so for the length of the contract”.²⁶⁴ For example, Mr Davies felt that: “with a sensible timetable, transitional arrangements are probably not required ... [but in the case of] ... a very aggressive timetable, transitional arrangements would be an eminently sensible thing to do”.²⁶⁵
165. The Financial Secretary recognised that: “for some businesses where there is a lot of subcontracting, this change may require some renegotiation of some of those contracts ... [but] that is not beyond the wit of man.” He hoped that after: “some inconvenience from this change ... [and] some transitional complications with some subcontractors, ... that point in the process will be easier in the medium to long term.”²⁶⁶
166. **We acknowledge that changes to the subcontracting rules announced at Autumn Statement 2023 should go some way to assuaging the concerns of larger companies concerning the adoption of the SME model for subcontracting arrangements. Nonetheless, such businesses will have a heavy compliance burden given the need for**

262 Written evidence from CIOT ([DFH006](#))

263 Written evidence from ICAEW ([DFH0005](#)). See also written evidence from CAI ([DFH0001](#)).

264 Written evidence from ICAEW ([DFH0005](#))

265 [Q 41](#) (Mark Davis) and [Q 56](#) (Michael Moore)

266 [Q 86](#) (Nigel Huddleston MP, FST)

them to review each subcontracting arrangement in order to confirm eligibility for R&D relief in advance of the merged scheme coming into effect.

167. Transitional rules within the merged scheme would be undesirable: they add to the overall complexity of the transition and could mean that affected businesses are subject to two different regimes (both the RDEC and the merged scheme) in relation to R&D spend until the end of the transitional period. The need for such transitional arrangements would be best avoided by deferring the start date for the merged scheme to allow companies to prepare for the changes.
168. *If the Government persists with its current timetable for the merged scheme, we recommend, notwithstanding the reservations set out in our conclusion above, that transitional provisions be included in the legislation so that providers can continue to claim relief for R&D done under an existing subcontracting arrangement for a specified period. This would enable them to review their existing arrangements and negotiate any changes needed for their contracts to remain financially viable. Any such transitional arrangements should be as simple as possible to implement and should last no longer than is necessary to enable those affected to adjust to the new sub-contracting regime.*

CHAPTER 6: CHANGES TO HMRC DATA COLLECTION

169. The draft Finance Bill published in July 2023 sets out a new power for HMRC to require additional data from employers and individual taxpayers.²⁶⁷ The background to this measure is the Government's 10-year tax administration strategy, *Building a trusted, modern tax administration system*, published in July 2020, which stated that: "COVID-19 has emphasised the value of a tax authority having access to real-time data."²⁶⁸ In July 2022 the Government followed up the strategy with a consultation, *Improving the data HMRC collects from its customers*²⁶⁹, proposing a number of potential options for improving the range of data HMRC collects. A summary of responses was published in April 2023, setting out plans to proceed with some of the less burdensome options where taxpayers already hold the relevant data.²⁷⁰ The Government also committed to publishing draft legislation for technical consultation before enacting these provisions.
170. The new power is broad and general in scope. It does not specify the precise information concerned but indicates that some of it will be required in the context of personal tax returns and some as part of PAYE returns by employers. The detailed requirements will be set out in regulations that are expected to be published during the parliamentary stages of the Finance Bill, likely in early 2024²⁷¹. The information required will be limited to that which HMRC considers relevant for: "the collection and management of any of the taxes listed in Section 1 of the Taxes Management Act 1970", i.e., income tax, capital gains tax and corporation tax.²⁷²
171. The draft regulations implementing this proposal were not available during the consultation period on the draft legislation, nor during the evidence-gathering stage of our inquiry. We and our witnesses have, therefore, had to rely on the consultation and summary of responses, the policy paper accompanying the draft legislation, published in July 2023 (the July policy paper)²⁷³, and explanations made by HMRC in the course of their evidence to this inquiry, to try to understand what is involved.
172. Witnesses told us that the absence of any draft regulations made it difficult for them to comment in detail on the proposals. CIOT urged HMRC: "to

267 HMRC, 'Change to data HMRC collects from customers' (18 July 2023, amended on 22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers> [accessed 22 December 2023]

268 HMRC & HM Treasury, *Building a trusted, modern tax administration system* (21 July 2020): <https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system> [accessed 22 December 2023]

269 HMRC, 'Improving the data HMRC collects from its customers' (27 April 2023): <https://www.gov.uk/government/consultations/improving-the-data-hmrc-collects-from-its-customers/improving-the-data-hmrc-collects-from-its-customers> [accessed 22 December 2023]

270 HMRC, 'Improving the data HMRC collects from its customers Summary of responses' (27 April 2023): <https://www.gov.uk/government/consultations/improving-the-data-hmrc-collects-from-its-customers/public-feedback/improving-the-data-hmrc-collects-from-its-customers-summary-of-responses> [accessed 22 December 2023]

271 Letter from Nigel Huddleston MP Financial Secretary to the Treasury to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (12 December 2023): committees.parliament.uk/publications/42711/documents/212323/default/

272 *Finance Bill*, clause 35 [Bill 014 (2023–24)]

273 HMRC, 'Changes to HMRC data collection' (22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection> [accessed 22 December 2023]

publish draft regulations before the enabling legislation has been enacted”²⁷⁴, and this was echoed by ATT and ICAS.²⁷⁵

173. The July policy paper listed three specific types of new data to be collected by HMRC, with effect from financial year 2025/26²⁷⁶. The first of these concerns employee hours, which the Government anticipates will affect 1.9 million PAYE-registered business²⁷⁷.
174. At the time the July policy paper was drafted, the proposal was for employers to be required to report the number of employee hours *worked* as part of PAYE returns under the Real Time Information (RTI) system. This was amended to require the number of employee hours *paid* to be reported when the July policy paper was updated on 22 November 2023. This was after we had taken evidence from our non-Government witnesses, whose evidence dealt with the Government’s original proposal.
175. In that context, the evidence on this point reflected general concern about the difficulties in collecting the number of hours actually worked, on the basis that few employers would routinely and systematically collect such data, particularly in the case of salaried employees: “If you are a salaried employee, your employer probably does not count how many hours’ work you do on the weekend, if you take a bit home and do it here and there, or if you are working the odd bit of overtime. It will be quite difficult to gather”²⁷⁸.
176. The second type of data requirement is for owner-managers of companies to differentiate between dividends paid to them by their own company and those paid by other companies in their self-assessment income tax returns. The Government expects 900,000 businesses will be affected.²⁷⁹
177. Finally, self-employed people will be required to provide information about the start and end dates of their periods of self-employment in their self-assessment tax returns. The Government expects this requirement to affect up to 1.2 million self-employed businesses each year.²⁸⁰

Employee Hours Data

178. There was general support from witnesses for the principle of improving HMRC data. Samantha O’Sullivan of the Chartered Institute of Payroll Professional (CIPP) said that: “improving the data that HMRC collect can only be a good thing”, provided that: “a massive additional administrative burden is not put on payroll teams.”²⁸¹ Dr Andy Summers, Associate Professor in the Law School at the London School of Economics (LSE), emphasised: “the potential utility of systematically collecting employee hours data for

274 Written evidence from CIOT ([DFH0006](#))

275 Written evidence from ATT ([DFH0002](#)) and ICAS ([DFH0018](#))

276 [Finance Bill](#), clause 35 [Bill 014 (2023–24)]

277 HMRC, ‘Changes to HMRC data collection’ (22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection> [accessed 22 December 2023]

278 [Q 23](#) (Dr Emma Rawson)

279 HMRC, ‘Changes to HMRC data collection’ (22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection> [accessed 22 December 2023]

280 HMRC, ‘Changes to HMRC data collection’ (22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection> [accessed 22 December 2023]

281 [Q 61](#) (Samantha O’Sullivan)

policy development purposes, not only in HMRC but across Government departments”.²⁸²

179. A number of witnesses, however, stated that they were unclear about the reasons for collecting data on employee hours, and how this data would be relevant to the ‘collection and management’ of the relevant taxes. Ms O’Sullivan said CIPP would: “push for [HMRC to set out] ... the intention behind the requirement for the data, in order to get buy-in in the first instance”,²⁸³ and explained that CIPP’s members were concerned that: “their clients would not be very forthcoming with the information unless they knew specifically what this data was going to be used for.”²⁸⁴
180. We asked HMRC how the additional information that it will require on employee hours will be used. Zoë Nettlefield, Deputy Director, Strategic Data Policy, told us that: “this work was prompted by the use of HMRC’s data to deliver Covid schemes and the data gaps that we identified in using tax administration data for non-tax purposes.” She explained that:

“It is the information, the intelligence that we can use to understand whether there is undeclared tax and [national insurance contributions (NICs)], and similarly with regard to the national minimum wage, which HMRC has operational responsibility for the enforcement of. Similarly, there is NICs relief in freeports and investment zones. It enhances the data that we can use to target activity and put nudges and prompts in those compliance areas.”
181. The Financial Secretary added that: “a lot of the information is genuinely—I know there is a lot of scepticism here—to help correct errors.”
182. Following his oral evidence, the Financial Secretary wrote to the Chair with more detail about the uses of the data:

“Employee hours data will provide a better understanding of economic activity, and the impact of economic shocks on the income of employees. ... HMRC envisages that the new hours information will enable them to accurately identify the correct population for any future promote and upstream activity²⁸⁵ and drive even more complaints from workers about underpayment of NMW.”
183. Some witnesses were not convinced that this data would help with HMRC’s responsibility for enforcing compliance with the National Minimum Wage (NMW) and National Living Wage (NLW) as, if the employer were paying less than NMW or NLW, the data could easily be manipulated to conceal this. Dr Emma Rawson of ATT said that if: “you are an employer who is purposefully and egregiously not paying minimum wage, will you reliably be reporting that, or will you perhaps massage your figures?”²⁸⁶.
184. Dr Summers recognised that only collecting: “information that is ‘relevant for the purpose of the collection and management of any taxes listed’” (income tax, capital gains tax and corporation tax) limited the data that could be

282 [Q 61](#) (Dr Andy Summers)

283 [Q 62](#) (Samantha O’Sullivan)

284 [Q 64](#) (Samantha O’Sullivan), [Q 22](#) (Dr Emma Rawson), [Q 61](#) (Kevin Hart), [Q 5](#) (Ellen Milner)

285 Promote activity is activity relating to NMW enforcement.

286 [Q 22](#) (Dr Emma Rawson), [Q 62](#) (Bill Dodwell, Kevin Hart)

collected and how it could be used.²⁸⁷ He stated that this new power: “seems barely any wider than the power which HMRC already has.”

185. ICAEW noted that:

“In the original consultation document on employee hours, the Government stated that: ‘Having a more detailed analysis of the hour[s] employees work would help with the analysis of labour market trends across government. It would improve government interventions in the labour market through increasing our understanding of both voluntary part-time work and under-employment.’”²⁸⁸

ICAEW added that the draft legislation states that the information requested must be: “to facilitate the collection or maintenance of tax. If the latter is not the true reason for collecting the data, then it is debatable whether the draft legislation could be enforced.”²⁸⁹

186. In terms of the benefits to be derived from the additional data, witnesses were sceptical of the claim in the July 2023 policy note that the additional data would: “provide better outcomes for taxpayers and businesses.”²⁹⁰ Dr Rawson said that she could: “see cost to businesses of doing a lot of this” and was: “doubtful as to whether there will be additional benefit.”²⁹¹ Because of the lack of clarity about how HMRC would use the data, CIOT found it: “very difficult to gauge to what extent these costs are proportionate to the expected benefit.”²⁹²

187. In terms of the benefits for HMRC, ATT’s view was that: “HMRC [has] not made a convincing case as to the benefits it will derive from much of the data.”²⁹³ ICAEW invited the Government to: “make better use of the data it already collects, rather than placing the burden of data collection on businesses.”²⁹⁴

Costs

188. The Government estimates that providing employees hours data will cost employers £35m in one-off set up costs, with negligible on-going costs. Our witnesses calculated that this meant costs of somewhere between £18.25 and £35 per employer. The July policy note said that HMRC’s estimate was:

“based on assumptions about data employers are required to keep, to satisfy National Minimum Wage and National Living Wage rules, and how easy it would be to include that data in the Real Time Information (RTI) submission process they already follow”²⁹⁵

The policy note did not, however, set out what these assumptions were.

287 Written evidence from Dr Andy Summers (DFH0004)

288 Written evidence from ICAEW (DFH0005)

289 Written evidence from ICAEW (DFH0005)

290 HMRC, ‘Changes to HMRC data collection’ (22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection> [accessed 23 January 2023]

291 Q 24 (Dr Emma Rawson) and written evidence from ICAEW (DFH0005) and ICAS (DFH0018)

292 Written evidence from CIOT (DFH0006)

293 Written evidence from ATT (DFH0002)

294 Written evidence from ICAEW (DFH0005)

295 HMRC, ‘Changes to HMRC data collection’ (22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection> [accessed 23 January 2023]

189. Witnesses suggested that the costs to employers of providing this information had been under-estimated. ICAEW said it considered that: “the one-off cost is likely to be significantly higher than the total cost of £35m estimated by HMRC”²⁹⁶. CIOT told us that they were: “mystified [about] how HMRC have calculated the average transitional costs to businesses. ... we expect the real-life costs to be significantly higher”²⁹⁷. Ms Milner said that it: “would be really helpful for HMRC to be transparent about the calculation”.²⁹⁸
190. While witnesses’ views that the costs have been under-estimated were driven in part by uncertainty about exactly what data would be required, they also felt that HMRC had not fully appreciated the amount of work that would be needed on the part of employers. ICAS told us that the information on employee hours that employers hold in their systems will: “not necessarily be in the reporting system used for filing RTI returns with HMRC”.²⁹⁹ Mr Hart stated that larger businesses have: “full-blown systems that do all their finance, payroll and HR” and that the software licenses alone for such systems are: “in the £1 million plus range, so you can imagine the change cost is not insignificant.” He noted that most older software includes mechanisms to handle legislative change but said that: “the costs come in when you want to install that software, test it in parallel with your live service, and make sure everything is performing.”³⁰⁰
191. Medium-sized companies, on the other hand, frequently have separate HR and payroll systems: “so they would have to onward develop the linkage between these ... systems. That has a cost, which may be bespoke for quite a lot of individual providers”.³⁰¹
192. In relation to smaller businesses Mr Hart explained that: “there is a complete mix.” There are simple and low-cost software solutions, but these are typically payroll systems, meaning that they quite often do not collect the number of hours worked. He added that, while upgrading the products may not lead to an additional software licensing costs, there would be other costs involved as: “they still have to implement it, test it, train on it and make sure nothing is broken.” In addition to these implementation costs: “there is a significant ongoing cost of trying to get this data on every pay period”.³⁰²
193. Similarly, employers who contract out their payroll operations would have to pay extra for these additional data requirements. Ms O’Sullivan told us that: “service providers ... may need to change their data-gathering processes” and explained that: “it is not just about what the system needs; it is the starting process ... That could take time to develop and implement alongside the financial implications.”³⁰³
194. Witnesses were not persuaded that the ongoing costs would be negligible. ICAEW told us that it did not: “agree with the government’s assessment that ongoing cost would be ‘negligible’.”³⁰⁴

296 Written evidence from ICAEW (DFH0005)

297 Written evidence from CIOT (DFH0006)

298 Q 5 (Ellen Milner)

299 Written evidence from ICAS (DFH0018)

300 Q 63 (Kevin Hart)

301 Q 63 (Kevin Hart)

302 Q 63 (Kevin Hart)

303 Q 65 (Samantha O’Sullivan)

304 Written evidence from ICAEW (DFH0005)

195. When we asked HMRC specifically about the costings, Ms Nettlefield told us that HMRC was: “refining the costings” and that it would publish an updated version: “when we publish the draft regulations in the new year.”³⁰⁵
196. Witnesses also emphasised the need for support and guidance ahead of the implementation of this requirement. Ms O’Sullivan asked for this to be: “brought forward ... to explain the new requirements and to get employers’ buy-in.”³⁰⁶ She added that CIPP: “would like to see some pilots run ... we could probably come up with a list of recommended companies that you could use for legislative pilots.”³⁰⁷
197. **From the evidence received, it seems very likely that the costs to employers of providing this data, both one-off and on-going, have been significantly underestimated.**
198. *We recommend that HMRC publishes the assumptions on which the costs to businesses of the employee hours requirement were based. HMRC should then work with interested parties to review these costings and produce revised estimates that are more realistic and re-evaluate the extent to which the proposed benefits outweigh these costs.*
199. **We consider that the case for requiring employers to provide employee hours data to HMRC has not been made out. Additional burdens should not be imposed on businesses unless there is a compelling reason for doing so. It is not clear how understanding economic activity, enforcing the National Minimum Wage and the National Living Wage, planning for contingencies, or assessing NICs reliefs can be considered to be “for the collection and management” of the listed taxes, as specified in the draft legislation.**
200. **At the time they gave evidence, witnesses remained unclear about exactly what information on employee hours was required and for what purpose, despite the fact that consultation on this measure has been on-going for more than a year. This level of uncertainty at this stage in the development of the measure is unacceptable. The Government should have been much more transparent from the beginning about what information is required and how it will be used. We do, however, welcome the Government’s clarification that the requirement is for data relating to hours paid rather than hours worked.**

Sharing data

201. There was uncertainty among some witnesses about whether HMRC intends to share the newly required data with other Government departments and agencies. CIOT noted that the original consultation document suggested that the data would be collected so it could be used for sharing across Government departments. It said that this: “does not seem to have much, if anything to do with tax” and that: “it is not at all clear what data HMRC will share with other parts of Government, or whether they will use it only for their own compliance purposes, or both.”³⁰⁸ ICAS said that, if there are

305 [Q 90](#) (Zoe Nettlefield)

306 [Q 64](#) (Samantha O’Sullivan)

307 [Q 67](#) (Samantha O’Sullivan)

308 Written evidence from CIOT ([DFH0006](#))

plans to share the data: “there should be further consultation and a clear explanation of what will be shared”.³⁰⁹

202. Conversely, Dr Summers felt that: “there should be a lot more sharing of ... individual level data ... We could get a great policy evaluation resource from this.”³¹⁰ Ms O’Sullivan felt that sharing this data across Government: “could result in a more holistic and compliant approach, which again could only be a good thing.”³¹¹
203. The Financial Secretary confirmed that: “there is the intent to gather this for sharing purposes” but acknowledged that this was subject to legal restrictions.³¹² HMRC explained to us that: “before any information can be passed to another government department or agency a legal power to disclose that information must be identified”,³¹³ and pointed us to Sections 18(2) and (3) of the Commissioners for Revenue and Customs Act 2005³¹⁴ which allows for this. It also told us that: “there are in excess of 250 of these ‘legal gateways’ which permit HMRC to disclose information it holds”.³¹⁵
204. Witnesses suggested that it was also unclear exactly what data HMRC will require where employees are not paid by the hour. Although contracted hours should be readily available, ICAEW noted that these: “are likely to change more often than in the past”³¹⁶ and Ms O’Sullivan pointed out other issues with contractual hours: “What about when someone is on statutory leave for sickness or maternity? If someone is doing a phased return to work, a number of hours are being worked, but that combines with taking time off sick.”³¹⁷
205. Ms Nettlefield confirmed that HMRC was only asking for: “contractual hours, or the number of hours paid if it is an hourly paid individual.”³¹⁸ She added that where: “overtime is paid, there are additional hours counted and paid for, and that would be counted as the amount of hours paid for.”³¹⁹
206. ***The Government should clarify its intentions concerning sharing data about employee hours with other Government departments and agencies. It should consult with relevant stakeholders before any such sharing takes place, even if it is permitted under existing powers.***
207. ***HMRC must publish guidance to help employers and businesses understand exactly what data they need to provide as early as possible in 2024.***
208. ***HMRC must set out how the collection of employee hours data falls within the stated purposes of being for “the collection and management of the listed taxes”, as specified in the draft legislation for Finance Bill 2023–24. If the Government wishes HMRC to collect***

309 Written evidence from ICAS ([DFH0018](#))

310 [Q 61](#) (Dr Andy Summers)

311 [Q 61](#) (Samantha O’Sullivan)

312 [Q 89](#) , [Q 92](#) (Nigel Huddleston MP, FST)

313 Written evidence from HMRC ([DFH0020](#))

314 Commissioners for Revenue and Customs Act 2005, [section 18](#)

315 Written evidence from HMRC ([DFH0020](#))

316 Written evidence from ICAEW ([DFH0005](#))

317 [Q 62](#) (Samantha O’Sullivan)

318 [Q 89](#) (Zoe Nettlefield)

319 [Q 90](#) (Zoe Nettlefield)

data that is not directly necessary for these purposes, this should be specifically legislated for, following a full consultation to consider the implications of such an extension of HMRC's powers.

Data on dividends and dates of self-employment

209. Witnesses could see a much clearer connection between: “the collection and management of tax”³²⁰ and the requirement for additional information about dividends for owner-managers and dates of self-employment. Dr Rawson explained that there are a number of reasons for HMRC to want data on dividends, particularly from owner-managed companies, noting that HMRC: “is interested in seeing what people are drawing out of their companies. There are aspects to do with off-payroll working and IR35.”³²¹ ICAS also saw that this information: “will help HMRC target its compliance activity.”³²²
210. HMRC told us that:
- “improved data will give HMRC a better view of the total package of remuneration received by the Company Owner Manager (COM) from their own company, which will help ensure better targeting of reliefs and the monitoring of tax-motivated incorporation. This will also provide greater flexibility in general, better insights into the COM population and help focus compliance activities on those individuals who engage in tax avoidance.”³²³
211. CIOT did not see that: “splitting dividends between the amount of dividend income received by a shareholder from their own company separately to other dividend income ... would be a particularly onerous task”. Similarly, on the start and end dates of self-employment, it told us that it did not: “consider this proposal to be too onerous.”³²⁴ None of the evidence we received challenged the Government’s estimate of £9 million one-off set-up costs and £9 million per annum on-going costs for the dividend information, and £600,000 per annum for the information on dates of self-employment.
212. The difficulties HMRC experienced during the COVID-19 pandemic in providing relief under the Covid schemes was also highlighted as a justification for the requirement of additional data. Bill Dodwell of the Administrative Burdens Advisory Board said that: “the Government have reasonably made the point that if they had only had more data, they could have awarded owner-managers of companies support money under Covid schemes, but clearly they could not do that.”³²⁵
213. Nonetheless, witnesses felt that some points of detail needed clarification. On the percentage shareholdings of directors of close companies³²⁶, ATT noted that this: “could change in-year and there could be different classes of

320 HMRC, ‘Changes to HMRC data collection’ (22 November 2023): <https://www.gov.uk/government/publications/change-to-data-hmrc-collects-from-customers/changes-to-hmrc-data-collection> [accessed 22 December 2023]

321 Q 24 (Dr Emma Rawson) and HMRC, ‘Understanding off-payroll working (IR35)’: <https://www.gov.uk/guidance/understanding-off-payroll-working-ir35> [accessed 22 December 2023]

322 Written evidence from ICAS (DFH0018)

323 Written evidence from HMRC (DFH0020)

324 Written evidence from CIOT (DFH0006)

325 Q 68 (Bill Dodwell)

326 A close company is a business entity owned by a small group of shareholders (participators); each shareholder will typically have some degree of decision-making authority within the company.

shares”,³²⁷ and CIOT suggested that: “the figure would need to be an annual snapshot.”³²⁸

214. There was also uncertainty about the position of shareholders in close companies who were not directors. ICAS said that it was: “important that the scope is not extended to cover all shareholders”³²⁹—that is, those who are not also directors.
215. On the requirement to provide the start and end dates of a period of self-employment, HMRC told us that: “more accurate information on trading activity would improve our understanding of the characteristics of the trading population during the crucial make-or-break first year”, which would help with the process of designing and evaluating policy interventions. It noted that this additional information: “could also help inform HMRC’s small business compliance activities and allow help to be provided early in the business cycle.”³³⁰
216. ICAS was concerned that: “unrepresented taxpayers may not always find it easy to identify their start date, particularly where, for example, a hobby has developed into a business”.³³¹ ATT noted that: “gross annual trading income does not need to be reported until it exceeds £1,000”, meaning that: “reporting profits may start or cease in a different year to that of the trade.”³³² CIOT said that: “appropriate guidance to help taxpayers identify the dates their business started and ended should be provided by HMRC.”³³³
217. **HMRC said that additional information about dividends for owner-managers would make it easier to operate relief schemes in any future emergency. This is not, in our view, relevant to the collection and management of tax.**

Other sources of information

218. In line with queries raised by several of our witnesses, the Committee noted that the information on directors and others with effective control over from close companies would now be held in electronic form by Companies House following the adoption of the Economic Crime and Corporate Transparency Act 2023. We questioned whether, rather than imposing additional requirements on taxpayers, the information on dividends from close companies could not therefore have been obtained directly from Companies House, rather than by requiring additional information from taxpayers in their self-assessment returns.
219. Dr Summers said that this could, in theory, be done: “via the short step of making it possible to link individuals’ Companies House records and HMRC records.”³³⁴ He explained, however, that: “across our systems of government, we do not have consistent identifiers for individuals. So, it is currently not straightforward to link up to Companies House records.”³³⁵

327 [Q 24](#) (Dr Emma Rawson)

328 Written evidence from CIOT ([DFH0006](#))

329 Written evidence from ICAS ([DFH0018](#))

330 Written evidence from HMRC ([DFH0020](#))

331 Written evidence from ICAS ([DFH0018](#))

332 Written evidence from ATT ([DFH0002](#))

333 Written evidence from CIOT ([DFH0006](#))

334 [Q 68](#) (Dr Andy Summers)

335 [Q 66](#) (Dr Andy Summers, Bill Dodwell)

220. HMRC explained that it had: “looked at whether we could bring across data” from Companies House but:

“To be able to match that data appropriately we would probably need Companies House to collect more data so that we had the right identifiers to be able to bring that across and match it to HMRC’s systems. Given that people are already submitting dividend data in their ITSA tax return, it is just a small addition, and the additional burden is minimal. We thought that, overall, that was the smaller burden than enhancing the Companies House collection and sharing it across to HMRC.”³³⁶

221. *While we accept that a lack of common identifiers in the data held by HMRC and Companies House respectively means that it is not possible for HMRC to cross reference the information held by Companies House regarding dividends paid to owner-managers, the Government should consider how to make its systems compatible with each other so that they are able to exchange data where appropriate.*

Timing

222. ATT told us that businesses and their software providers will: “need time to create or update their systems to collate the additional information required.”³³⁷ ICAS was keen to ensure that there was: “adequate time for implementation of changes,” asking that HMRC: “commence this vital work as soon as possible” as the extent to which the target of 2025/26 is achievable: “will depend on how quickly HMRC publishes regulations and undertakes the detailed consultation required and its ability to produce guidance for all three categories.”³³⁸
223. Mr Dodwell, however, felt that implementation: “was perfectly achievable by 2025,” provided that HMRC releases relevant details to software providers in: “plenty of time.”³³⁹ Mr Hart agreed but cautioned that: “it may still take some time to work through the scenarios to make sure we are able to capture all that information ... there needs to be transparent government briefing.”³⁴⁰ He pointed out that, in relation to 2025: “it is all hands to the pump in delivering Making Tax Digital for income tax and self-assessment” and there is, therefore, already a: “tight timeline to make [software for this] available for public beta in 2025 and to go live in its entirety in 2026 ... we would not welcome even more obligations to incorporate here.”³⁴¹
224. **It is disappointing that the Government did not publish draft regulations with detail about the nature and extent of the additional data to be required by HMRC for consultation at the same time as it published the draft legislation or even the Finance Bill. This delay reduces the amount of time businesses have to prepare for the introduction of these new requirements.**
225. *Early publication of draft regulations and full consultation on the detail of the additional data to be required by HMRC is crucial if the*

336 Q 93 (Zoe Nettlefield)

337 Written evidence from ATT (DFH0002)

338 Written evidence from ICAS (DFH0018)

339 Q 67 (Bill Dodwell)

340 Q 67 (Kevin Hart)

341 Q 67 (Kevin Hart)

Government is to go ahead with a 2025/26 start and the Government must, in any event, allow all stakeholders sufficient time to make the changes necessary for these additional requirements before they are implemented.

CHAPTER 7: DEALING WITH PROMOTERS OF TAX AVOIDANCE

Background

226. In July 2023, the Government published draft legislation to deal with promoters of tax avoidance schemes. The Government described these measures as being targeted at: “the most persistent and determined promoters.”³⁴²
227. The draft legislation contained two measures. The first creates a new criminal offence where promoters who have received a ‘stop notice’ from HMRC requiring them to stop promoting a particular scheme, fail to comply and continue to promote that scheme without a reasonable excuse. The second confers on HMRC a new power to apply to the court directly to disqualify directors of a company involved in promoting tax avoidance, including other individuals who control or exercise influence over such a company (so-called ‘shadow directors’).
228. Previously, if HMRC wanted to have a director disqualified it had to refer the matter to the Insolvency Service—it could not apply to the court itself. Under the draft legislation, HMRC would be able to make an application directly to the court where it considers it would be in the public interest to do so, in one of two circumstances: 1) following an order winding up the relevant company, or 2) where tax avoidance is being promoted. Where the application follows a winding up order, disqualification is mandatory—the court will have no discretion.
229. The Government had earlier consulted on these proposals in a consultation document published in April 2023: *Tougher consequences for promoters of tax avoidance*.³⁴³ The measures build on anti-avoidance legislation in the Finance Acts 2021 and 2022. The Finance Act 2021 introduced stop notices, which are designed to halt the sale of a scheme prior to that scheme being challenged in court.³⁴⁴ When a stop notice is issued, HMRC publishes details of the promoter and the scheme to make people aware both of the scheme itself and of the fact that HMRC is challenging the scheme. Failure on the part of the promoter to comply with a stop notice attracts a range of civil penalties.³⁴⁵
230. The Finance Act 2022 empowered HMRC to publish additional information about tax avoidance schemes that it considers do not work in order to deter potential users from getting involved in these schemes and to alert existing users to the risks of continuing to use them.³⁴⁶
231. HMRC told us that there are currently: “around 20-30 active promoter organisations.”³⁴⁷ Very few stop notices have been issued to promoters since June 2021: as of 7 December 2023, only 16 had been issued, one of which

342 HMRC, ‘Tougher consequences for promoters of tax avoidance’ (23 November 2023): <https://www.gov.uk/government/publications/dealing-with-promoters-of-tax-avoidance/tougher-consequences-for-promoters-of-tax-avoidance> [accessed 2 January 2024]

343 HMRC, ‘Tougher consequences for promoters of tax avoidance’ (18 July 2023): <https://www.gov.uk/government/consultations/consultation-tougher-consequences-for-promoters-of-tax-avoidance/tougher-consequences-for-promoters-of-tax-avoidance--3> [accessed 2 January 2024]

344 [Finance Act 2021](#)

345 [Finance Act 2021](#)

346 [Finance Act 2021](#)

347 Written evidence from HMRC (DFH0020)

had ceased to have effect.³⁴⁸ HMRC told us that, as of the end of August: “no penalties have been charged for continued promotion of a scheme covered by a Stop Notice.”³⁴⁹

New criminal offence for promoters

232. Witnesses were generally supportive of the draft legislation. They recognised the difficulties HMRC faced in dealing with a hard core of promoters who had not been deterred from their activities by previous Finance Act measures. Mr Dodwell, who is also a member of HMRC’s advisory General Anti-Abuse Rule panel (though he did not give evidence in that capacity), highlighted the importance of having: “as many deterrents as possible against promoters of quite aggressive tax avoidance.” He added that: “stop notices are really important as part of that” as they: “shut down the market for aggressive tax avoidance.” Mr Dodwell explained that, while this may be challenging for HMRC to deal with, adding criminal sanctions: “will make it even harder for anyone to ignore a stop notice, and carry on marketing their aggressive avoidance scheme.”³⁵⁰
233. Joshua Toovey of the Association of Independent Professionals and the Self-Employed agreed and spoke of: “the devastating impact on ... families’ lives” when schemes were challenged and shown not to work, and it is: “right that the Government [is] now looking at going to the source of this issue rather than going after contractors themselves, who quite often are unaware that they are inadvertently falling foul of these tax avoidance rules.”³⁵¹
234. Witnesses acknowledged how much HMRC had already achieved. Ms Cattell told us that: “we are now down to a very small hardcore of promoters; a great many of them have been driven out of the market already by the previous measures which have been taken.” She highlighted the: “huge reduction in the sort of marketed tax avoidance schemes that stop notices are aimed at,”³⁵² and that the part of the tax gap relating to marketed schemes had been reduced from £1.5 billion in 2006 to £0.5 billion in the latest tax gap report, published in June 2023.³⁵³
235. ICAS also referred to action taken by the professional bodies to ensure that their members did not get involved in tax avoidance schemes which it said had: “also played a part.”³⁵⁴ ICAS referred to the *Professional Conduct in Relation to Taxation*, which sets standards for tax professionals and states that:
- “Members must not create, encourage or promote tax planning arrangements or structures that: i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant

348 HMRC, ‘List of tax avoidance schemes subject to a stop notice’ (21 December 2023): <https://www.gov.uk/government/publications/named-tax-avoidance-schemes-promoters-enablers-and-suppliers/list-of-tax-avoidance-schemes-subject-to-a-stop-notice> [accessed 2 January 2024]

349 Written evidence from HMRC (DFH0020)

350 Q 70 (Bill Dodwell)

351 Q 70 (Joshua Toovey)

352 Q 1 (Susan Cattell)

353 HMRC ‘Measuring tax gaps tables’ (22 June 2023): <https://www.gov.uk/government/statistics/measuring-tax-gaps-tables> [accessed 22 January 2023]

354 Written evidence from ICAS (DFH0018)

legislation; and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.”³⁵⁵

236. Witnesses also referred to an earlier call for evidence, *Raising standards in the tax advice market*, published in March 2020. This considered whether tax advice should be regulated and suggested that professional regulation might also have a part to play in countering the use of mass-marketed schemes.³⁵⁶ ATT felt that, if the provision of tax services in the UK was subject to professional regulation, many of: “the issues surrounding the promotion and marketing of tax avoidance schemes would not arise—or at least could be countered more swiftly and effectively” and the measures needed: “to be considered in the wider context of the Government’s commitment to raising standards in the tax advice market.”³⁵⁷

237. Mr Jones emphasised the importance of publicity to the deterrent effect of the measures, as these are: “effective only if they are well known.”³⁵⁸ In that regard, ICAS suggested that more might be done to deter potential users from getting involved in schemes in the first place. Ms Cattell said that: “HMRC has some very good communications on its website that are aimed at schemes being promoted to agency workers, contractors and people working for umbrella companies.” She noted that: “unrepresented taxpayers probably do not find that material” and suggested that HMRC could: “try to give this more publicity and write directly to people it thinks are getting involved in these schemes.”³⁵⁹

238. Ms Cattell also suggested that the Government use its rules for public procurement to limit the market for schemes:

“If there were rules in place for public sector procurement that meant public sector bodies could not engage with any agency or umbrella company that was using these disguised remuneration schemes, that would be really helpful in stopping people from getting drawn into them in the first place, which would be very beneficial.”³⁶⁰

239. Some witnesses, while supportive of the proposals in principle, questioned the timing, suggesting that it might have been better to wait until there had been more time to assess the effectiveness of civil sanctions rather than progressing so swiftly to the creation of a criminal offence. Lydia Challen of the Law Society of England and Wales expressed concern about the timing of the measures given that the: “civil measures have not been properly tested yet.”³⁶¹ She added that the civil sanctions regime is: “quite onerous; its financial penalties can be very substantial. ... It seems to us that introducing a strict liability criminal offence, which is what these measures propose, before the existing regime has been tested is a bit disproportionate at this stage.”³⁶²

355 ICAEW, *Professional conduct in relation to taxation* (1 March 2019): <https://www.icaew.com/-/media/corporate/files/technical/tax/pcrt/pcrt.ashx?la=en> [accessed 2 January 2024]

356 HMRC, ‘Call for evidence: raising standards in the tax advice market’ (19 March 2020): <https://www.gov.uk/government/calls-for-evidence/call-for-evidence-raising-standards-in-the-tax-advice-market> [accessed 2 January 2024]

357 Written evidence from ATT (DFH0002)

358 Q 1 (Richard Jones) and written evidence from CIOT (DFH006)

359 Q 2 (Susan Cattell)

360 Q 2 (Susan Cattell)

361 Q 26 (Lydia Challen)

362 Q 26 (Lydia Challen, Isobel d’Inverno)

240. When we raised this point with the Financial Secretary, he said that, while civil penalties can work in many cases: “the criminal element elevates it to show how important the issue is and how seriously we take it.” He highlighted the importance of: “the signalling ... as well as the process,” adding that the Government: “will carefully monitor the situation and see how it goes.”³⁶³

Concerns

Effectiveness: offshore promoters

241. A widely expressed reservation was whether the legislation would be effective against promoters who operate offshore.³⁶⁴ CIOT said that the efficacy of the criminal offence would: “largely depend on how realistic promoters believe the prospect of criminal conviction is.” Adam Craggs of Reynolds Porter Chamberlain LLP (RPC) agreed—unless there were prosecutions: “the deterrent effect, which is generally the purpose of any sort of criminal action, is lessened and weakened.”³⁶⁵
242. ATT told us that, depending on the jurisdiction in which the offshore promoter is based: “it may not always be possible to enforce a criminal penalty without the necessary reciprocal agreements. The criminal offence is therefore unlikely to discourage persistent offshore promoters.”³⁶⁶ In the summary of responses to the consultation the Government said:
- “The UK has one of the world’s largest networks of tax treaties and exchange agreements and HMRC regularly uses this to exchange information with other countries’ tax authorities. This includes asking for information to help with investigations into tax avoidance schemes and the companies and agents who promote them.”³⁶⁷
243. However, Ms Challen told us that, in order to prosecute someone who is overseas, her: “understanding is that you would need to extradite that person.” She noted that this would be possible in certain jurisdictions but would be challenging and time-consuming for HMRC. In addition: “one of the principles for extradition is that there has to be dual criminality: it has to be a criminal offence [both] here and in the jurisdiction where the person is based.” This is unlikely in most cases as this is a: “relatively niche procedural offence.”³⁶⁸
244. Mr Craggs told us that, in some of the cases he has seen: “the promoters have deliberately ensured that they are in places like Northern Cyprus [which is not recognised by the UK], so it would be very difficult to extradite them.”³⁶⁹ ICAEW raised concerns that: “If the measure does not prove effective, the impact could be to drive promoters overseas.”³⁷⁰

363 [Q 72](#) (Nigel Huddleston MP,FST)

364 Written evidence from CIOT ([DFH0006](#))

365 [Q 28](#) (Adam Craggs)

366 Written evidence from ATT ([DFH0002](#))

367 HMRC, ‘Tougher consequences for promoters of tax avoidance’ (18 July 2023): <https://www.gov.uk/government/consultations/consultation-tougher-consequences-for-promoters-of-tax-avoidance/tougher-consequences-for-promoters-of-tax-avoidance--3> [accessed 2 January 2024]

368 [Q 29](#) (Lydia Challen)

369 [Q 29](#) (Adam Craggs)

370 Written evidence from ICAEW ([DFH0005](#)) and [Q 1](#) (Richard Jones)

245. When we raised these concerns with HMRC, Doug Stoneham, Deputy Director, Policy and Technical, in the Counter Avoidance Directorate, recognised that: “it is an area of concern” but added:

“We feel that introducing the new powers in the stop notice measure and the disqualification measure gives us greater scope ... to utilise the network of tax treaties It is also worth suggesting that the vast majority of avoidance cases, or avoidance schemes coming through, that we see are still related to disguised remuneration schemes, where there will almost always be a UK footprint in place so that the UK company is able to offer employment services as part of that process.”³⁷¹

246. **Given the difficulties inherent in extradition, in particular in the case of territories with which the UK does not have extradition agreements, we remain concerned about how the legislation aimed at dealing with the promoters of tax avoidance schemes can be applied to offshore promoters.**

247. *We recommend that, during the passage of the Finance Bill, the Government provides greater clarity about how the legislation will be effective against promoters of tax avoidance schemes that are based offshore.*

Safeguards

248. Witnesses felt that the draft legislation would add significantly to HMRC powers, but without the additional safeguards that they would expect in relation to criminal sanctions. ATT said that it was: “concerned that safeguards initially designed to support a civil penalty have not been strengthened to take account of the proposed ‘strict liability’ criminal offence, potentially leaving some exposed to a criminal record with little recourse.”³⁷² There was particular concern about the fact that decisions on stop notices were taken wholly internally by HMRC without independent oversight. As CIOT told us, this means that: “something can be a crime on HMRC’s say-so, given that a decision to issue a stop notice will rest entirely with HMRC with no external oversight,” and that: “simply relying on [HMRC’s] goodwill and good sense is not a sufficient safeguard against a (potentially arbitrary) criminal charge.”³⁷³
249. We received a number of suggestions about how improved oversight could be built into the legislation. Mr Craggs suggested that: “there should be independent judicial scrutiny and review before one of these notices gets issued, given the potential criminal liability,”³⁷⁴ adding that: “there should be authorisation by the Upper Tribunal and, ideally, by a High Court Judge.”³⁷⁵ Ms Challen suggested that the adoption of a penal notice to a court order would make it: “clear to the recipient that breach of the order will lead to a criminal sanction.”³⁷⁶ ICAEW considered that stop notices: “should be issued by a body that reflects the seriousness of a criminal offence measure.

371 [Q 74](#) (Doug Stoneham)

372 Written evidence from ATT ([DFH0002](#))

373 Written evidence from CIOT ([DFH0006](#))

374 [Q 27](#) (Adam Craggs)

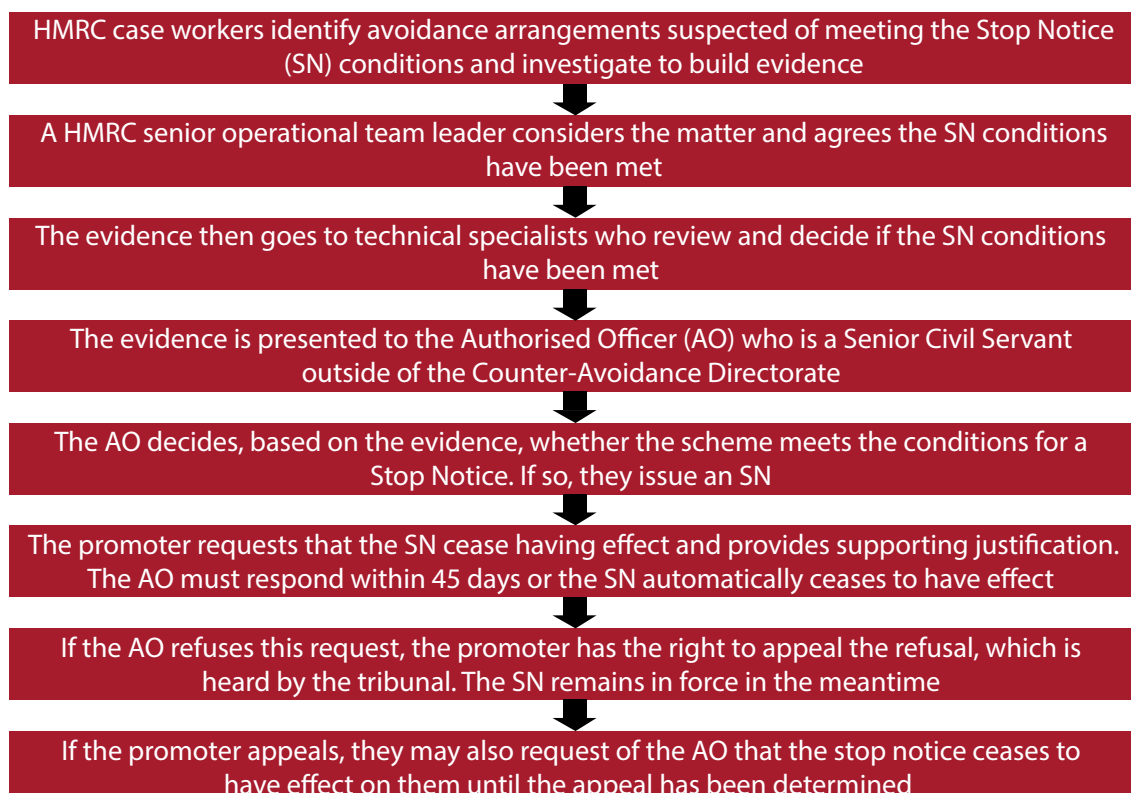
375 [Q 27](#) (Adam Craggs) and written evidence from CIOT ([DFH0006](#))

376 [Q 27](#) (Lydia Challen)

For example, it could be added to the list of responsibilities of HMRC's Tax Dispute Resolution Board (or the Tax Assurance Commissioners)."³⁷⁷

250. Mr Stoneham told us about the: “safeguards in place within HMRC in relation to issuing a stop notice in the first place”. He added that HMRC: “recognise that there are some concerns here and we are planning to publish a document setting out the various safeguards that are in place.”³⁷⁸ In his letter of 12 December 2023³⁷⁹, the Financial Secretary provided a chart showing the process diagrammatically³⁸⁰.

Figure 1: HMRC Stop notice process



Letter from Nigel Huddleston MP Financial Secretary to the Treasury to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (12 December 2023): <https://committees.parliament.uk/publications/42711/documents/212323/default/>

251. We note that previous Finance Bill Sub-Committees have recommended that, where HMRC is granted additional powers, these should be accompanied by safeguards.³⁸¹
252. **We agree with witnesses that the creation of a criminal offence for the promoters of tax avoidance schemes requires greater safeguards, including effective, independent oversight of the stop notice and subsequent criminal prosecution processes, to be built into the legislation.**

377 Written evidence from ICAEW (DFH0005)

378 Q 73 (Doug Stoneham)

379 Letter from Nigel Huddleston MP Financial Secretary to the Treasury to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (12 December 2023): <https://committees.parliament.uk/publications/42711/documents/212323/default/>

380 See Figure 1.

381 Economic Affairs Committee, *New powers for HMRC: fair and proportionate?* (4th Report, Session 2019–21, HL Paper 198)

Stop notices under appeal to the tax tribunal

253. The policy note issued in July 2023 said that: “failure to comply with a stop notice would be a criminal offence,”³⁸² regardless of any dispute about the effectiveness of the tax scheme. Even if the courts subsequently found that the scheme subject to a stop notice did deliver the promised tax advantage, if the stop notice was not complied with: “the criminal offence would already have been committed.”³⁸³
254. ICAEW said that it was concerned that the criminal offence measure: “could result in a person being prosecuted for failing to comply with a stop notice despite that stop notice being struck down by the tribunal.” It suggested two possible remedies: “the criminal offence case is referred to the Crown Prosecution Service when the person does not comply with the stop notice, but if the person wins their appeal against the notice then the case is not taken to court.” Alternatively, the draft legislation could be amended: “to specifically state that a person has a reasonable excuse if they successfully appeal a stop notice.”³⁸⁴
255. In the course of our inquiry, there was an exchange of correspondence between CIOT and HMRC in which HMRC set out how, in practice, this issue could be dealt with at the time of the appeal against the stop notice.³⁸⁵ Commenting on this, Ms Challen explained to us that she understood HMRC to be saying that:
- “... if the tribunal orders that the stop notice should cease to have effect, it can order that with retrospective effect. If it ordered it back to the date on which it was issued, HMRC’s argument appears to be that it would effectively cut off the legs of the criminal offence because there is no stop notice.”³⁸⁶
256. She added that: “That is likely to be a very debatable legal point” and: “could go to the Supreme Court to work out the right answer ... It is obviously open to Parliament to legislate for that situation.”³⁸⁷
257. **Greater clarity is needed about the position where a stop notice is under appeal, and that appeal may be successful. It cannot be right for someone to be at risk of criminal prosecution as a result of a stop notice that the tribunal then strikes down.**
258. ***We recommend that there be independent oversight, external to HMRC, of the issuing of stop notices leading to criminal prosecution. While there are different ways of approaching this, our preference would be for these to be authorised by the tax tribunal.***

382 HMRC, ‘Tougher Consequences for promoters of tax avoidance’ (23 November 2023): <https://www.gov.uk/government/publications/dealing-with-promoters-of-tax-avoidance/tougher-consequences-for-promoters-of-tax-avoidance> [accessed 2 January 2024]

383 HMRC, ‘Tougher Consequences for promoters of tax avoidance’ (23 November 2023): <https://www.gov.uk/government/publications/dealing-with-promoters-of-tax-avoidance/tougher-consequences-for-promoters-of-tax-avoidance> [accessed 2 January 2024]

384 Written evidence from ICAEW (DFH0005)

385 CIOT, ‘Dealing with Promoters of tax avoidance’ (31 October 2023): <https://www.tax.org.uk/ref1198> [accessed 2 January 2024]

386 Q 30 (Lydia Challen)

387 Q 30 (Lydia Challen)

259. *Criminal proceedings should not be taken in circumstances where a stop notice is under appeal and so may be overturned by the tax tribunal. We therefore recommend that the legislation be amended to put this beyond doubt.*

Disqualification of directors—who should be targeted?

260. Another concern was the targeting of the legislation relating to the disqualification of directors would disproportionately and unfairly affect so-called ‘stooge directors’ who, CIOT told us, were: “young, inexperienced or otherwise naïve/unsophisticated individuals ... recruited ... to front non-compliant umbrella companies.”³⁸⁸
261. Ms Challen agreed that: “there are directors of some of these companies who are recruited via advertising on social media and paid an amount of money to operate effectively as a letterbox.” She explained that ‘stooge directors’ may be either naïve or actively misled by the real promoters and that: “these people need protecting under this legislation and perhaps from the effects of the legislation.”³⁸⁹
262. Witnesses were concerned that disqualification as a director might be an unreasonably harsh penalty in such cases. ICAEW said that: “the measure prevents the individual becoming a director of any company, not just one carrying on the promotion of tax avoidance.”³⁹⁰ Ms Challen pointed to the: “significant effect of director disqualification on someone’s wider life”, also noting the absence of any discretion for the court to take account of individual circumstances where an application for disqualification followed the winding up of the relevant company:
- “The court must disqualify. That is a wholly exceptional situation in the regime for company director disqualification ... It seems to us that the court must have the opportunity to review that at each point, to work out whether the person is unfit to be a director.”³⁹¹
263. Echoing Ms Challen’s point about the wider impact of disqualification on an individual’s life, CIOT said that HMRC must not: “make examples of people who have been recruited as directors for a fee and who are not really the ones in charge but are just desperate for, or tempted by, the money.”³⁹²
264. ICAEW argued for the draft legislation to include a further safeguard: “to protect directors of companies who were not involved personally in tax avoidance. Such a safeguard could allow directors to demonstrate that they had no knowledge of the promoter of the company concerned.”³⁹³ CIOT considered that the best approach was for: “HMRC only [to] seek disqualification in cases where they have identified the ‘controlling mind’ behind the company.”³⁹⁴

388 Letter from CIOT to Lord Leigh of Hurley Chair of the Economic Affairs Finance Bill Sub Committee (14 November 2023): <https://committees.parliament.uk/publications/42710/documents/212322/default/>

389 Q 31 (Lydia Challen)

390 Written evidence from ICAEW (DFH0005)

391 Q 32 (Lydia Challen)

392 Letter from CIOT to Lord Leigh of Hurley Chair of the Finance Bill Sub Committee (14 November 2023): <https://committees.parliament.uk/publications/42710/documents/212322/default/>

393 Written evidence from ICAEW (DFH0005)

394 Written evidence from CIOT (DFH0006)

265. As with the proposed criminal sanction, our witnesses told us that the measure would need to be well publicised for it to be effective as a deterrent. CIOT suggested that HMRC: “explore how the Department for Business and Trade and Companies House can be involved in publicising the measure and educating directors about the risks and responsibilities”. This could be included in the: “information Companies House provides to newly appointed directors,” and the Government: “could consider generating media interest, in conjunction with HMRC and Companies House.” CIOT emphasised that this would need to be done on a regular basis to reach people who are asked to be ‘stooge’ directors in the future.³⁹⁵
266. In response, the Financial Secretary said: “We want to make sure that the right people are targeted here.” He acknowledged that some of these directors may be: “naïve, young individuals who are trapped or taken advantage of, and this can be pretty harsh treatment for them,” but: “anybody taking on these roles has a responsibility to know what they are letting themselves in for.” He did suggest, however, that there may be: “a mechanism for a bit of leniency in the processes and in any criminal sanctions at a later stage.”³⁹⁶
267. *We recommend that HMRC do more to publicise the risks of involvement in avoidance schemes to potential and actual users, employing more direct communication channels than just GOV.UK, including social media, as well as traditional media outlets such as advertising, the press, and the broadcast media.*
268. *We recommend that the legislation on disqualification of directors is amended to afford protection to ‘stooge directors’ by targeting it more narrowly at the ‘controlling minds’ behind the promotion activities. Although there are different ways of doing this, one possibility would be to take into account the extent of a director’s knowledge or involvement in the company’s activities in deciding whether they had a ‘reasonable excuse’ as provided in the legislation.*

Disqualification in the Public Interest

269. The draft legislation said that HMRC can apply for a disqualification order if it appears that: “it is expedient in the public interest for such an order to be made.”³⁹⁷ We asked witnesses how the ‘public interest’ should be interpreted in reaching decisions about applying for disqualification of directors.³⁹⁸ CIOT said:

“Presumably this would include cases where a promoter has a track record of not complying with requests or notices from HMRC, cases where a promoter persists in promoting new schemes despite being involved in previous failed schemes and assessing what harm their actions have caused those taxpayers caught up in their scheme(s) and the tax system in general.”³⁹⁹

395 Written evidence from CIOT (DFH0006)

396 Q 75 (Nigel Huddleston MP, FST)

397 HMRC, ‘Dealing with promoters of tax avoidance’ (23 November 2023): <https://www.gov.uk/government/publications/dealing-with-promoters-of-tax-avoidance> [accessed 2 January 2024]

398 Finance Bill Sub-Committee, ‘Finance Bill Sub-Committee launch call for evidence’ (13 September 2023): <https://committees.parliament.uk/committee/230/finance-bill-subcommittee/news/197409/finance-bill-subcommittee-launch-call-for-evidence/> [accessed 02 January 2024]

399 Written evidence from CIOT (DFH0006)

It added that, in relation to the director disqualification measure: “the level of culpability of the director concerned should also be considered” and noted that, if it appears that the individual recruited as a ‘stooge’: “has little or no knowledge or involvement in the promotion of the scheme, that would tend to suggest that disqualification may not be an appropriate sanction.”⁴⁰⁰

270. ICAS suggested a few key factors that could be considered when determining whether prosecution is in the public interest:

“ ... firstly, persistent involvement in the promotion of schemes and secondly, the adoption of the behaviours outlined in the 2023 consultation and the previous consultation *Clamping down on promoters of tax avoidance*⁴⁰¹ to try to delay or sidestep action from HMRC. Another factor to be considered could be the targeting of lower paid and unrepresented taxpayers by promoters.”⁴⁰²

It pressed for further steps to be taken: “to prevent lower paid, unrepresented taxpayers from being drawn into these schemes in the first place.” Where promoters have targeted these individuals: “it would be in the public interest for this to be taken into account by prosecuting authorities, when considering whether to bring a charge⁴⁰³.”

271. *When deciding whether to apply for a disqualification order in the ‘public interest’, HMRC must assess the extent of the director’s culpability and knowledge of the tax avoidance scheme in question, and whether there is a history of persistent involvement in such schemes, or of a failure to comply with stop notices.*
272. *We recommend that HMRC publish the criteria it intends to apply when deciding whether disqualification is in the public interest.*

Resources

273. Some witnesses had doubts about HMRC’s capacity to take on the extra work involved in applying these new sanctions. Mr Craggs told us that he interacts with HMRC every day and that his personal view is that HMRC: “needs to be given far more resources than it has and is incredibly stretched... In particular in the criminal context where investigations take far more resources than a civil inquiry and cost more.”⁴⁰⁴
274. Isabel d’Inverno of the Law Society of Scotland agreed: “HMRC is really struggling to do what it is supposed to be doing at the moment. Having to undertake these additional areas, which are quite complex, would be challenging.”⁴⁰⁵ ICAS was concerned that, without additional resources for HMRC, these measures could lead to the: “further deterioration of core services.”⁴⁰⁶

400 Written evidence from CIOT ([DFH0006](#))

401 HMRC, ‘Clamping down on promoters of tax avoidance’ (23 March 2021): https://assets.publishing.service.gov.uk/media/605ccc17e90e07260e390b3a/Clamping_down_on_promoters_of_tax_avoidance_-_consultation.pdf [accessed 2 January 2024]

402 Written evidence from ICAS ([DFH0018](#))

403 Written evidence from ICAS ([DFH0018](#))

404 [Q 33](#) (Adam Craggs)

405 [Q 33](#) (Isabel d’Inverno)

406 Written evidence from ICAS ([DFH0018](#))

275. The Financial Secretary said: “We do ... redeploy, enhance and increase resources ... additional deployment was announced in the Autumn Statement, as were additional resources in HMRC to focus on compliance and fraud.”⁴⁰⁷
276. **We are concerned that, in the context of its present difficulties, HMRC lacks the capacity to undertake the extra work entailed by these measures to deal with promoters of tax avoidance schemes.**
277. *We recommend that resourcing within HMRC for these measures be kept under review so that any lack of capacity can be remedied as quickly as possible.*

407 [Q 78-79](#) (Nigel Huddleston MP, FST)

CHAPTER 8: DOUBLING THE MAXIMUM SENTENCE FOR TAX FRAUD

Background

278. In July 2023 the Government published draft legislation extending the maximum term of imprisonment for tax fraud from seven to 14 years.⁴⁰⁸ This arose from a commitment in the 2019 Conservative election manifesto to double the maximum prison term to: “14 years for individuals convicted of the most egregious examples of tax fraud.”⁴⁰⁹ There was no prior consultation.
279. The Government said that the measure: “demonstrates the government’s intent to crack down on tax fraud and deter criminal actions.”⁴¹⁰ The National Audit Office published a report in March 2023, *Tackling fraud and corruption against government*, looking at the incidence and impact of fraud across the whole of Government.⁴¹¹ The Public Accounts Committee also looked at prosecutions for tax fraud as part of its report in May 2023, *Managing tax compliance following the pandemic*.⁴¹²
280. In July 2023, HMRC issued the paper *Customer compliance: our approach to tax compliance and serious fraud in HMRC’s Fraud Investigation Service* as part of its annual report. This states that HMRC prevented £3.5 billion from being lost to serious fraud in 2022/23.⁴¹³

Doubling the maximum sentence for tax fraud

281. When we asked HMRC how many times the existing maximum sentence of seven years had been applied, we were told that: “HMRC does not hold this data” but that work: “to understand the deterrent effect of the department’s criminal investigations resulting in prosecutions has begun [and] the data to support this work is currently being collected for use by HMRC’s specialist analysis function.”⁴¹⁴
282. We asked Mr Craggs whether doubling the maximum sentence would be an effective deterrent against tax fraud. He was not convinced, telling us that, in most of the tax fraud investigations he has dealt with, HMRC: “generally charges with a common-law offence, such as cheating the public revenue, which has an unlimited fine and could in theory lead to a life sentence.” He

408 HMRC, ‘Doubling the maximum prison term for the most egregious examples of tax fraud’ (22 November 2023): <https://www.gov.uk/government/publications/increasing-the-maximum-prison-term-for-tax-fraud/doubling-the-maximum-prison-term-for-the-most-egregious-examples-of-tax-fraud> [accessed 21 December 2023]

409 Conservative Party, ‘Conservative Party Manifesto 2019’ (24 November 2019): <https://www.conservatives.com/our-plan/conservative-party-manifesto-2019> [accessed 21 December 2023]

410 HMRC, ‘Doubling the maximum prison term for the most egregious examples of tax fraud’ (22 November 2023): <https://www.gov.uk/government/publications/increasing-the-maximum-prison-term-for-tax-fraud/doubling-the-maximum-prison-term-for-the-most-egregious-examples-of-tax-fraud> [accessed 21 December 2023]

411 National Audit Office, ‘Tackling fraud and corruption against government’ (30 March 2023): <https://www.nao.org.uk/tackling-fraud-and-corruption-against-government/> [accessed 21 December 2023]

412 Public Accounts Committee, *Managing tax compliance following the pandemic* (Forty Ninth Report Session 2022–23, HC739)

413 HMRC, ‘Customer compliance: our approach to tax compliance and serious fraud for HMRC’s Fraud Investigation Service’ (17 July 2023): <https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2022-to-2023/customer-compliance-our-approach-to-tax-compliance-and-serious-fraud-for-hmrcs-fraud-investigation-service> [accessed 21 December 2023]

414 Written evidence from HMRC (DFH0020)

added that the average custodial sentences that he sees: “are of around four to seven years.”⁴¹⁵

283. Dr Sam Bourton, Senior Lecturer in Law at the University of the West of England, agreed with this analysis, noting also that: “doubling the maximum sentence for some types of tax evasion may be inappropriate, while more significant maximum sentences may be required for VAT, customs, and excise frauds.” In the absence of differentiation in the legislation between different types of tax fraud, in terms of the severity of the sentence: “it is imperative that sentencing guidelines fulfil this role.”⁴¹⁶
284. The application of maximum sentences is generally influenced by sentencing guidelines and particular circumstances. For example, during the course of our inquiry, Bernie Ecclestone was convicted of a serious tax fraud for which he had to pay over £650 million in tax, interest and civil penalties.⁴¹⁷ However, he only received a 17-month custodial sentence, suspended for two years, once his age and health had been taken into account.⁴¹⁸
285. The Financial Secretary said that the measure was: “a manifesto commitment” and that it would: “certainly have an effective impact on somebody who is sent to jail for 14 years” and: “send a signal to others. The signal itself is important ... in this case and for other serious crimes.” He added that: “there is too lax an attitude that it is the taxman that is being impacted and it is not. It has a serious impact on the way we fund and provide our public services.”⁴¹⁹
286. With regards to the execution of the measure, the Financial Secretary said that it: “is a matter for the Sentencing Council guidelines, but ... if there are these extreme cases... [there is now] greater flexibility.”⁴²⁰
287. **We consider the fact that HMRC does not hold data about the sentences handed down in cases of prosecution for tax fraud to be a serious oversight, as it makes it difficult to assess the deterrent effect of custodial sentences.**
288. **Given that it is four years since the commitment to double the maximum prison term for tax fraud was made, and the importance of a robust evidence base for policy development, we feel that the work to understand the deterrent effect of HMRC’s criminal investigations resulting in prosecution should have been undertaken sooner—and in any event before the draft legislation was published in July 2023. In the absence of any such analysis, we do not see what justification there can be for the change in policy and are sceptical about the deterrent effect of doubling the maximum sentence for tax fraud.**
289. ***We recommend that HMRC collects data about the sentences handed down for tax fraud, including the number of times the new maximum***

415 Q 34 (Adam Craggs)

416 Written evidence from Dr Sam Bourton (DFH0011)

417 CPS, ‘Bernie Ecclestone convicted of fraud’ (12 October 2023): <https://www.cps.gov.uk/cps/news/bernie-ecclestone-convicted-fraud> [accessed 21 December 2023]

418 BBC, ‘Bernie Ecclestone pleads guilty to fraud’ (12 October 2023): <https://www.bbc.co.uk/news/uk-67088503> [accessed 21 December 2023] and Courts and Tribunals Judiciary, *R v Ecclestone*: <https://www.judiciary.uk/wp-content/uploads/2023/10/R-v-Ecclestone-sentencing-121023.pdf> [accessed 5 January 2024]

419 Q 76 (Nigel Huddleston MP, FST)

420 Q 76 (Nigel Huddleston, MP, FST)

sentence is imposed by the courts, and provides annual reports of its analysis of this data, including an analysis of the deterrent effect of these sentences.

HMRC's Approach to Prosecution

290. HMRC's approach to prosecution is set out in the guidance note, *HMRC's criminal investigation policy*, which was last updated in July 2021. This explains that:

“HMRC's policy is to deal with fraud by use of the cost effective civil fraud investigation procedures under Code of Practice 9 wherever appropriate. Criminal investigation will be reserved for cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate.”⁴²¹

291. HMRC is not itself a prosecuting authority—instead prosecution for tax fraud is undertaken: “by the Crown Prosecution Service (England and Wales), the Crown Office and Procurator Fiscal Service in Scotland, and the Public Prosecution Service Northern Ireland.” HMRC told us that it aims to make full use of its civil powers but:

“where necessary we will not hesitate to open criminal investigations, seek prosecutions, and look to use confiscation to recover the proceeds of crime. HMRC typically uses criminal (and associated specialist) powers in circumstances where ... mainstream civil tax interventions won't work. These more complex investigations are resource intensive and time consuming but deliver a strong impact in tackling serious tax crime.”⁴²²

292. HMRC supplied us with information about the number of prosecutions undertaken in the previous five years, and the number of convictions. We were told that, from a high of 749 prosecutions in 2018/19, numbers had dropped to 240 in 2022/23⁴²³. The National Audit Office (NAO) attributes this fall to delays in the criminal justice system as well as HMRC's strategy to increasingly focus its criminal investigations on the most serious cases.⁴²⁴

293. Dr Bourton told us that: “deterrence not only requires severity (a significant penalty attached to noncompliance), but also certainty (a strong prospect of enforcement action) and celerity (a rapid enforcement response).” He added that enforcement policies and approaches: “are just as important as the legal framework in deterring tax crimes” but that HMRC's approach to enforcing tax crimes had been: “inconsistent and is in need of fundamental review.” He felt that: “HMRC's Criminal Investigation Policy, based on its revenue-collection centred approach, has led to very low numbers of prosecutions for tax evasion offences. ... The low number of prosecutions raises deterrence concerns.”⁴²⁵

294. Mr Craggs raised concerns about the impact of the deterrent measures. He noted that if: “the proposals ... are enacted ... it will be quite important

421 HMRC, ‘HMRC's criminal investigation policy’ (13 July 2021): <https://www.gov.uk/government/publications/criminal-investigation/hmrc-criminal-investigation-policy> (accessed 21 December 2023)

422 Written evidence from HMRC (DFH0020)

423 Written evidence from HMRC (DFH0020)

424 NAO, ‘Tackling fraud and corruption against government’: <https://www.nao.org.uk/reports/tackling-fraud-and-corruption-against-government> [accessed 22 December 2022]

425 Written evidence from Dr Sam Bourton (DFH0011)

for the Revenue to bring prosecutions because, ... if nothing happens for five or six years, as with the Criminal Finances Act, the deterrent effect will weaken.” With HMRC’s limited resources, it is understandable that: “it targets the subject of criminal investigations carefully.” Citing the Bernie Ecclestone case, he said that HMRC investigations: “normally involve either a very large sum of money or someone who is in the public arena and is well known ... and attracts a huge amount of publicity, which is important to any law enforcement body such as HMRC.”⁴²⁶

295. **While we recognise the impact of wider delays in the criminal justice system and of resource constraints within HMRC, we are concerned by the sharp decline in the number of prosecutions for tax fraud in recent years, and the impact this is likely to have on deterrence.**
296. *We ask that HMRC review its strategy for the prosecution of tax fraud to ensure that the deterrent effect is maximised and ensure that it has sufficient resources to make prosecution an effective deterrent.*

Whistleblower scheme

297. HMRC operates a scheme to encourage and reward whistleblowers who supply information about tax fraud.⁴²⁷ It told us that: “there will be times when it is appropriate for us to make payments to individuals for providing ... information that helps ... tackle avoidance and evasion.” HMRC explained that it made these decisions at its own discretion: “based on what is achieved as a direct result” and that: “a range of factors determine the exact amount, such as the tax recovered, how much estimated revenue loss was prevented and other benefits, such as time saved in working cases.”⁴²⁸
298. RPC reports that use of this scheme has increased in recent years, with 157,720 reports being made in the 12 months to 30 June 2023, up from 108,920 in the previous year.⁴²⁹ HMRC told us that the amounts paid out have risen from £290,250 in 2018/19 to £508,500 in 2022/23.⁴³⁰ Our witnesses, however, appeared to know very little about the scheme and felt it was not well publicised. Mr Craggs, himself a partner at RPC, told us that the scheme: “is not very well known or understood in this jurisdiction, unlike in the States with the [Internal Revenue Service], for example, where it is more formalised.” He argued that greater transparency would make the scheme more effective and that: “perhaps a percentage of any tax that is recovered could, as in the US, be payable to the whistleblower. That would save HMRC an awful lot of time and it would help with resources.”⁴³¹
299. We asked HMRC and the Financial Secretary about the scheme. Mr Stoneham urged: “anyone who has evidence of tax fraud to report it to us. The details of how to do so are on GOV.UK.” The Financial Secretary said:

“I hope and believe that most people would call that out out of a sense of duty and citizenship rather than financial reward, but there are

426 Q 35 (Adam Craggs)

427 HM Government, ‘Report tax fraud or avoidance to HMRC’: <https://www.gov.uk/report-tax-fraud> [accessed 22 December 2023]

428 Written evidence from HMRC (DFH0020)

429 RPC, ‘Whistleblower fraud reports to HMRC surge 47% in the past year’ (13 November 2023): <https://www.rpc.co.uk/press-and-media/whistleblower-fraud-reports-to-hmrc-surge-47-percent-in-the-past-year/> [accessed 22 December 2023]

430 Written evidence from HMRC (DFH0020)

431 Q 36 (Adam Craggs)

cases where there can be an element of financial reward. If we push financial reward a bit too hard, it may have some negative, unintended consequences on the broader picture.”⁴³²

300. **We are concerned about the apparent lack of awareness of the whistleblower scheme to report tax fraud. If the scheme was publicised more widely more whistleblowers might be encouraged to come forward, to the general public benefit.**
301. *We recommend that HMRC do more to publicise its whistleblower scheme, using channels other than GOV.UK, including social media, as well as traditional media outlets such as advertising, the press, and the broadcast media.*
302. *We recommend that HMRC consider what further incentives it could deploy to encourage greater participation in the whistleblower scheme.*

432 [Q 77](#) (Nigel Huddleston MP, FST)

CHAPTER 9: CROSS CUTTING ISSUES

303. This chapter covers themes that emerged during our evidence gathering which go beyond the specific measures discussed in earlier chapters. It is intended to highlight issues that recurred across the topics considered and discuss how they might be addressed in the future.

Consultation

304. We were encouraged by the amount of consultation that the Government had undertaken in respect of the measures discussed in this report. There was consultation on each of the subject areas we looked at except (understandably) for the increase in the maximum sentence for fraud, which was both a manifesto commitment and a straightforward change to make. In the case of the measures on promoters and R&D, there had been successive consultations over a number of years, while the consultation on data collection was part of a series of consultations on the Government's tax administration strategy—allowing the proposed measures to be seen in context. By and large witnesses welcomed consultation even though they were sometimes disappointed by the results.
305. However, we consider that there is scope for improvement in the nature and quality of consultation. Too often, a consultation begins when it appears that the Government has already decided what it wants to do: in those cases, it consults only on how to go about making the changes in question.
306. This approach ignores Stage 1 and even partially pre-empts Stage 2 of the Government's own Tax Consultation Framework: Stage 1 should be: "setting out objectives and identifying options", and Stage 2: "determining the best option and developing a framework for implementation including detailed policy design."⁴³³
307. In the case of the additional HMRC data requirement, the lack of clarity about the rationale for collecting the additional data, and how this data would be used, caused a great deal of confusion and uncertainty among our witnesses.
308. In addition, our evidence highlighted the Government's use of informal consultation to develop policy. For example, the possibility of additional tax relief for R&D intensive businesses was first mooted at Autumn Statement 2022⁴³⁴, with the Government stating that it would work with industry to develop policy in this area. The first public consultation on the new scheme was when draft legislation was published in July 2023—more than four months after the Government set out the detail (in an HMRC technical note)⁴³⁵ and three months after the scheme came into effect. Following that consultation, as discussed in Chapter 3, the qualifying test for R&D intensity was changed. Given that one of those changes—the addition of a grace period—was raised by most of our witnesses in their evidence, it seems

433 HM Treasury and HMRC, *Tax consultation framework* (March 2011), p 2: <https://assets.publishing.service.gov.uk/media/5a79567ee5274a3864fd622b/tax-consultation-framework.pdf> [accessed 5 January 2024]

434 HMRC, 'Research and Development Tax Reliefs—Reform' (21 November 2022): <https://www.gov.uk/government/publications/research-and-development-rd-tax-reliefs-reform> [accessed 3 January 2023]

435 HMRC, 'Additional tax relief for research and development intensive small and medium sized enterprises' (15 March 2023): <https://www.gov.uk/government/publications/additional-tax-relief-for-research-and-development-intensive-small-and-medium-sized-enterprises> [accessed 5 January 2024]

likely that this could have been picked up earlier had there been a formal consultation.

309. **We note that the Tax Policy Framework recognises the useful role that informal consultation can play in developing policy. That does not mean, however, that it should be used in place of public consultation when designing policy—particularly as, by limiting engagement to a pre-selected group of stakeholders, the Government risks missing out on useful input.**
310. *The Government should follow its Tax Consultation Framework and start consultations on significant changes at Stage 1.*

Introducing changes too quickly

311. Our inquiry showed that witnesses felt that the Government often moved too quickly from initial consultation to setting a timetable for implementation. In relation to the merger of the two existing R&D schemes, discussed in Chapter 4, many of our witnesses felt that the Government had not factored in sufficient time for proper consultation, or to consider the responses received to its consultation on the creation of a single scheme, before publishing draft legislation.⁴³⁶ Ayming concluded: “rushed legislation is rarely good or effective legislation ... it would be preferable to take the time to make decisions with due consideration to all relevant factors.”⁴³⁷
312. Witnesses also made the point that there were frequently successive changes in the same area in too short a period. For example, the Law Society considered that it would have been better to wait for the civil measures taken against promoters of tax avoidance schemes to bed in before moving to the creation of a criminal offence of failing to comply with a stop notice⁴³⁸. Similarly, in relation to R&D relief, witnesses told us of the destabilising effect of successive changes to the R&D relief schemes over recent years⁴³⁹, making it difficult for business to take account of R&D relief when planning R&D activity.
313. Another aspect was in setting timetables for implementation that took insufficient account of the preparations taxpayers need to make in anticipation of changes, and the time needed for this. For example, Mr Hart, told us that the timetable for introducing the new data requirements was extremely tight and, the target of April 2025 was undesirable in the absence of: “a strong benefit statement associated with it.”⁴⁴⁰
314. We also received evidence suggesting that the R&D changes were being rushed, particularly given that, although the merged scheme is to come into effect for accounting periods beginning on or after 1 April 2024, businesses only knew that it would be coming into effect in late November 2023⁴⁴¹.
315. Some changes, such as HMRC data collection, require secondary legislation, and most require HMRC to publish guidance to taxpayers detailing how the new legislation will work in practice and what HMRC will expect of

436 Written evidence from ATT ([DFH0002](#))

437 Written evidence from Ayming ([DFH0014](#))

438 [Q 2](#) (Susan Cattell)

439 Written evidence from BIA ([DFH0013](#)) which contains an overview of the changes since 2018.

440 [Q 67](#) (Kevin Hart)

441 Written evidence from ICAS ([DFH0018](#)), ForrestBrown ([DFH0016](#)), BVCA ([DFH0017](#)) and Evelyn Partners ([DFH0012](#))

taxpayers. We concluded in Chapter 6 that it would have been helpful if the regulations relating to the additional data requirement had been published either in July with the draft primary legislation or at the same time as the 2023/24 Finance Bill—the primary legislation did not contain the detail necessary for a proper understanding of the measure.

316. The importance of timely guidance was raised by BIA in relation to the R&D intensive scheme. BIA was concerned that, although the scheme was in effect, nothing had been published on how the test of R&D intensity would apply in practice, which it said would impact SMEs' ability to forecast cashflow as they could not identify whether they would be in or out of the new scheme.⁴⁴²
317. *In setting a timetable for the implementation of a measure, the Government must take full account of the steps taxpayers need to take to prepare for the change and the support HMRC needs to provide for this. Regulations and guidance relevant to changes should be published as early as possible, and with a timetable that ensures sufficient time for proper consultation on regulations before the measure takes effect.*

Underestimating the cost of change

318. HMRC's cost calculations and methodology have been a recurring theme in recent Finance Bill Sub-Committee inquiries⁴⁴³. Mr Henty explained that there is: "an established methodology for business-customer costs. It is a forecast based on a set of assumptions".⁴⁴⁴
319. However, as we discussed in Chapter 6, with reference to the cost to businesses of the new HMRC data requirements, HM Treasury and HMRC need to be transparent about what these assumptions are. On R&D, as discussed in Chapter 4, we were particularly disappointed that no estimate of the impact on businesses was published until Autumn Statement 2023, despite the possibility of a merged scheme coming into force from 1 April 2024.
320. On the other hand, when estimates are provided in a timely fashion, as discussed in Chapter 6, in relation to employee hours data, witnesses often question their accuracy—suggesting that HMRC has underestimated the costs involved.
321. *The Government needs to revisit its standard model for costing and ensure that HM Treasury and HMRC conduct a meaningful dialogue with stakeholders about what businesses need to do to prepare for any change, including being transparent about any assumptions made.*

Resourcing and performance

322. Throughout our inquiry, witnesses questioned how HMRC would cope with measures that put additional strain on its capacity, such as changes to the R&D schemes and the introduction of criminal prosecutions for promoters. Various tax professional bodies wrote to the Chancellor on 1 March 2023:

442 Written evidence from BIA ([DFH0013](#)), [Q 48](#) (Colin Hailey)

443 Economic Affairs Committee, *Research and development tax relief and expenditure credit* (3rd Report, Session 2022–23, HL Paper 137); Economic Affairs Committee, *New powers for HMRC: fair and proportionate?* (4th Report, Session 2019–21, HL Paper 198)

444 [Q 87](#) (Matt Henty)

“we increasingly hear from our members about the severe delays, business disruption and frustration that has become a regular occurrence when dealing with HMRC.”⁴⁴⁵ In September 2023 CIOT published the results of a survey showing that there was: “deep dissatisfaction with HMRC’s service levels”⁴⁴⁶ and, in evidence to the Public Accounts Committee in October, it said that: “HMRC’s service levels have been, and remain, the single greatest concern expressed by our members for at least the previous eighteen months.”⁴⁴⁷

323. Although the Financial Secretary assured us that HMRC was adequately resourced to cope with the new measures, he said as a: “constituency MP I hear concerns expressed all the time about HMRC’s performance”. He acknowledged that: “it is a very difficult job” and that: “some of the criticism and some of the customer service points are fair, because I have seen them in a constituency role, but we are working on it.”⁴⁴⁸
324. During this inquiry, HMRC announced a further curtailment of its telephone services, limiting the categories of inquiries it would deal with in the run-up to the filing deadline of 31 January 2024 for income tax self-assessment returns—one of the busiest periods of the tax year for individuals and agents.⁴⁴⁹ This followed an earlier closure of the service from 12 June to 4 September 2023.
325. **The Financial Secretary assured us that HMRC’s resources have been increased and are monitored. Nonetheless, we note that successive Finance Bill Sub-Committees have raised the question of HMRC resourcing in recent reports, yet the situation seems to be getting worse. It is counter-productive to keep introducing new legislation placing additional burdens on HMRC if the department is already unable to provide a satisfactory level of service to taxpayers.**
326. *The Government should review resourcing for HMRC not only in relation to individual measures but also to ensure that taxpayers receive the level of service they have a right to expect.*

Concerns about increasing HMRC powers

327. In general, witnesses were supportive of proposed extensions of HMRC powers where a good case for the extension was made. However, concerns focussed on whether additional powers were needed—in the case of requirements to collect employee hours data—or appeared not to be accompanied by adequate safeguards—such as the new criminal offence for promoters of avoidance schemes and the disqualification of directors. This has also been a familiar theme in recent reports by successive Finance

445 CIOT, ‘Professional bodies urge chancellor to improve HMRC service levels’ (1 March 2023): <https://www.tax.org.uk/professional-bodies-urge-chancellor-to-improve-hmrc-service-levels> [accessed 5 January 2024]

446 CIOT, ‘Poor HMRC service levels harming business CIOT survey finds’ (19 September 2023): <https://www.tax.org.uk/poor-hmrc-service-levels-harming-business-ciota-survey-finds> [accessed 5 January 2024]

447 CIOT, ‘Public Accounts Committee inquiry into the performance of HMRC’ (19 December 2023): <https://www.tax.org.uk/ref1212> [accessed 5 January 2024]

448 **Q 78** (Nigel Huddleston MP, FST)

449 HMRC, ‘Self-assessment: general enquiries’: <https://www.gov.uk/government/organisations/hm-revenue-customs/contact/self-assessment> [accessed 5 January 2024]

Bill Sub-Committees⁴⁵⁰, who have consistently taken the view that increases in powers must be accompanied by appropriate safeguards, including mechanisms independent of HMRC. This is particularly so in the context of: “falling levels of trust in HMRC and wider government tax policy in recent years.”⁴⁵¹

328. **We consider that proper safeguards in these cases are essential both for the protection of taxpayers and because safeguards are necessary to secure buy-in from stakeholders and voluntary compliance by taxpayers.**
329. *Against a backdrop of increased distrust of HMRC and the Government’s tax policy in recent years, the Government must ensure that additional powers for HMRC are tempered by appropriate safeguards for the taxpayer.*

450 Economic Affairs Committee, *New powers for HMRC: fair and proportionate?* (4th Report, Session 2019–21, HL Paper 198); Economic Affairs Committee, *The powers of HMRC: treating taxpayers fairly* (4th Report, Session 2017–19, HL Paper 242)

451 [Q 66](#) (Joshua Toovey)

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Government Review of Research and Development Tax Relief

1. While it is right for the Government to keep the R&D relief scheme under review to ensure that it meets the needs of a modern economy and provides value for money for the taxpayer, too much change over too short a period can create uncertainty. We are concerned that the number of significant R&D changes made in the last 5 years has led to a perception of instability in the UK's R&D tax relief regime and undermined the intended incentive effect of the relief. (Paragraph 32)
2. The Government's postponement of a final decision on creating a single merged scheme of R&D relief added to the uncertainty around R&D relief. Businesses can only start to prepare in earnest once a change is confirmed. The Government's announcement of a prospective commencement date of an unconfirmed measure did not give businesses sufficient certainty to be able to plan effectively. (Paragraph 33)
3. *We welcome the announcement at Autumn Statement 2023 that the R&D review is now complete. Businesses need time to adjust to all the recent changes to R&D relief. We recommend that, over the medium term, the Government does not make further changes to R&D tax relief, other than to simplify the relief as set out in this report.* (Paragraph 34)

The Research & Development Intensive Scheme for Small and Medium Enterprises

4. We acknowledge that the Government responded promptly to concerns about the impact of the reduction in the rate of R&D relief for SMEs following its announcement in November 2022. However, the development of the R&D intensive scheme over only a few months, and without the benefit of formal consultation, was not an example of good policy-making. (Paragraph 47)
5. It is disappointing that the Government did not carry out a public consultation on the R&D intensive scheme, but instead appears to have chosen to consult on a confidential basis with selected stakeholders. We acknowledge that a formal consultation would have taken more time, but this might have avoided the need to make significant changes to the scheme in November 2023, only a few months after first announcing it. (Paragraph 48)
6. We welcome the Government's continued commitment to work with businesses on possible further improvements to the scheme. It is important that the Government is as transparent as possible about its further engagement with stakeholders on this measure. (Paragraph 49)
7. A scheme based on R&D intensity is agnostic as to the type of R&D that a company is undertaking. We note that a number of our witnesses did not understand why this approach had been taken, rather than targeting specific policy objectives, such as providing tax credits for activities that support the Government's net zero commitments. (Paragraph 59)
8. *The Government should explain why it considers this approach to be the best way of incentivising the types of innovation that will support economic growth.* (Paragraph 60)

9. We acknowledge that the threshold test for R&D intensity creates a cliff-edge, but we recognise that many alternative approaches, such as tapering relief as R&D intensity decreases, could create more complexity. However, we welcome the announcement at Autumn Statement 2023 of a grace period to help mitigate this. (Paragraph 61)
10. It is important that modelling of the threshold for R&D intensity is based on accurate data, is properly tested, and can be justified objectively by reference to the policy aim. We are concerned that this appears not to have been the case with the original proposed 40 per cent threshold—and this may also be true of the new 30 per cent threshold. (Paragraph 62)
11. *We recommend that the Government monitors the operation of the R&D intensive scheme and, in particular, keeps the threshold for R&D intensity under review to ensure that the scheme is appropriately targeted and effective in achieving its policy objectives.* (Paragraph 63)
12. It is disappointing that, although the R&D intensive scheme has applied since April 2023, HMRC has not yet published any guidance—including draft guidance—on how the scheme will work in practice. Businesses need to know whether they are R&D intensive in advance of April 2024, when they will be able to make their first claims under the new scheme, so they can plan accordingly. (Paragraph 69)
13. We are concerned that the incentive effect of R&D intensive relief will be weakened because SMEs have no certainty about whether they are R&D intensive, and so eligible for additional relief, until after they have invested in R&D. (Paragraph 70)
14. We acknowledge that the lower R&D intensity threshold should mean that more companies will have confidence that they qualify as R&D intensive in a given period. However, a lower threshold is no substitute for clear rules that businesses can readily understand. (Paragraph 71)
15. *We recommend that HMRC publishes draft guidance on applying the R&D intensity test as a matter of urgency.* (Paragraph 72)
16. We are concerned about the abuse of R&D relief, which has increased due to exploitation of the tax repayment available under the SME scheme. We note the Government's commitment to tackling this abuse but we agree with our witnesses that there is a risk that, with the creation of the R&D intensive scheme, new opportunities for spurious claims could be created. (Paragraph 77)
17. We welcome the Government's announcement that HMRC will be funded to deploy additional officers to manage the compliance risks relating to the new scheme. (Paragraph 78)

A new merged Research & Development tax relief scheme

18. We recognise that the Government has sought to engage with stakeholders on merging the two existing R&D tax relief schemes since January 2023. However, given the significance of this change, the consultation in January 2023 should not have been limited to the design and implementation of the scheme; it should also have considered the fundamental question of whether a single scheme was desirable. (Paragraph 84)

19. We welcome the Government's acknowledgement that having one scheme, instead of the proposed two, would be simpler and its apparent willingness to consider further simplification in the future. (Paragraph 94)
20. We agree that providing relief under the merged scheme by way of an above the line credit to all companies, whatever their size, is the right decision. (Paragraph 95)
21. We acknowledge that, for those companies that are not R&D intensive, having just one scheme for R&D tax relief will be a simplification. However, we agree with many of our witnesses that retaining the existing SME scheme for R&D intensive businesses is a missed opportunity in terms of the Government's tax simplification agenda. (Paragraph 96)
22. *We recommend that the Government consult in the near term on bringing the R&D intensive scheme within the new merged scheme to create a fully merged and simplified scheme.* (Paragraph 97)
23. We acknowledge that the change to the start date announced at Autumn Statement 2023 will mean that the merged scheme may not apply to some businesses until 1 January 2025. For some companies, however, it will be much earlier. (Paragraph 104)
24. We remain concerned that, even with the latest possible start date under the revised timetable, businesses will not have enough time to prepare for the new scheme. (Paragraph 105)
25. *We recommend that the start date for the new scheme be delayed until a company's first accounting period to start on or after 1 April 2025.* (Paragraph 106)
26. Given the significance of these changes, it is critical that businesses that could be affected know that they are happening sooner rather than later. We welcome the work of representative bodies and advisers in raising awareness of the changes among the business community. However, the primary responsibility for informing taxpayers of changes to tax regimes lies with the Government. We welcome the Minister's confirmation that there is a communication plan and a specific budget allocated to HMRC for this purpose. (Paragraph 110)
27. *We recommend that, as a priority, HMRC should implement an education campaign about what the merged scheme will mean for businesses investing in R&D.* (Paragraph 111)
28. We are doubtful that final guidance of the quality needed to support businesses as they adjust to the merged scheme can be put in place by 1 April 2024. Without final detailed guidance, well in advance of the start date, it is not sensible or appropriate to bring the merged scheme into effect. (Paragraph 121)
29. We are concerned that the introduction of the merged scheme will impact investment in R&D by SMEs, and subsequently impact UK productivity and growth. We note the concerns raised by witnesses that the reduction in the rate of the relief may deter SMEs from submitting future claims. If it is the Government's intention to reduce the number of claims from SMEs and focus the relief on larger companies, then it should make this clear. (Paragraph 122)

30. *We recommend that the Government commits now to evaluating the effectiveness of the merged scheme in incentivising investment in R&D by large and small businesses in three years' time. (Paragraph 123)*
31. *We ask the Government to provide evidence of the economic impact of the merged scheme and the R&D intensive scheme and, in particular of the additional monies they have injected into the UK's R&D systems. (Paragraph 124)*
32. The cost to taxpayers of implementing new tax rules is an important consideration when developing new policies. While not confirming whether the merged scheme would go ahead, the Government has been clear since January 2023 that, if it did, it would take effect from April 2024. Changing the way in which R&D relief is given is a major change and we see no reason why indicative cost estimates could not have been provided in July 2023. By only publishing its costings in late November 2023, the Government left it too late for stakeholders to engage on whether its estimates accurately capture those costs. (Paragraph 129)
33. *Where the Government is proposing a major change to how businesses are taxed, we recommend that costs are modelled at an earlier stage in the consultation process to allow for stakeholder engagement, even where some details have not yet been finalised. (Paragraph 130)*

Subcontracting Arrangements

34. *We recommend that in 2024 HMRC work closely with members of its Research and Development Communication Forum in order to clarify the treatment of both 'contracted out R&D' and subsidised expenditure. (Paragraph 139)*
35. It is clear that changing the rules on subcontracted R&D would always result in winners and losers. The Government should have been more transparent in July about its reasons for its chosen approach so that those businesses at risk of losing out could at least understand the policy rationale for this. (Paragraph 158)
36. We consider that there should have been a wider, and more formal, consultation on the treatment of subcontracting arrangements at an earlier stage. It is particularly disappointing that the new Finance Bill provisions on subcontracting were not themselves subject to formal consultation before being laid before Parliament. (Paragraph 159)
37. Given the range of commercial arrangements relating to R&D activity, we consider that defining 'subcontracted R&D' to exclude what the Government calls a 'normal' contract may be very challenging, if not impossible. We therefore agree that it is vital that detailed guidance on the meaning of 'subcontracted R&D' is made available as soon as possible. We are concerned, however, that there is insufficient time for such guidance to be developed prior to the legislation coming into force from April 2024. (Paragraph 160)
38. We welcome the Government's decision to remove the restriction on relief for subsidised expenditure under each of the merged and R&D intensive schemes. (Paragraph 161)
39. *Detailed guidance on subcontracted R&D, including realistic examples, must be available to businesses in advance of 1 April 2024 when some businesses will have to apply the new rules. HMRC needs to assure businesses that final guidance will be available before the start date of the merged scheme. (Paragraph 162)*

40. We acknowledge that changes to the subcontracting rules announced at Autumn Statement 2023 should go some way to assuaging the concerns of larger companies concerning the adoption of the SME model for subcontracting arrangements. Nonetheless, such businesses will have a heavy compliance burden given the need for them to review each subcontracting arrangement in order to confirm eligibility for R&D relief in advance of the merged scheme coming into effect. (Paragraph 166)
41. Transitional rules within the merged scheme would be undesirable: they add to the overall complexity of the transition and could mean that affected businesses are subject to two different regimes (both the RDEC and the merged scheme) in relation to R&D spend until the end of the transitional period. The need for such transitional arrangements would be best avoided by deferring the start date for the merged scheme to allow companies to prepare for the changes. (Paragraph 167)
42. *If the Government persists with its current timetable for the merged scheme, we recommend, notwithstanding the reservations set out in our conclusion above, that transitional provisions be included in the legislation so that providers can continue to claim relief for R&D done under an existing subcontracting arrangement for a specified period. This would enable them to review their existing arrangements and negotiate any changes needed for their contracts to remain financially viable. Any such transitional arrangements should be as simple as possible to implement and should last no longer than is necessary to enable those affected to adjust to the new sub-contracting regime.* (Paragraph 168)

Changes to HMRC Data Collection

43. From the evidence received, it seems very likely that the costs to employers of providing this data, both one-off and on-going, have been significantly underestimated. (Paragraph 197)
44. *We recommend that HMRC publishes the assumptions on which the costs to businesses of the employee hours requirement were based. HMRC should then work with interested parties to review these costings and produce revised estimates that are more realistic and re-evaluate the extent to which the proposed benefits outweigh these costs.* (Paragraph 198)
45. We consider that the case for requiring employers to provide employee hours data to HMRC has not been made out. Additional burdens should not be imposed on businesses unless there is a compelling reason for doing so. It is not clear how understanding economic activity, enforcing the National Minimum Wage and the National Living Wage, planning for contingencies, or assessing NICs reliefs can be considered to be “for the collection and management” of the listed taxes, as specified in the draft legislation. (Paragraph 199)
46. At the time they gave evidence, witnesses remained unclear about exactly what information on employee hours was required and for what purpose, despite the fact that consultation on this measure has been on-going for more than a year. This level of uncertainty at this stage in the development of the measure is unacceptable. The Government should have been much more transparent from the beginning about what information is required and how it will be used. We do, however, welcome the Government’s clarification that the requirement is for data relating to hours paid rather than hours worked. (Paragraph 200)

47. *The Government should clarify its intentions concerning sharing data about employee hours with other Government departments and agencies. It should consult with relevant stakeholders before any such sharing takes place, even if it is permitted under existing powers. (Paragraph 206)*
48. *HMRC must publish guidance to help employers and businesses understand exactly what data they need to provide as early as possible in 2024. (Paragraph 207)*
49. *HMRC must set out how the collection of employee hours data falls within the stated purposes of being for “the collection and management of the listed taxes”, as specified in the draft legislation for Finance Bill 2023–24. If the Government wishes HMRC to collect data that is not directly necessary for these purposes, this should be specifically legislated for, following a full consultation to consider the implications of such an extension of HMRC’s powers. (Paragraph 208)*
50. HMRC said that additional information about dividends for owner-managers would make it easier to operate relief schemes in any future emergency. This is not, in our view, relevant to the collection and management of tax. (Paragraph 217)
51. *While we accept that a lack of common identifiers in the data held by HMRC and Companies House respectively means that it is not possible for HMRC to cross reference the information held by Companies House regarding dividends paid to owner-managers, the Government should consider how to make its systems compatible with each other so that they are able to exchange data where appropriate. (Paragraph 221)*
52. It is disappointing that the Government did not publish draft regulations with detail about the nature and extent of the additional data to be required by HMRC for consultation at the same time as it published the draft legislation or even the Finance Bill. This delay reduces the amount of time businesses have to prepare for the introduction of these new requirements. (Paragraph 224)
53. *Early publication of draft regulations and full consultation on the detail of the additional data to be required by HMRC is crucial if the Government is to go ahead with a 2025/26 start and the Government must, in any event, allow all stakeholders sufficient time to make the changes necessary for these additional requirements before they are implemented. (Paragraph 225)*

Dealing with Promoters of Tax Avoidance

54. Given the difficulties inherent in extradition, in particular in the case of territories with which the UK does not have extradition agreements, we remain concerned about how the legislation aimed at dealing with the promoters of tax avoidance schemes can be applied to offshore promoters. (Paragraph 246)
55. *We recommend that, during the passage of the Finance Bill, the Government provides greater clarity about how the legislation will be effective against promoters of tax avoidance schemes that are based offshore. (Paragraph 247)*
56. We agree with witnesses that the creation of a criminal offence for the promoters of tax avoidance schemes requires greater safeguards, including effective, independent oversight of the stop notice and subsequent criminal prosecution processes, to be built into the legislation. (Paragraph 252)

57. Greater clarity is needed about the position where a stop notice is under appeal, and that appeal may be successful. It cannot be right for someone to be at risk of criminal prosecution as a result of a stop notice that the tribunal then strikes down. (Paragraph 257)
58. *We recommend that there be independent oversight, external to HMRC, of the issuing of stop notices leading to criminal prosecution. While there are different ways of approaching this, our preference would be for these to be authorised by the tax tribunal.* (Paragraph 258)
59. *Criminal proceedings should not be taken in circumstances where a stop notice is under appeal and so may be overturned by the tax tribunal. We therefore recommend that the legislation be amended to put this beyond doubt.* (Paragraph 259)
60. *We recommend that HMRC do more to publicise the risks of involvement in avoidance schemes to potential and actual users, employing more direct communication channels than just GOV.UK, including social media, as well as traditional media outlets such as advertising, the press, and the broadcast media.* (Paragraph 267)
61. *We recommend that the legislation on disqualification of directors is amended to afford protection to ‘stooge directors’ by targeting it more narrowly at the ‘controlling minds’ behind the promotion activities. Although there are different ways of doing this, one possibility would be to take into account the extent of a director’s knowledge or involvement in the company’s activities in deciding whether they had a ‘reasonable excuse’ as provided in the legislation.* (Paragraph 268)
62. *When deciding whether to apply for a disqualification order in the ‘public interest’, HMRC must assess the extent of the director’s culpability and knowledge of the tax avoidance scheme in question, and whether there is a history of persistent involvement in such schemes, or of a failure to comply with stop notices.* (Paragraph 271)
63. *We recommend that HMRC publish the criteria it intends to apply when deciding whether disqualification is in the public interest.* (Paragraph 272)
64. We are concerned that, in the context of its present difficulties, HMRC lacks the capacity to undertake the extra work entailed by these measures to deal with promoters of tax avoidance schemes (Paragraph 276)
65. *We recommend that resourcing within HMRC for these measures be kept under review so that any lack of capacity can be remedied as quickly as possible.* (Paragraph 277)

Doubling the Maximum Sentence for Tax Fraud

66. We consider the fact that HMRC does not hold data about the sentences handed down in cases of prosecution for tax fraud to be a serious oversight, as it makes it difficult to assess the deterrent effect of custodial sentences. (Paragraph 287)
67. Given that it is four years since the commitment to double the maximum prison term for tax fraud was made, and the importance of a robust evidence base for policy development, we feel that the work to understand the deterrent effect of HMRC’s criminal investigations resulting in prosecution should have been undertaken sooner—and in any event before the draft legislation was published in July 2023. In the absence of any such analysis, we do not see what justification there can be for the change in policy and are sceptical

about the deterrent effect of doubling the maximum sentence for tax fraud. (Paragraph 288)

68. *We recommend that HMRC collects data about the sentences handed down for tax fraud, including the number of times the new maximum sentence is imposed by the courts, and provides annual reports of its analysis of this data, including an analysis of the deterrent effect of these sentences.* (Paragraph 289)
69. While we recognise the impact of wider delays in the criminal justice system and of resource constraints within HMRC, we are concerned by the sharp decline in the number of prosecutions for tax fraud in recent years, and the impact this is likely to have on deterrence. (Paragraph 295)
70. *We ask that HMRC review its strategy for the prosecution of tax fraud to ensure that the deterrent effect is maximised and ensure that it has sufficient resources to make prosecution an effective deterrent.* (Paragraph 296)
71. We are concerned about the apparent lack of awareness of the whistleblower scheme to report tax fraud. If the scheme was publicised more widely more whistleblowers might be encouraged to come forward, to the general public benefit. (Paragraph 300)
72. *We recommend that HMRC do more to publicise its whistleblower scheme, using channels other than GOV.UK, including social media, as well as traditional media outlets such as advertising, the press, and the broadcast media.* (Paragraph 301)
73. *We recommend that HMRC consider what further incentives it could deploy to encourage greater participation in the whistleblower scheme.* (Paragraph 302)

Cross Cutting Issues

74. We note that the Tax Policy Framework recognises the useful role that informal consultation can play in developing policy. That does not mean, however, that it should be used in place of public consultation when designing policy—particularly as, by limiting engagement to a pre-selected group of stakeholders, the Government risks missing out on useful input. (Paragraph 309)
75. *The Government should follow its Tax Consultation Framework and start consultations on significant changes at Stage 1.* (Paragraph 310)
76. *In setting a timetable for the implementation of a measure, the Government must take full account of the steps taxpayers need to take to prepare for the change and the support HMRC needs to provide for this. Regulations and guidance relevant to changes should be published as early as possible, and with a timetable that ensures sufficient time for proper consultation on regulations before the measure takes effect.* (Paragraph 317)
77. *The Government needs to revisit its standard model for costing and ensure that HM Treasury and HMRC conduct a meaningful dialogue with stakeholders about what businesses need to do to prepare for any change, including being transparent about any assumptions made.* (Paragraph 321)
78. The Financial Secretary assured us that HMRC's resources have been increased and are monitored. Nonetheless, we note that successive Finance Bill Sub-Committees have raised the question of HMRC resourcing in recent reports, yet the situation seems to be getting worse. It is counter-productive to keep introducing new legislation placing additional burdens on HMRC if

the department is already unable to provide a satisfactory level of service to taxpayers. (Paragraph 325)

79. *The Government should review resourcing for HMRC not only in relation to individual measures but also to ensure that taxpayers receive the level of service they have a right to expect. (Paragraph 326)*
80. We consider that proper safeguards in these cases are essential both for the protection of taxpayers and because safeguards are necessary to secure buy-in from stakeholders and voluntary compliance by taxpayers. (Paragraph 328)
81. *Against a backdrop of increased distrust of HMRC and the Government's tax policy in recent years, the Government must ensure that additional powers for HMRC are tempered by appropriate safeguards for the taxpayer. (Paragraph 329)*

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members of the Finance Bill Sub-committee

Lord Altrincham
 Lord Leigh of Hurley (Chair)
 Lord Kestenbaum
 Lord Palmer of Childs Hill
 Lord Rooker
 Lord Stevenson of Balmacara
 Baroness Valentine

Declarations of interests

Lord Altrincham
No relevant interests

Lord Leigh of Hurley (Chair)
Member of the Institute of Chartered Accountants England and Wales (ICAEW)
Member of the Chartered Institute of Taxation
Employee at Cavendish Financial PLC
Chairman of Manolete Partners PLC

Lord Kestenbaum
No relevant interests

Lord Palmer of Childs Hill
Fellow of the Institute of Chartered Accountants (ICAEW)

Lord Rooker
No relevant Interests

Lord Stevenson of Balmacara
Retired fellow of the Association of Chartered Certified Accountants (ACCA)

Baroness Valentine
Director of Value and Indexed Property Income Trust PLC and its associate Value and Income Property Income Services Limited and is therefore regulated by the Financial Conduct Authority
Has a personal pension
Is invested in start up companies and in larger companies which take advantage of various tax reliefs

Members of the Economic Affairs Committee

Lord Bridges of Headley (Chair)
Adviser to and Shareholder in Banco Santander, Madrid, Spain

Lord Blackwell
Direct and indirect fund investments in a wide range of listed companies, some of which may benefit from tax reliefs
Trustee of charities listed in the Register of Interests which have a wide spread of investments

Lord Davies of Brixton
No relevant interests

Lord Griffiths of Fforestfach
No relevant interests

Lord King of Lothbury
No relevant interests

Baroness Kramer

No relevant interests

Lord Layard

No relevant interests

Baroness Liddell of Coatdyke

No relevant interests

Lord Londesborough

Direct investor in SME companies qualifying for R&D tax relief

Baroness Noakes

Shares held in a wide range of listed companies as declared in the Register of Interests some of which may benefit from research and development tax reliefs

Lord Rooker

No relevant interests

Lord Turnbull

No relevant interests

Lord Verjee

No relevant interests

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at: <https://committees.parliament.uk/work/7923/draft-finance-bill-202324/publications/> and available for inspection at the Parliamentary Archives (020 7219 3074).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with ** gave both oral and written evidence. Those marked with * gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

Oral evidence in chronological order

- | | |
|---|---------------------------------|
| ** Ellen Milner, Director of Public Policy, Chartered Institute of Taxation (CIOT) | <u>QQ 1–9</u> |
| ** Susan Cattell, Head of Tax Technical Policy, Institute of Chartered Accountants of Scotland (ICAS) | |
| * Richard Jones, Senior Technical Manager, Tax Policy, Institute of Chartered Accountants England and Wales (ICAEW) | |
| ** Dr Emma Rawson, Technical Officer, Association of Taxation Technicians (ATT) | <u>QQ 10–24</u> |
| * Andrew Harding, Secretary General, CIMA and Chief Executive–Management Accounting, AICPA-CIMA | |
| * Lydia Challen, Co-Chair of the Tax Law Committee, Law Society of England and Wales | <u>QQ 25–36</u> |
| * Isobel d’Inverno, Tax Law Sub Committee Convenor, Law Society of Scotland | |
| * Adam Craggs, Partner, Reynolds Porter Chamberlain LLP | |
| * Mark Davis, Managing Director, ela8 Ltd | <u>QQ 37–45</u> |
| ** Justin Arnesen, Partner R&D Tax and Government Grants, Business Tax, Evelyn Partners LLP | |
| ** Benjamin Craig, Associate Director R&D Tax Incentives, Ayming UK | |
| * Colin Hailey, Chair of the Finance and Tax Committee, UK BioIndustry Association (BIA) | <u>QQ 46–59</u> |
| * Dr Roger Barker, Director of Policy and Corporate Governance, Institute of Directors (IOD) | |
| * Michael Moore, Chief Executive, British Private Equity and Venture Capital Association (BVCA) | |
| ** Gillian Thomson, Group Tax Manager, Skanska | |
| ** Dr Andy Summers, Associate Professor of Law, London School of Economics (LSE) | <u>QQ 60–70</u> |

- * Bill Dodwell, Member, Administrative Burdens Advisory Board (ABAB)
- * Samantha O’Sullivan, Policy Lead, Chartered Institute of Payroll Professionals (CIPP)
- * Kevin Hart, Chief Executive Officer at Business Application Software Developers Association (BASDA)
- * Joshua Toovey, Senior Research and Policy Officer, Association of Independent Professionals & and the Self Employed (IPSE)
- * Nigel Huddleston MP, Financial Secretary, HM Treasury [QQ 71–93](#)
- * Doug Stoneham, Deputy Director, Counter-Avoidance Policy and Technical, HMRC
- * Matthew Henty, Deputy Director, Enterprise and Tax Policy, HM Treasury
- * Zoë Nettlefield, Deputy Director, Strategic Data Policy, HMRC

Alphabetical list of witnesses

- ** AICPA-CIMA ([QQ 10–24](#)) [DFH0008](#)
- ** Justin Arnesen, Partner R&D Tax and Government Grants, Business Tax, Evelyn Partners LLP ([QQ 37–45](#)) [DFH0012](#)
- ** Association of Taxation Technicians (ATT) ([QQ 10–24](#)) [DFH0002](#)
- ** Ayming UK Ltd ([QQ 37–45](#)) [DFH0014](#)
- * Dr Roger Barker, Director of Policy and Corporate Governance, Institute of Directors (IOD) ([QQx46–59](#))
- ** British Private Equity and Venture Capital Association (BVCA) ([QQ 46–59](#)) [DFH0017](#)
- ** Susan Cattell, Head of Tax Technical Policy, Institute of Chartered Accountants of Scotland (ICAS) ([QQ 1–9](#)) [DFH0018](#)
- * Lydia Challen, Co-Chair of the Tax Law Committee, Law Society of England and Wales ([QQ 25–36](#))
- Chartered Accountants Ireland [DFH0001](#)
- * Adam Craggs, Partner, Reynolds Porter Chamberlain LLP ([QQ 25–36](#))
- ** Benjamin Craig, Associate Director R&D Tax Incentives, Ayming UK ([QQ 37–45](#)) [DFH0014](#)
- * Isobel d’Inverno, Tax Law Sub Committee Convenor, Law Society of Scotland ([QQ 25–36](#))
- * Mark Davis, Managing Director, ela8 Ltd ([QQ 37–45](#))
- * Bill Dodwell, Member, Administrative Burdens Advisory Board (ABAB) ([QQ 60–70](#))

**	ela8 limited (QQ 37–45)	DFH0015
**	Evelyn Partners LLP (QQ 37–45)	DFH0012
	ForrestBrown Ltd	DFH0016
*	Colin Hailey, Chair of the Finance and Tax Committee, UK BioIndustry Association (BIA) (QQ 46–59)	
*	Andrew Harding, Secretary General, CIMA and Chief Executive–Management Accounting, AICPA-CIMA (QQ 10–24)	
*	Kevin Hart, Chief Executive Officer at Business Application Software Developers Association (BASDA) (QQ 60–70)	
*	Matthew Henty, Deputy Director, Enterprise and Tax Policy, HM Treasury (QQ 71–93)	
**	HMRC (QQ 71–93)	DFH0020
*	Nigel Huddleston MP, Financial Secretary, HM Treasury (QQ 71–93)	
**	Institute of Chartered Accountants in England and Wales (ICAEW) (QQ 1–9)	DFH0005
**	Institute of Chartered Accounts Of Scotland (ICAS) (QQ 1–9)	DFH0018
*	Richard Jones, Senior Technical Manager, Tax Policy, Institute of Chartered Accountants England, and Wales (ICAEW) (QQ 1–9)	
	Mace	DFH0007
**	Ellen Milner, Director of Public Policy, Chartered Institute of Taxation (CIOT) (QQ 1–9)	DFH0006
*	Michael Moore, Chief Executive, British Private Equity and Venture Capital Association (BVCA) (QQ 46–59)	
	Morgan Sindall Group	DFH0003
	National Centre for Universities and Business (NCUB)	DFH0009
*	Zoë Nettlefield, Deputy Director, Strategic Data Policy, HMRC (QQ 71–93)	
*	Samantha O’Sullivan, Policy Lead, Chartered Institute of Payroll Professionals (CIPP) (QQ 60–70)	
**	Dr Emma Rawson, Technical Officer, Association of Taxation Technicians (ATT) (QQ 10–24)	DFH0002
**	Skanska UK plc (QQ 46–59)	DFH0010
*	Doug Stoneham, Deputy Director, Counter-Avoidance Policy and Technical, HMRC (QQ 71–93)	
**	Dr Andy Summers, Associate Professor of Law, London School of Economics (LSE) (QQ 60–70)	DFH0004
**	The Chartered Institute of Taxation (CIOT) (QQ 1–9)	DFH0006

- ★★ Gillian Thomson, Group Tax Manager, Skanska [DFH0010](#)
([QQ 46–59](#))
- ★ Joshua Toovey, Senior Research and Policy Officer,
Association of Independent Professionals & and the Self
Employed (IPSE) ([QQ 60–70](#))
UK Bioindustry Association [DFH0013](#)