The view from the trenches

Dave Wase describes his experiences of dealing with HMRC's R&D Tax Credits Volume Compliance Team

With the UK tax gap estimated to be somewhere north of £34bn, inflation remaining high and the ongoing government deficit from spending exceeding income, there is plenty of pressure currently being applied by HM Treasury for HM Revenue and Customs to increase tax receipts.

In their 2023 annual report and accounts, HMRC's total tax revenues increased to £814bn, up on 2022's earlier record of £731bn collected. This is an impressive result especially on the back of a huge loss of experience in recent years. As covered in a previous article, this loss of experience has led to a new intake of officers. This new intake are invariably more intransigent and aggressive in their use of letters than previously was the norm. However they are usually not so keen to engage in face-to-face combat over a Microsoft Teams call or via an actual meeting.

With this constant pressure to increase the tax yield arising from enquiries, HMRC have looked across their 'patch' at new rich veins of yield to exploit. Additionally, HMRC have it seems become ever more creative in their interpretation and application of legislation and/or enquiry guidance available to them (or not, as the case may be).

R&D, the theatre of operations

In their drive for yield, HMRC have landed on R&D Tax Credits claims. No surprise really given the rise in R&D claims prepared by 'no win, no fee' engagements and HMRC's parlous lack of enquiry activity in the field over the past decade. HMRC have estimated that fraud and error within the SME scheme accounts for nearly a quarter of all claims.

R&D is to some extent subjective and also a highly complex area of taxation. To competently consider claims, the officers need a decent degree of technical training married to some commercial experience. HMRC previously recognised that and enquiries into claims from companies that sat within Individuals and Small Business Compliance (ISBC) were handled by inspectors based within Wealthy and Mid-Sized Business Compliance (WMBC).

However, in a novel departure HMRC have deployed a campaigns-and-projects approach to their enquiries into R&D claims via their newly formed R&D Tax Credits Compliance Team. In a further departure, this team is based within ISBC, not WMBC. Our experience in dealing with this new unit has established that the team is made up primarily of non-technical grade officers opening enquiries, taking decisions and closing enquiries but with the support of a team of higher grade trained officers.

We have been informed that this is a volume compliance team – namely, all cases are 'team worked' so that any enquiry related post is assigned to separate officers on receipt and no enquiry is the direct responsibility of any one officer.

What are the rules of engagement?

The following highlight how this HMRC team approach matters.

- No discussion please! No enquiry has a named officer and no officer will speak to you or your client in order to better understand the claim that has been made. HMRC have made it plain (in correspondence, of course) that their officers are not trained to take calls. Apparently, speaking with taxpayers is a skill few of the officers on the team possess and, according to one recent letter, "is a standalone competence" acquired through training.
- The rise of the keyboard expert. With no apparent or evident commercial experience, HMRC act as expert in whatever field of business your client might be operating within. They undertake a desktop approach to considering the veracity of the claim and whether it qualifies as genuine R&D. This is despite their own guidance at CIRD80525 telling HMRC officers not to put themselves forward as such experts.
- Don't engage in debate. As yet we have no experience of HMRC allowing a partial claim, which are either accepted 100% (rarely) or more often rejected 100%. HMRC do not share their internet research findings to evidence that a solution has been developed by a third party previously.
- Penalties, penalties, penalties. Before we can have any further debate, in writing of course, over HMRC's generally flawed conclusions to reject a claim, HMRC rush to issue penalty correspondence.
- Is it a closure notice? The officers generally issue a 'view of the matter' letter which purports to be a closure notice, but it isn't. The closure notice goes out some time afterwards and generally, once issued, the tax arising from the removal of the claim is transferred to HMRC DMB tax collection unit and becomes immediately payable. To save heartbreak further down the line, it is therefore important that the statutory appeals period of 30 days from date of closure notice is not ignored and your client's appeal is lodged forthwith.

- It's para 16 Jim… but not as we know it! Since the introduction of CTSA, HMRC have had the ability to correct obvious errors within returns filed by virtue of Para 16(1)(b) Sch18 FA 1998. HMRC are now using this to circumvent enquiries and simply remove the claim from the return. Clients can reinstate the correction and can then expect that an enquiry will follow. Per the legislation, this tool should be used in relation to obvious errors or omissions and anything else the officer has reason to believe is incorrect considering the information available. HMRC are directed in their guidance and not to exercise judgement in applying Para16 – the error should be obvious, for example arithmetic or a claim in the wrong box on the return. Deciding whether or not a claim for R&D is legitimate does obviously demand the exercise of judgement.

In some ways there is a degree of irony in that traditionally HMRC have focused resource in tackling the dubious work of volume tax agents; those that act on behalf of a multitude of clients and process large amounts of claims, with little or no basis in the legislation or rules applying. Now we have a volume enquiry approach from HMRC where the team concerned are opening large amounts of enquiries, worked by insufficiently trained officers who have a disregard for legislation and guidance laid down.

A war of attrition

Faced with this paper-based approach, we have little choice but to respond in kind and as readers are aware, letters take a great deal longer to put together than simply picking up the phone and speaking to an officer. That additional time diverts the client from their day-to-day business. By turn it also increases professional costs.

Clients often take the commercial decision to give up the fight and concede by withdrawing their legitimate but, usually, fairly modest claim.

This then does not prevent HMRC from seeking penalties to rub salt into the fresh wound. We have had some success in getting HMRC to drop the application of careless penalties but this has been mixed. Additionally, HMRC should consider suspension of any careless penalties; however, this too has been widely rejected by the officers concerned for largely ridiculous reasons.

Essentially, we have found that HMRC's default position is to charge a 15% careless penalty no matter what the circumstances. This is appalling behaviour from HMRC as the circumstances and behaviour leading to the R&D claim should not be considered careless and indeed there probably isn't a great deal wrong with the claim. It is just the quantum of the claim which led to the clients to take the commercial decision to withdraw it and not fight back. However, with the penalty at the bottom of the careless range (15%-30%) and generally a small figure in real terms, the clients usually will not want us to engage the further resource and their time in order to challenge it.

Where clients wish to fight on, or where the claim is considered too large simply to drop, then we have been raising a number of tier one and tier two complaints. Variously, the responses to our complaints shy away from addressing the true point – HMRC's wilful departure from their published guidance and the principles of the Charter.

We press on now to Alternative Dispute Resolution (ADR) and, if no further forward, then ultimately to the First-tier Tax Tribunal (FTT). At least at ADR we should actually get to speak with a human as, currently, HMRC do not hold these by correspondence. The problem is, however, cost and time. ADR takes around a day of time to prepare and attend, possibly more. It also similarly ties up the client for at least a day. Time commitment and actual financial cost is therefore quite high, even though it is some way short of the costs associated with a FTT.

Wider impact for the UK

The UK government are at pains to emphasise their 10-year aim to make the UK a world-leading science and innovation hub. Having certainty over the availability of R&D tax reliefs and a company's tax position going forwards greatly assists businesses in deciding when and where to invest resources both in terms of people, assets and finance. We have found that clients with a footprint across multiple countries are currently considering their continued R&D investment operations within the UK, looking instead to mainland Europe and the USA, where the position is more certain and in some ways more generous.

Forays into no man's land

Naturally, this current situation cannot continue. With their departure from the Charter principles and their own published guidance, HMRC must be drowning in a sea of complaints. Cases must be heading toward the FTT, based on ill-conceived HMRC conclusions. HMRC must in some ways be desperate for these cases not to land in front of a tribunal judge as some of the letters are frankly appalling – we even have one that states that HMRC are unaware of, and cannot find, CIRD80525, their own guidance (it is their practice note for R&D units detailing their approach to handling claims).

Likely following the intervention of a local MP, we managed to speak with the person currently heading up the ISBC volume compliance team. While there was a degree of sympathy shown in relation to the collateral damage the team were creating, there was a steadfast reliance on stats generated from this exercise which we suggested were in essence nonsense, in view of the fact that genuine claims were being rejected and clients forced to give up based on costs of defending, not the validity of claim.

Some of the decisions by HMRC to deny R&D relief that we have seen are ludicrous, including university spin-out companies based on an R&D park, a project sold to NASA and employed successfully, and a project that won the Queens Award for Innovation. Of course, none of these should constitute a free pass to relievable R&D, but we are talking large sums of monies in expenditure on these projects, extremely competent professionals and, in one case, actually it is 'rocket science'. And to all, HMRC steadfastly concluding in very short shrift that no (0%) R&D exists within the claim.

Jaw-jaw not war-war

Somehow, from all of this there needs to be a period where HMRC agree to come out of their trenches and talk. Otherwise, where clients do not want to simply give up or where the claim is sufficiently large to merit pressing onwards, we will all end up in one place – the FTT in front of a tribunal judge.

Once at the FTT then cases such as this will likely be designated complex, therefore presenting the opportunity to elect for costs. This will leave HMRC potentially liable to pay the appellant's costs if HMRC fail to defend their position.

A war without end?

The concern is that the use of this volume compliance team approach could spread to targeted widespread enquiries into other reliefs or other business sectors. Across the profession and wider, especially with Parliament and the professional bodies, this is gaining a lot of attention. Our hope is that HMRC listen and react positively to the recommendations being put forward.

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