



HM Treasury



HM Revenue  
& Customs

# Preventing abuse of the R&D tax relief for SMEs: Spring 2019 consultation – summary of responses

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March 2020



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relief for SMEs:  
Spring 2019 consultation – summary of  
responses

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ISBN 978-1-913635-16-9  
PU2955

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# Chapter 1

## Introduction

- 1.1 Budget 2018 announced that, to deter abuse, the amount of payable tax credit that a loss-making business can receive in any one year through the R&D SME relief will be capped at three times the company's total PAYE and NICs liability. The government committed to consult on how the cap would be applied, to minimise any effects on genuine businesses.
- 1.2 On 28 March 2019, the government launched the formal consultation on the cap with the publication of a consultation document, "Preventing abuse of the R&D tax relief for SMEs<sup>1</sup>". The consultation closed on 24 May 2019.
- 1.3 HMRC received nearly 90 responses. Those responding included individuals, industry groups, businesses across a number of sectors, individual accountants and agents and accountancy professional bodies.
- 1.4 The government has also met a number of stakeholders, including trade bodies, businesses and accountants. Their views have been taken into account and expressed in this document. A summary of responses is set out in Chapter 2
- 1.5 Following consideration of the consultation responses summarised in this document, the government announced at Spring Budget 2020 that changes would be made to the PAYE cap design to minimise the impact on genuine businesses. It was also announced that implementation of the cap would be delayed until April 2021 to allow for further consultation on those changes.

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<sup>1</sup> <https://www.gov.uk/government/consultations/preventing-abuse-of-the-rd-tax-relief-for-smes>

# Chapter 2

## Consultation responses

- 2.1 Respondents were broadly sympathetic to the government's need to prevent abuse, but some noted that there might be genuine businesses which could be negatively affected by the cap. Respondents from the life sciences sector, in particular who argued that the cap could particularly affect R&D intensive early-stage companies, due to specific business models adopted in the sector.
- 2.2 The government is very grateful to all those who took the time to explain their concerns. The further consultation announced at Spring Budget 2020 seeks to respond to these, in ways that will help genuine companies across all sectors, including life sciences.

### 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?**

- 2.3 The idea of a threshold was generally welcomed as helping to remove or reduce the impact on small companies ('especially those who subcontract') although a significant minority felt that no threshold was necessary, and it would only add complexity. There was concern that regardless of the threshold level, the measure would have a negative impact on, especially, the life sciences sector.
- 2.4 On the appropriate level, although there were a number of responses around £10k - £20k, a wide range of suggestions were made ranging from £10k up to £2m. One respondent warned that the level should not be set too high ('it should not be the purpose of R&D tax credits to fund expenditure that must already be funded from other sources (as most of these companies are pre-revenue)') and went on to suggest linking it to 'the national average SME repayable claim'. Another response suggested the threshold should be sector-specific to account for differences in business practice – others stated that it was impossible to make one size fit all, but did not offer detail on what factors to take into account in setting different levels.
- 2.5 Some concerns were expressed that the level should be reviewed regularly and linked to factors such as inflation and levels of claims. There were concerns that any given threshold would still allow abusive claims below that level, perhaps leading to large volumes of work for HMRC (i.e. numerous claims just below the threshold).

## 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?

- 2.6 There was no consensus on whether or not it was common for a single company within a group to be the claimant, with multiple responses saying both “common” and “uncommon”. Some responses were framed differently, to the effect that this rule would affect or “catch” many, suggesting that multiple claims are not uncommon. Similarly, a number of respondents commented that the proposal was reasonable and would be effective in preventing abuse.
- 2.7 One response was concerned that “group structures vary so much that it would be very difficult for these rules to reach the outcome the government are trying to achieve”. The particular concern here was over group structures where the payroll and the R&D may be in separate entities (and it would be inefficient to move the payroll) with collaboratively organised R&D another worry.
- 2.8 Some respondents which do not currently make claims through separate companies pointed out that the flexibility to do so in future – for strategic reasons, such as to manage risk of R&D project failure and of new investment – was important. There were also concerns about what would happen where ownership or group structure changed mid-year.
- 2.9 A significant number of respondents made the point that this was less of an issue for smaller companies, which were less likely to be in groups and that when a business had grown the point where there might be multiple claims, it should have significant PAYE/ NIC. (‘Clients which would benefit from threshold are single entity starts ups. Those in group structures tend to be profit-making and therefore do not claim credit.’) Against that, it was pointed out that even some SMEs do use a “holding company” to develop IP for them.
- 2.10 Several responses suggested that if claims were limited to a single company, that company should be able to cover the claim with the entire PAYE/ NIC of the group. As an alternative approach several suggested that a threshold be applied at group, rather than company, level or that unused “capacity” be surrenderable between firms.



### **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?**

- 2.11 Some responses supported these proposals, however others felt that it would add complexity or that in practice the information required would be difficult to obtain. There was acknowledgment by some supporters of this proposal that there would be increased complexity, however most of those opposing it also accepted that it would provide flexibility for some.
- 2.12 Some responses suggested this was unlikely to add complexity or, in the opposite direction, took a very pessimistic view of the possible complexity. The judgement made often seemed to come down to perceptions of the benefit against the additional complexity, a judgement that will vary based on experience and circumstances.

### **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?**

- 2.13 Despite the focus of the question on group/ connected companies, many responses warned of the difficulties in obtaining information from third parties.
- 2.14 Particular points raised included the additional administrative burden even where information was readily available ('the burden of obtaining confidential information from sub-contractors or EPWs and being responsible for the accuracy of the information given, would add significant complexity and a much greater compliance burden on SMEs'). Other possible problems included differing interpretations of GDPR obligations, difficulties over sharing material deemed to be confidential such as remuneration of senior management, ('payroll is always a sensitive subject and even as an advisor it can be difficult to obtain from clients') and unfairness where companies were unable to obtain information from third parties. There were also concerns about potential abuse of the feature. However, the fact that groups would typically use the same or compatible software was pointed to as a factor making it easier to share information. For some, a fundamental issue remains – that 'most companies have no group or connected party companies so they remain [affected] by the cap'.

## 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?

- 2.15 This idea was generally welcomed, although many respondents felt that 2 years was insufficient and 3, 5, 8 or 10 years were suggested as alternatives, or even having no time limit.
- 2.16 Some respondents noted that the proposal would increase the admin burden ('this could be beneficial but note that the loss carry forward rules are already very complicated'). Some pointed out that it would not help all companies ('most very small tech companies are concerned with the here and now', 'For SMEs, cashflow is king, so they would need to be able to use previous-year unused PAYE/NICs first', 'does not solve the issue for biotech (and other start-ups)').
- 2.17 A number of respondents echoed this final point, that delaying availability of support would mean the effectiveness of the credit would still be reduced. There were also concerns about how HMRC would check carry forward amounts.

## 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?

- 2.18 The majority of respondents felt that carry forward of losses would not lead to additional staff being taken on, although a smaller number disagreed. Reasons given included hiring staff being costly, 'The decision process is: "No cash flow, no employees, cashflow, maybe employees', the size of the resulting tax credit being too small to influence decisions, 'We don't believe so as it is still a net cost to the company to take on an employee', 'Taking on more staff simply to generate the PAYE/NIC to "frank" a credit payment would be a very short-term measure and very unlikely to happen in practice.'
- 2.19 A number of tax professionals who responded felt that a tax-driven decision here would actually be undesirable ('the business case for recruiting staff for SMEs will be made on commercial need not to unlock R&D tax credit') and some were concerned this feature could have perverse effects – such as encouraging bonuses for existing staff.

## 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?

- 2.20 Responses to this question tended to focus on describing companies likely to be affected rather than directly giving details of respondents.
- 2.21 Those likely to be affected included companies in the life sciences sector, early stage companies with 1 or 2 staff, 'small, self-run, entrepreneurial owner/ Director businesses who try to keep the commercial risks in the business down (by not employing staff too early)'. Others mentioned included start-ups in their first few (1-3) years, software companies ('employment of the professionals is increasingly difficult due to supply/demand and likely to have significant spend as an EPW or subcontractor'). Finally, companies engaging in R&D projects involving high value consumables might be affected.

## Question 8 and further comments

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?

- 2.22 A number of proposals on the application of the cap, and suggestions of alternatives the government could consider in preventing abuse, were raised. They included:
- Exempting particular sectors or expenditure such as companies working on environmentally beneficial projects (e.g. energy efficiency), biotech, drug/device development expenditure, 'key growth sectors' or those who have certification from regulators (e.g. FDA approval, UK MHRA approval)
  - Exempting companies which meet particular conditions (directors to be UK resident, no linked enterprises, location of employees, location of leadership of the project or those owned by UK universities)
  - Relaxations including:
    - o increasing the PAYE/ NIC cap by an amount depending on proportion of subcontract costs incurred in the UK
    - o a "gateway" test based on "hallmarks" to establish genuine activity

- excluding very young companies (eg those up to 5 years old)
  - allowing offset against other tax obligations of the group (perhaps even the shareholders' own tax obligations)
  - an "economic substance" test that could override the strict cap ('...substance tests and evidence requirements regarding the knowledge, qualifications and experience of those overseeing, managing and leading the R&D...')
  - a "commerciality" threshold such as possession of valuable rights to any technology or intellectual property developed, exemption where the R&D is subcontracted to a party which undertakes it in the course of a chargeable trade / activity
- Suggested "Anti-avoidance" rules included:
- denying payment where R&D is done outside the UK and IP held offshore
  - the possibility of an "appeals" mechanism whereby companies with capped claims are able to submit evidence such as 'banking records, information about the subcontractors used to prove they are genuine, references from professionals like lawyers or accountants, clients and suppliers etc which in conjunction with all the data HMRC already hold on companies and individuals could be cross referenced and would allow HMRC to vet claimants'
  - applying the advance assurance mechanism for any claim outside certain parameters (or a preapproval mechanism similar to that used for EIS)
  - jurisdictional restriction or nexus rules
  - motive tests
  - anti-avoidance measures against companies with no UK presence
  - reintroduction of de minimis for spending
  - differential credit rates depending where work is done
  - use of s1084 CTA 2009 plus general anti-avoidance provisions and the requirement of the R&D to be for the purposes of the company's trade

2.23 Many respondents also used Question 8 and the further comments section to request in strong terms that the proposals be rethought, that the operation of any cap be reviewed after three years, and that an appropriate level of cap be set.

# Chapter 3

## Next steps

- 3.1 After considering all the views put forward, government proposes that the introduction of the cap should be delayed to April 2021. The design will include, as suggested in the consultation, a threshold (question 1) below which claims to payable credit will be uncapped but with no restriction to one payable credit claim per group (question 2). Related party PAYE and NICs liabilities attributable to the R&D project can be included in the cap calculation (questions 3 and 4). There will be no provision for losses/ expenditure to be carried forward to underwrite payable credit claims in future years (questions 5 and 6).
- 3.2 As stated above, there were a wide variety of responses on the level of threshold. The government announced at Budget it will include a threshold of £20,000 announced this at Spring Budget 2020 alongside the limit, mentioned in the previous paragraph, on subcontracted expenditure and EPW payments.
- 3.3 The government has also published a further consultation on other proposed changes to the design of the cap, covering issues such as what activities constitute management of intellectual property, and what intellectual property should be considered for this purpose.
- 3.4 The government proposes an additional step to ensure the impact on businesses is minimised. Using some of the suggestions made in response to Question 8, the government proposes that a company that meets two further tests will be not be subject to the cap.
- 3.5 These tests are that it performs a significant amount of management activity in respect of the intellectual property arising, or which will arise, from the R&D project, and that its expenditure on work subcontracted to, or EPWs provided by, a related party is less than a certain proportion of its overall R&D expenditure on the project.
- 3.6 The closing date for the consultation is 28 May. Draft legislation, upon which further views will be welcome, will then be published later this year.
- 3.7 Final legislation will then be included in Finance Bill 2020-21 and the cap will be introduced in April 2021.

# Annex A

## List of respondents

Aiglon Consulting( ICAEW chartered accountant)  
AKL RESEARCH and Development  
Arecor Limited  
ATT( Association of Taxation technicians  
Barwell consulting limited  
BDO  
Beavis Morgan  
Berkley Associates  
BIA  
Biodivide  
Bishop Fleming  
Blueberry therapeutic Limited  
Bright R&D Limited  
Business Wizards Ltd  
CAMPHOS THERAPEUTICS  
CATAX  
CEO Adorx Therapeutics and Partner of Epidarex Capital  
Chartered Insitute of Taxation  
Circassia Ltd  
Confluence Tax  
CooperFaure  
Crowe UK LLP  
Customem  
David Cooke  
DeepMatter  
Deloitte  
Diurnal  
Eagle genomics  
Edwards accountants  
Encipher Biotherapeutics  
Evox Therapeutics Limited  
Excalibur Group)  
EY  
F2G  
Federation of Small Businesses  
Fiscale LTD  
ForrestBrown  
FTI Consulting  
Gateley Capitus  
GovGrant  
Hazlewoods  
Highland Venture Capital LTD  
Hvivo Services Ltd  
ICAEW  
ICAS - The Institute of Chartered Accountants of Scotland

IMMUNOCORE  
Institute of Financial Accountants  
James Cowper Kreston  
Johnston Carmichael LLP  
KalVista  
KaNDy therapeutics  
Kingly Brookes LLP  
Kingston Smith  
KPMG  
LeytonLSCA (London Society of Chartered Accountants)  
Mazar  
Medannex and sister company Aten Therapeutics  
Medannex and sister company Aten Therapeutics  
Menzies  
Mercia Technologies PLC  
MMP Tax  
NeRRe Therapeutics Ltd  
Osborne Clarke LLP  
PraxisAuril  
Profactor Pharma Limited  
PWC  
Randall &Payne - R&D  
Randd Tax  
Royal Academy of Engineering  
RSM  
Saffery Champness LLP  
Sean Sutcliffe  
Signature Tax  
SLA  
Spybiotech  
Summit Therapeutics  
Synairgen plc  
Tax Insight U.K ( U.K Science park community)- Maria Kitt  
TMB Tax Consultancy - Agents  
Tokamak Energy Ltd  
Trio Medicines ltd  
Verona Pharma plc

## **HM Treasury contacts**

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If you require this information in an alternative  
format or have general enquiries about  
HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

Email: [public.enquiries@hmtreasury.gov.uk](mailto:public.enquiries@hmtreasury.gov.uk)