

Why HMRC must sharpen focus on R&D reliefs

Paul Rosser asks: are HMRC reducing the rate of fraudulent R&D claims?

HMRC has estimated that the rate of error and fraud within the R&D tax relief schemes has roughly halved due to the impact of recent compliance interventions, but are these interventions enough, and why weren't they introduced earlier? As I mentioned in my previous article which gave a brief history of R&D advisor scams (HMRC EIP, June/July 2024), R&D claims have always been prone to error and fraud due to claims being processed on a self-assessment basis, with little checking being undertaken by HMRC as to the accuracy of the claims. Errors were missed which led to them being repeated and after a while it became clear that the schemes could easily be taken advantage of which, over the years, has turned into a pretty lucrative business model for many R&D advisors. No one knows exactly when this trend started but it is likely rooted in the actions of a decade ago when HMRC began a range of cost saving measures, including shutting down the seven specialist R&D units, reducing their head count and adopting "an operational policy that R&D claims below a certain size would not be subject to any careful scrutiny."

Damaging marketing

This was followed a few years later by severely damaging marketing released by the R&D Advisory company Catax, claiming that HMRC owed UK SMEs £84 billion, which was untrue but really fuelled the 'cash-cow' mentality around the R&D schemes. With so much seemingly unclaimed and a system almost guaranteed to pay out with no questions asked, is it any wonder that abuse of the schemes snowballed? Until August 2023, all that was needed to submit an R&D claim was a figure in the company's Corporation Tax return. Even though prior to this most advisors would include some supporting project evidence, advisors taking advantage of the schemes knew how to fabricate something that sounded plausible, even if it was untrue.

Error and fraud has been calculated to have cost the country over £2 billion in a two-year period (2020/2021 and 2021/2022), which are the first relatively accurate estimates that we have. A large portion of this (and whatever the figures for previous years add up to) will have lined the pockets of R&D advisors who knew that the claims they were submitting were invalid.

As of 8 August 2023, it is now mandatory to submit supporting evidence with every R&D claim and this is an example of one of HMRC's recent compliance interventions. Others include using its powers under paragraph 16 of the Finance Act 1998, schedule 18, to simply remove R&D claims from a company's tax return where they believe it to be ineligible (meaning a time-consuming compliance check is not

necessary), and additional staff combined with a new approach to checking claims so that HMRC can open more compliance checks in an effort to stop ineligible claims from being paid out. There is also clawback of some of the funds that have been released in recent years.

These clawbacks are having a devastating effect on companies who were told by advisors that their claims were valid and, in many cases, that they had been checked and approved by HMRC, so there was no chance of HMRC querying their claim in the future.

Protecting companies

So could HMRC have done more to protect these companies (and the public purse)? HMRC has been very vocal about its recent compliance interventions and its projections as to the positive impact they've had on tackling error and fraud, but I'm not convinced it's doing enough to tackle the fraud. Error is the simpler problem of the two, and HMRC are focused on educating the wider public on what does/doesn't qualify, whilst also checking more claims to catch errors earlier. The system they have for doing this is flawed but that's an issue for another article.

In terms of fraud, HMRC seem to be doing very little. Fraud isn't often committed by the claiming company (and HMRC do seem to be on top of this type of fraud when it is done at a very high level), but rather by their advisor, who will be urging hundreds of companies to unknowingly submit invalid claims.

Those at HMRC would have to have been blind not to see what was happening, especially as many honest R&D advisors would tell them when they came across new evidence. But aside from some limited information released about arrests in 2022, HMRC has been slow to respond to the very real issue of some R&D advisors submitting vast amounts of invalid/fraudulent R&D claims.

That's not to say HMRC aren't responding at all, but it only appears to have one trick in its arsenal and that trick doesn't work very well.

When HMRC suspects a particular advisor is submitting a large quantity of fraudulent R&D claims it will increase the amount of compliance checks into claims compiled by that advisor significantly. While this would severely impact the advisor's cashflow, it this can go one of three ways, with none of them adequately addressing the issue.

Firstly, the advisor can close down the company and start a new one, with HMRC being unaware of the connection.

One advisory firm it's suspected HMRC targeted in such a way liquidated in 2021, and based on its statement of affairs there was nearly a £1.3 million creditor deficit – with over £250k owed to HMRC itself in unpaid VAT and PAYE.

While it's reported that the firm did have Work In Progress (WIP) of £160,931, in the latest liquidator's statement it was noted that "following a review of the fee submissions, there was a distinct possibility of clawbacks being applied" and the

revised figure of £33,333 was sold to another company, which was set up by the owners of the one being liquidated.

This new company, which also offered R&D services, has recently liquidated – this time owing HMRC nearly £700k in unpaid VAT and PAYE, and yet another new company has already been set up by the same people, again offering R&D tax relief advisory services.

Secondly, those behind the advisory company can use various methods to disguise their involvement in the claims; for example, establishing a network of companies so if one seems to have been noticed by HMRC, they can start submitting through another in the network. Or they are using a log-in to their client's tax portal to submit claims (rather than their own agent code), which is not allowed but HMRC can't stop what they don't know is happening.

Thirdly, the advisor can liquidate the company and leave the R&D space all together. Companies such as these can retire with their ill-gotten gains or may be on the lookout for the next inadequately policed tax scheme, with Stamp Duty Land Tax (SDLT) seeming of particular interest currently.

Earlier this year we saw one of the biggest players in the R&D advisory space, RDI Solutions, suddenly liquidate. It subsequently emerged that millions of pounds generated via the submission of invalid/fraudulent R&D and SDLT claims appear to have been syphoned offshore.

In the liquidation statement of affairs for RDI Solutions Limited from 10 May 2024, preferential creditors are listed as HMRC with £160,000 in VAT and £185,000 in PAYE owing.

Unsecured creditors include £1.2million for HMRC in relation to Corporation Tax, £1,995,508 in other trade creditors, and £115,794 owed to employees.

Meaning that, at the time of their liquidation, RDI Solutions Limited owed an eye-watering £3,656,302 to their secured and unsecured creditors, with just £64,949 listed as an estimate of assets which might be realised.

What is most interesting though is that a loan of £4,904,432 made to another company (with the same owner) is shown in their March 2022 accounts but had vanished by the time their March 2023 accounts were submitted, after they entered liquidation.

Where this money went at present is uncertain, but as it would more than cover their creditors hopefully the IP dealing with the liquidation will be able to realise it.

What's the alternative?

I've written many posts, blogs and articles on this issue and it comes down to a hope that HMRC are doing something in the background of which we are unaware.

Current measures to tackle this type of fraud seem too slow and ineffective – something needs to happen to ensure those behind it are stopped, punished and not allowed to move onto the next scam, which would serve as a deterrent to others looking to take advantage of the R&D, or other, tax schemes in this way.

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