

R&D Claims

Your guide to what HMRC need



Insights on what HMRC require to process
your claim first-time, every-time

Unlock the capital you need.
Fuel your growth and innovation.



R&D Tax Relief Claims – What HMRC expect

Much has been written in the accountancy and tax press over the last couple of years on how some R&D advisers are not helping clients to get R&D claims right. The Treasury are rightly concerned with any abuse and fraud that exists within the R&D claims industry. At Easy R&D, we believe the best claim is the one that is robust, but also correctly claims the relief your business is due for its innovation. Below, we will talk about some of the themes that can lead to an incorrect claim.

The self-assessment regime

R&D claims are made within the normal corporation tax self-assessment regime. This means when a company makes a claim, they make their own assessment of eligibility for relief and the amounts claimed.

HMRC has wide-ranging powers to open an 'enquiry': a formal check on a specific tax return.

HMRC do enquire into a number of tax returns every year and R&D claims are no different. HMRC even has a specific team that investigates these claims and they've recently added 100 inspectors.

As such, there is no such thing as a claim being completely immune from an HMRC check, but there are things you can do to mitigate the risk.

In the unlikely event of an enquiry, at Easy R&D, we have ex-HMRC Inspectors who will assist our customers with any enquiry, minimising any disruption or commercial impact.

Time Limits for HMRC Intervention

Parliament wants taxpayers to have certainty over their tax affairs within a reasonable amount of time. Therefore, HMRC's powers to check tax returns are restricted, generally with reference to the period of time elapsed since the submission of a return. Where a corporation tax return is submitted on time for a small or medium entity, HMRC must send a notice of enquiry within one year; but this deadline is extended where a return is late. This means that normally, after one year, HMRC cannot begin asking questions about a 'closed period'.

However, to prevent taxpayers using this to their advantage, there are rules that allow HMRC to assess underpaid tax up to 20 years after the event.

These rules are behaviour-based and allow HMRC to raise an assessment up to: four years for mistakes despite taking reasonable care:

six years for mistakes arising from careless behaviour or up to 20 years for deliberate errors.

'Deliberate' requires knowledge that the tax return was incorrect when submitted, whereas the difference between 'mistake' and 'careless' behaviours is a question of what is deemed reasonable in the scenario. HMRC generally expect a business owner to take and follow suitable advice but not to be completely blind to the relevant legal issues or one's better judgement.

These behaviour-based rules are also relevant for potential penalties. HMRC does not charge penalties for mistakes. However, 'careless' mistakes can attract a penalty up to 30% of tax underpaid and penalties for deliberate errors can be up to 100%, where there are no offshore issues.

HMRC's limit for normal enquiries on corporation tax returns is one year from the date of the return submission. However, if an error is made the investigation window can extend to up to 20 years

HMRC Strategy in an R&D check

Generally, HMRC check R&D claims on a logical basis. They begin with an examination of whether the projects for which a claim is submitted meet the requirements in the relevant legislation. Then they move on to assess the amount claimed. This question of how much is claimed must be supported by evidence; there are recent cases where R&D claims have been either reduced or completely wiped out because the tribunal was not satisfied there was sufficient evidence of the R&D spend.

Useful evidence in a check

Where HMRC do carry out a check, evidence to support costs claimed will be essential in defending a claim.

For example, we often see claims with a significant amount of staff costs. These costs will normally be based on time spent on a project by members of staff. However, in the absence of timesheets, proving the time spent on R&D activities can be a challenge.

Contemporaneous evidence detailing time investment in R&D will always be worth far more than statements made after the fact.

Best practice is to try and capture this level of detail at the time of carrying out activities. Where timesheets are not kept, records of board meetings discussing progress and activity on R&D or email exchanges discussing the time spent on project, can be used as supporting evidence.

Contemporaneous records of time invested in R&D will minimise the chance of an enquiry

What HMRC is checking now

Because we are plugged into the R&D community we understand what HMRC are focusing on in their enquiries:

Subcontractor & Subsidised Costs

This is a complex issue that HMRC on several occasions have litigated on. The key here is to understand who bears the ultimate cost of the R&D. Where you have any doubt whether your R&D project could fall foul of the subsidised costs rules, we strongly recommend taking suitable professional advice.

Claiming under the wrong scheme

The small and medium enterprise scheme (SME Scheme) is far more beneficial than the Research and Development Expenditure Credit, RDEC scheme. Sometimes companies fail to appreciate all the criteria for eligibility.

The main claimant company criteria are:

- Fewer than 500 staff
- And either turnover of €100m or less,
- Or net balance sheet assets of €86m or less

However, there are other rules that can prevent a company being eligible, including receiving grant income in relation to a specific project. Additionally, for companies which are partner or linked enterprises, there can be added complexity in working out exactly whether or not a company has breached these thresholds.

Excessive Staff Costs

HMRC will begin with a consideration of the activities taking place, and then determine whether the level of expenditure matches what they would expect to be taking place. It is important to ensure that any costs included in the claim are supported by evidence.

Useful evidence, for example if a company makes an historic claim, might be a statement explaining who did what within the company, and how often it took place. If HMRC were to question staff costs in the absence of clear documentary evidence such as a timesheet, they will likely probe the sorts of activity each

individual member of staff was doing; how they structured their days, weeks and months, and what other work they undertook. It is important to also consider how the 'normal' running of the company is sustained and whether that could be evidence that time on R&D could be lower than first estimated.

The introduction of the coronavirus support scheme and flexi-furlough created extra difficulties. Companies should not include any furlough payments in an R&D claim, even if they have 'topped-up' employees wages.

Lack of evidence

We have mentioned above the evidence that can be useful in establishing the level of staff costs to be included in a claim.

In a recent tax cases, the First Tier Tribunal did not admit an important witness statement because procedure was not correctly followed, and therefore the decision was that without establishing the expenditure, there could be no claim.

HMRC do provide limited assistance in their guidance at CIR80560 and CIR80570, which sets out records that may assist in demonstrating R&D activities and the quantum

of expenditure. However, often this can be a challenge where companies have not realised they could make an R&D claim until perhaps a year or more after the activities took place. So, it is always advisable to keep the best, cotemporaneous records possible to substantiate a claim.

Lack of explanations of R&D

HMRC does not generally employ technical specialists who are capable of understanding whether an advance – required for qualifying R&D – is actually being sought. This means that the better this is explained to HMRC, in laymen's terms, the greater chance of them accepting that qualifying R&D is taking place.

HMRC's continuing compliance agenda

Rishi Sunak is keen for businesses to access relief for R&D to incentivise innovation and drive growth in the UK economy.

However, the Treasury is also nervous about the levels of claims that are potentially fraudulent. HMRC as part of its remit to investigate claims and ensure compliance with the scheme, may check a number of claims. Those claims may turn out to be accepted, yet still there could be some level of disruption to the business having to answer probing questions from HMRC.

In April 2023, regulatory change is coming; we believe that this will not have a significant impact on respectable R&D advisers who are openly associated with an R&D tax relief claim.

In contrast, those advisers that act behind the scenes will, in the future, have to take responsibility for their advice with their details being disclosed on the tax return and with a claim.

We make claiming R&D tax credits easy. If you want to discuss how you can improve R&D record keeping or how to submit a better claim, please get in touch for a no-obligation discussion.

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