



HM Treasury



HM Revenue  
& Customs

# Preventing abuse of the R&D tax relief for SMEs: consultation

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March 2019



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ISBN 978-1-912809-56-1  
PU2254

# Contents

Chapter 1	Introduction	2
Chapter 2	Background to R&D tax reliefs	3
Chapter 3	The Budget 2018 announcement	4
Chapter 4	How the cap will be applied	6
Chapter 5	Summary of questions and how to respond	10
Annex A	Example of how the cap might work in practise	14

# Chapter 1

## Introduction

- 1.1 Investment in Research and Development (R&D) is vital for increasing productivity. R&D tax reliefs, including the small or medium sized enterprise (SME) scheme, support businesses investing and are a core part of the government's support for innovation. A study by HMRC found that for every £1 of tax forgone, between £1.53 and £2.35 of additional R&D is stimulated.
- 1.2 Government support through the SME scheme has increased rapidly in recent years. Between 2014-15 and 2015-16 the cost of the scheme increased by 33% to £1.8 billion, and the partial outturn data for 2016-17 shows the cost for that year on track rise further. This supports the government's aim of seeing UK spending on R&D reach 2.4% of GDP by 2027.
- 1.3 While R&D tax reliefs are effective, HMRC has identified (and prevented) fraudulent attempts to claim the SME scheme payable tax credit totalling over £300 million. In these cases, companies were set up to claim the cash available through the payable tax credit even though they had no R&D activity. HMRC also identified structures set up deliberately to claim the payable tax credit despite there being little employment or activity in the UK.
- 1.4 Budget 2018 announced that, to deter abuse, the amount of payable tax credit that a qualifying loss-making business can receive through the relief in any one year will be capped. The cap will be three times the company's total PAYE and NICs liability for that year and will be implemented from April 2020 (after legislation in Finance Bill 2019-20).
- 1.5 However, the government understands that some genuine companies may have low PAYE and NICs liability relative to R&D spend and therefore could be affected by this measure, despite the cap being set at three times their PAYE and NICs liability. As genuine companies are not the intended target of the cap, the government is determined to keep any impact on them to a minimum and committed to consult on the cap before it is implemented.
- 1.6 This consultation is about how the cap will be applied, so as to minimise any impact on genuine businesses. The government welcomes responses and input from businesses and their representatives currently claiming or planning to claim the payable tax credit.

# Chapter 2

## Background to R&D tax reliefs

- 2.1 R&D is defined as an activity that seeks to achieve an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technological uncertainty. R&D drives productivity and growth in the economy and is vital for the success of UK companies competing on the global stage. Evidence suggests that the benefits of R&D to society are 3-4 times higher than the private benefits realised by an individual company.<sup>1</sup> There is a strong case for supporting R&D through the tax system to incentivise greater investment by companies to realise these wider societal benefits.
- 2.2 There are two separate R&D tax reliefs in the UK: the small or medium sized enterprise (SME) scheme and the R&D Expenditure Credit (RDEC). The RDEC offers a payable credit, while the SME scheme provides either a corporation tax deduction or a payable tax credit. The SME scheme is more generous than RDEC as SMEs are typically less able to handle the risks that undertaking R&D activity entails. The payable tax credit in the SME scheme is particularly valued by new and smaller companies, for whom cashflow is crucial. Both schemes are available to loss-making companies.
- 2.3 R&D tax reliefs are available to any eligible company undertaking R&D and are not limited to any one sector. They support both major steps forward and valuable, incremental development. For example: scientists developing crops that have substantially increased vitamin content, specialists developing new operating systems or computer languages, or engineers finding ways for batteries to store more power.
- 2.4 Support for businesses through R&D tax reliefs overall rose by nearly a quarter between 2014-15 and 2015-16. In 2015-16 they provided £3.7 billion worth of relief, with nearly £1.8 billion from the SME scheme and around £1.9 billion from the RDEC. Furthermore, the number of companies claiming relief increased by 22% between 2014-15 and 2015-16 to around 43,000. SMEs make most claims for the reliefs, with claims for the SME scheme making up 86% of all claims in 2015-16.<sup>2</sup>

The government has also increased the additional rate of relief for the SME scheme from 75% to 130%. This means, including the normal corporation tax deduction, R&D tax relief effectively reduces the cost of R&D by up to 44% for a profit-making SME and 33% for loss-making SMEs.

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<sup>1</sup>'Have R&D Spillovers Changed?', Centre for Economic Performance, May 2018

<sup>2</sup>'Research and Development Tax Credits Statistics', HM Revenue & Customs, September 2018

# Chapter 3

## The Budget 2018 announcement

### Abuse of the SME scheme's payable tax credit

- 3.1 The payable tax credit in the SME scheme provides valuable support to loss-making companies. It allows those companies to claim a tax credit worth up to 14.5% of the R&D element of their losses and receive an immediate cash-flow benefit. However, because the tax credit effectively generates a cash payment to the company from HMRC, the tax credit has become a target for abuse. Two types of abuse of the payable tax credit have been identified.
- 3.2 First, HMRC has identified and prevented a number of fraudulent claims, worth over £300 million in total, involving companies that were set up to claim payable tax credit even though they undertook no R&D.<sup>1</sup>
- 3.3 Secondly, HMRC have also identified a number of structures where expenditure outside the UK has been re-routed through a UK entity, these entities have little or no employment or activity and are set up wholly or mainly for the purpose of accessing the payable tax credit. The government understands that there will be circumstances in which a UK company will benefit from carrying out R&D outside the UK and the SME scheme has always allowed for this. This is, however, different from manipulating the scheme to gain a benefit for activity which would have taken place anyway and would not otherwise have had anything to do with a UK business.
- 3.4 If this sort of abuse continues, it could place the integrity of the wider SME scheme at risk, especially considering the continued expansion of the scheme. Given the amounts spent on the relief, and the importance of the support it gives, it is vital to make sure that every pound spent is well targeted, delivering maximum value to the UK.

### The Budget 2018 announcement

- 3.5 HMRC remains vigilant and the government is confident that it will continue to identify any attempts at fraud. However, it is notable that abusive claims have risen substantially since a previous PAYE cap was removed in 2012 (alongside an overall increase in genuine claims). When that change was announced, the government made clear that it would continue to keep the tax relief under review to ensure that the tax credit is being delivered to companies genuinely undertaking R&D.

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<sup>1</sup>HMRC arrest three during investigation into suspected £300 million corporation tax scam', HM Revenue & Customs Press Release, June 2016

- 3.6 Given the scale of the challenge the abuse poses, the government announced at Budget 2018 the introduction of a new anti-abuse “cap” to the SME scheme payable tax credit.<sup>2</sup>
- 3.7 The proposed cap is based on a company’s total Pay As You Earn (PAYE) and National Insurance Contributions (NICs) liability in any one year. This will deter abuse because fraudulent companies and those where the UK activities amount to little more than claiming the payable credit typically do not employ many people or pay PAYE and NICs.
- 3.8 However, it is also the government’s intention that genuine companies undertaking R&D should not be adversely impacted by the cap. This is why the government announced that the cap will be based on three times a company’s PAYE and NICs liability. The government also committed to consult on how the cap will be applied, to minimise any impact on genuine businesses.

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<sup>2</sup>‘Budget 2018’, HM Treasury, October 2018

# Chapter 4

## How the cap will be applied

- 4.1 Under the current SME scheme, where expenditure incurred by a SME qualifies for relief, a company can claim an extra deduction in calculating its taxable profits. That extra deduction is currently 130% of the qualifying expenditure, which means that the company obtains a total deduction of 230% (that is the original spend plus the additional deduction) of the original qualifying expenses.
- 4.2 If the company makes a loss for corporation tax purposes, the loss from the R&D deduction can (with some restrictions) be 'surrendered' in return for a payment of R&D tax credit. The payable tax credit is then 14.5% of the loss surrendered. Surrendered losses cannot be carried forward to set against future profits. The amount of payable tax credit a company can claim is only linked to the amount of loss surrendered and is not limited by other means.

### Making a payable tax credit claim with the cap

- 4.3 Budget 2018 announced that the amount of payable tax credit that a qualifying loss-making company can receive in any tax year through the SME scheme will be capped to three times the company's total PAYE and (both employee and employer) NICs liability for that year. The whole of the PAYE and NICs liability which is payable during the accounting period to which the claim relates will count towards the cap, not just that part which relates to staff involved in the R&D activity. The change will come into effect for accounting periods which commence on or after 1 April 2020.
- 4.4 As set out above, the aim of the cap is to address abuse that has been identified and not adversely impact genuine companies. The cap would also need to be applied in such a way that it adheres to State aid rules and the principles of non-discrimination. Furthermore, the design must take into account the administrative burden placed on both companies and HMRC.
- 4.5 An example of how the cap could be applied has been provided in the annex.

### The "threshold"

- 4.6 The government is aware that applying a cap on the amount of payable tax credit a company could claim will add some administrative burden for businesses. The government is therefore considering applying the cap only to payable tax credit claims above a certain "threshold", so that the smallest claims would be unaffected, keeping things as simple as possible.

### Question 1

If the cap is only applied for payable tax credit claims above a defined “threshold”, at what level would this be useful at reducing any potential administrative burdens on genuine companies?

- 4.7 However, to prevent abuse from groups making small but numerous claims at or below the defined threshold, the government intends to allow only one “below threshold” payable tax credit claim per year for any given group of companies under common control.

### Question 2

If a group was only able to submit one payable tax credit claim at or below a certain threshold per year, how would this fit with the way that claims are currently made? How common is it for more than one company in a group or common control entity to make a claim for the payable R&D tax credit?

## Group or Connected Party PAYE and NICs liability

- 4.8 To claim more than the threshold level of payable tax credit, a company would need to calculate its maximum claim by multiplying its entire PAYE and NICs liability for that year by three.
- 4.9 To allow companies to maximise the amount of payable tax credit that can be claimed, the government is considering allowing some of the PAYE and NICs liabilities of other companies that are part of the same group or part of the same connected party as the claimant company in the calculation of the cap – in certain circumstances. This amount would be added to the claimant company’s PAYE and NICs contributions and multiplied by three, to calculate the maximum amount of payable tax credit the company could claim.
- 4.10 The group or connected party PAYE and NICs that the government is considering including would be an element of the PAYE and NICs contributions of workers engaged in an R&D project subcontracted by the company to its group or connected party. This could also apply to the PAYE and NICs related to any Externally Provided Workers (EPWs) used by a company.
- 4.11 The rules as to whether companies are connected will be the same rules as those used elsewhere in the R&D legislation. A company is connected with another company if the same person or persons have control of both companies.

### Question 3

If an element of the PAYE and NICs liabilities of another group or connected company were included as a part of the cap (where R&D has been subcontracted to it or EPWs provided by it), to what extent would this benefit companies? How much additional complexity would this add to claiming the payable tax credit?

- 4.12 In practise, this would mean the claimant company obtaining the relevant PAYE and NICs information from the other company.

### Question 4

Would it be practical for claimant companies to obtain the PAYE and NICs information from other group or connected companies? Are there any limitations to their doing so? Would the other company be willing to provide this information?

## Carrying forward losses

- 4.13 If a company's payable tax credit is limited by the cap, it will still be able to claim a payable tax credit up to the level of the cap and carry forward any unused losses against future profits in the normal way.
- 4.14 However, the government is also considering allowing these companies affected by the cap to access the rest of their payable tax credit when they've built up enough PAYE and NICs liabilities in a future year.
- 4.15 Where potentially surrenderable losses cannot be surrendered for a payable tax credit because of the cap, those losses, to the extent that they are carried forward, would still be potentially surrenderable. These "carried forward (potentially surrenderable) losses" can be used as normal in later accounting periods, but companies would also have the option to surrender them in exchange for payable tax credit for a limited period of time – e.g. for 2 years – if there is sufficient PAYE and NICs liability after any claim which relates to the current year.

### Question 5

How beneficial would surrendering carried forward losses, to claim a future payable tax credit when sufficient PAYE and NICs liability has been generated, be to a company affected by the cap? Would a time limit of 2 years be appropriate? How straightforward would it be to keep track of the origin year of the losses?

### Question 6

Would carrying forward losses make companies consider taking on more staff in the future – to unlock some (or all) of the rest of their payable tax credit?

## Genuine companies still affected by the cap

- 4.16 While the cap is intended to target abuse, the government is aware that some genuine companies could still be affected – despite the cap being set at three times a company's PAYE and NICs liability and the other specific design features the government is considering. These could be genuine companies paying low amounts of PAYE/ NIC relative to their R&D spend; either because of the stage they are at in their lifecycle, or because of their particular business model.

### Question 7

The government is interested in the characteristics of companies that could be affected by the cap. For example, if you are or represent a company likely to be affected by the cap, how large is the company in terms of employees? How many staff are primarily engaged in R&D activity? How old is the company? What sector does it operate in?

- 4.17 As these genuine companies are not the intended targets of the cap the government will work with stakeholders to refine its application so that legitimate companies and business models will be protected as far as possible – whilst preventing the abuse that has been identified.

## Other proposals

- 4.18 The government is open to receiving representations for other proposals from how to apply the cap to preventing abuse of the payable tax credit more generally and welcomes further discussion around them.

### Question 8

What else could the government consider, regarding how the cap is applied to preventing abuse, to ensure genuine companies can continue access the payable tax credit? Are there any alternative measures that could prevent abuse of the payable tax credit?

# Chapter 5

## Summary of questions and how to respond

### Question 1

If the cap is only applied for payable tax credit claims above a defined “threshold”, at what level would this be useful at reducing any potential administrative burdens on genuine companies?

### Question 2

If a group was only able to submit one payable tax credit claim at or below a certain threshold per year, how would this fit with the way that claims are currently made? How common is it for more than one company in a group or common control entity to make a claim for the payable R&D tax credit?

### Question 3

If an element of the PAYE and NICs liabilities of another group or connected company were included as a part of the cap (where R&D has been subcontracted to it or EPWs provided by it), to what extent would this benefit companies? How much additional complexity would this add to claiming the payable tax credit?

### Question 4

Would it be practical for claimant companies to obtain the PAYE and NICs information from other group or connected companies? Are there any limitations to their doing so? Would the other company be willing to provide this information?

### Question 5

How beneficial would surrendering carried forward losses, to claim a future payable tax credit when sufficient PAYE and NICs liability has been generated, be to a company affected by the cap? Would a time limit of 2 years be appropriate? How straightforward would it be to keep track of the origin year of the losses?

### Question 6

Would carrying forward losses make companies consider taking on more staff in the future - to unlock some (or all) of the rest of their payable tax credit?

### Question 7

The government is interested in the characteristics of companies that could be affected by the cap. For example, if you are or represent a company likely to be affected by the cap, how large is the company in terms of employees? How many staff are primarily engaged in R&D activity? How old is the company? What sector does it operate in?

## Question 8

What else could the government consider, regarding how the cap is applied to preventing abuse, to ensure genuine companies can continue access the payable tax credit? Are there any alternative measures that could prevent abuse of the payable tax credit.

## How to respond

- 5.1 This consultation will run from 28 March to 24 May 2019.
- 5.2 Responses should be sent by email to:  
consultation2019.rdtaxrelief@hmrc.gov.uk
- 5.3 Alternatively, please send responses by post to:  
  
Business, Assets and International  
CT Innovation & Growth team  
HM Revenue and Customs  
100 Parliament Street  
Westminster  
London  
SW1A 2BQ
- 5.4 When responding, please say if you are making a representation as a business, individual or representative body. In the case of representative bodies, please provide information on the number and nature of people you represent.

## Confidentiality

- 5.5 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018, General Data Protection Regulation (GDPR) and the Environmental Information Regulations 2004. 29
- 5.6 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue & Customs.

## Consultation privacy notice

- 5.7 This notice sets out how we will use your personal data, and your rights. It is made under Articles 13 and/or 14 of the General Data Protection Regulation.

## Your data

### The data

5.8 We will process the following personal data:

Name

Email address

Postal address

Phone number

Job title

### Purpose

5.9 The purpose(s) for which we are processing your personal data is: Developing tax policy by consulting with interested parties – the particular consultation is ‘Preventing abuse of the R&D tax relief for SMEs: consultation’.

### Legal basis of processing

5.10 The legal basis for processing your personal data is that the processing is necessary for the exercise of a function of a government department. HM Revenue & Customs may share responses with HM Treasury.

### Recipients

5.11 Your personal data may be shared by us with HM Treasury.

### Retention

5.12 Your personal data will be kept by us for six years and will then be deleted.

## Your rights

- you have the right to request information about how your personal data are processed, and to request a copy of that personal data
- you have the right to request that any inaccuracies in your personal data are rectified without delay
- you have the right to request that any incomplete personal data are completed, including by means of a supplementary statement
- you have the right to request that your personal data are erased if there is no longer a justification for them to be processed
- you have the right in certain circumstances (for example, where accuracy is contested) to request that the processing of your personal data is restricted

### Complaints

5.13 If you consider that your personal data has been misused or mishandled, you may make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office  
Wycliffe House  
Water Lane  
Wilmslow  
Cheshire  
SK9 5AF

0303 123 1113

casework@ico.org.uk

- 5.14 Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

### Contact details

- 5.15 The data controller for your personal data is HM Revenue & Customs. The contact details for the data controller are:

HMRC  
100 Parliament Street  
Westminster  
London  
SW1A 2BQ

The contact details for HMRC's Data Protection Officer are:

The Data Protection Officer  
HM Revenue & Customs  
7th Floor, 10 South Colonnade  
Canary Wharf,  
London  
E14 4PU

advice.dpa@hmrc.gsi.gov.uk

### Consultation principles

- 5.16 This consultation is being run in accordance with the government's [consultation principles](#).
- 5.17 If you have any comments or complaints about the consultation process please contact:

John Pay,  
Consultation Coordinator,  
Budget Team,  
HM Revenue & Customs,  
100 Parliament Street,  
London  
SW1A 2BQ.

Email: [hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk](mailto:hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk)

**Please do not send responses to the consultation to this address.**

## Annex A

# Example of how the cap might work in practise

- A.1 Company A is loss-making. It spends £100,000 on R&D in 2025. The R&D relief increases its loss by £130,000 ( $=130\% \times 100,000$ ). The company surrenders losses of £230,000 for a payable tax credit of £33,350 ( $=14.5\% \times 230,000$ ). In the same year, Company A is liable for total PAYE and NICs of £40,000.
- A.2 The company could therefore receive a maximum payable tax credit of £120,000 ( $=300\% \times 40,000$ ). If there were a “threshold” set at £10,000 (for the purpose of this example), the company would not be affected by the cap since it has enough PAYE and NIC liability to go beyond the threshold level. The company would receive its entire R&D payable tax credit claim.
- A.3 Company B has the same R&D spend as Company A but a lower PAYE and NICs liability of £3,000, so it doesn't have enough PAYE and NICs liability to go above the threshold level and can receive a maximum of £10,000 payable credit. The company would need to have just under £11,117 ( $33,351 = 300\% \times 11,117$ ) of PAYE/ NIC liability to claim all its potential payable tax credit, but it can make a claim at the threshold level instead. Therefore, it would receive a payable tax credit of £10,000.
- A.4 This is equivalent to surrendering losses of £68,965 ( $14.5\% \times 68,965 = 10,000$ ). The company would be able to carry the remaining £161,035 ( $=230,000 - 68,965$ ) losses forward to 2026 to use against future profits.
- A.5 If Company B conducts less R&D in 2026, or employs more staff, it may be able to surrender some of that £161,035 in that later year to claim a payable credit of £23,350. This would be in addition to any other eligible losses in that year.



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