Government must ensure that HMRC has the resources to tackle fraud and error within R&D tax relief

Large Corporate OMB



31 January 2023

Lord Leigh of Hurley, Chair of the Economic Affairs Finance Bill Sub-Committee, on its report on the proposed reforms to R&D relief.

Each year, the House of Lords Economic Affairs Committee appoints the Finance Bill Sub-Committee to consider aspects of the draft Finance Bill from the point of view of technical issues of tax administration, simplification and clarification. In this context the Sub-Committee, which I chair, published its report on 31 January considering the potential impact of the proposed reforms to research and development (R&D) tax relief.

In today's fast paced and competitive global economy, R&D is a key driver of economic growth and job creation. Investment in R&D is essential in supporting businesses to increase their productivity and meet the changing needs of consumers, while contributing to our economic growth and recovery. It is therefore essential that HMRC and the Treasury get the management of R&D tax relief right for private investment in UK R&D to continue thriving.
Yet, recent reports have highlighted the scale of the abuse of R&D tax relief and the increasing loss of revenue as a result of spurious claims, threatening to undermine the objective of the relief. The government has promised to tackle this urgent issue in the next budget, with their proposed measures published in draft legislation last summer.

Despite the government making several proposals to combat abuse and improve compliance within HMRC, multiple witnesses told us that they felt that HMRC was introducing more hurdles for genuine claimants without getting to the root cause and tackling the abuse. Amongst these measures is the pre-notification requirement which means that if a company intends to make an R&D claim, they must notify HMRC in advance.

In our report, we consider that it is right that tighter processes should be put in place to prevent fraudulent claims being accepted. However, a more targeted and consistent approach which involves the careful selection of claims for investigation, as well as greater inspection of claims being carried out before claimants are asked further questions, is needed from HMRC. This will ensure that the scheme does not unfairly penalise genuine claimants. Further, a review of the resources available to HMRC to enable them to combat abuse of the relief should be carried out with immediate effect. Our report concludes that without sufficient resources and more careful administration of the relief, amending the legislation alone will be ineffective in tackling the abuse.

In addition to the abuse of the relief, there is also the matter of erroneous claims. HMRC stated that the process to submit a claim is 'pretty straightforward'. However, witnesses told us that one of the challenges faced by SMEs is identifying whether their activity constitutes R&D for tax purposes. Firms which find the process to be too complex are therefore more likely to turn to advisers, who might include rogue advisers, and may encourage the firm to submit an invalid claim. HMRC should prioritise helping businesses to understand the schemes, as well as raise more awareness of the Advanced Assurance process available for SMEs.

More broadly, we highlight that a wider review and consultation of the relief is needed, particularly as the government has announced a consultation on the merger of the two R&D schemes to create a single RDEC scheme for all. During our inquiry, we heard various views from witnesses regarding the two schemes becoming one, some of which were in favour of the merger, while others were more sceptical that this would create a scheme that was even more complex. We consider that it is disappointing to see that the announced consultation is limited to design and implementation, which prevents the government from having an open-ended consultation on how R&D relief should progress in the UK.

The role that R&D tax relief plays in today's economy is crucial. I hope the government takes this opportunity to reflect on the Sub-Committees recommendations and engages with relevant stakeholders to ensure that the right measures that will support the UK's growth and productivity are implemented.