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# HMRC R&D Fraud Arrests: A New Era for Tax Enforcement?

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- On 30 October 2024, the Government published its highly anticipated Autumn Budget 2024 (the "Budget"). Among measures promised to "fix the foundations of the economy" is the Government's commitment to implement "the most ambitious ever package to close the tax gap," including by "taking stronger action on the most egregious tax fraud" and "enhancing HMRC's powers and sanctions against tax adviser facilitated non-compliance."[1]
- The Government's declaration of increased scrutiny of the UK's tax system (and of tax advisors in particular) is consistent with the recent rise in enforcement activity by HMRC against suspected perpetrators of fraud in connection with R&D tax relief, which is intended to allow companies carrying out qualifying R&D to claim tax relief for certain qualifying expenditure.
- Attention on the R&D tax relief scheme has been building momentum over recent years. In its latest published annual accounts, HMRC indicates that over £4bn of its total expenditure on R&D tax relief scheme since 2020/21 was paid out as a result of fraud and error by the taxpayer.
- In September 2024, several arrests were made following raids by HMRC on R&D tax consultancy firms. The arrests came just one day after the Chancellor first announced plans to recruit 5,000 additional compliance staff to help curb abuse of the UK's tax system.
- This enforcement action underscores HMRC's focus on addressing misuse of the R&D tax relief scheme. It also suggests renewed vitality within HMRC to investigate and enforce tax non-compliance more broadly, which taxpayers should prepare for following the Government's commitment to closing the tax gap.

## What is the R&D tax relief scheme?

Research and Development (R&D) tax credits were first introduced for small and medium business enterprises in 2000 to encourage scientific and technological innovation within the United Kingdom. Since its inception, the incentive has undergone several legislative changes. Most recently, however, the implementation of the Finance Act 2024 introduced a consolidated scheme allowing for relief in respect of qualifying revenue expenditure upon R&D in accounting periods commencing on or after 1 April 2024.

[1] https://assets.publishing.service.gov.uk/media/672232d010b0d582ee8c4905/Autumn_Budget_2024__web_accessible_.pdf

Broadly, the scheme allows eligible companies[2] to claim tax relief in respect of expenditure on qualifying R&D.

For tax purposes, R&D is defined by HMRC as taking place when a project seeks to achieve an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technological uncertainty.[3] Such uncertainty exists "when knowledge of whether something is scientifically possible or technologically feasible, or how to achieve it in practice, is not readily available or deducible by a competent professional working in the field."[4]

This definition goes beyond common industry uses of the term, such as in accounting or engineering, and requires that the work conducted extends the overall knowledge or capability in the field of science or technology as opposed to the company's own state of knowledge or capability.[5] The project does not need to succeed in advancing overall knowledge or capability in order to qualify for R&D relief.[6]

The taxpayer bears the burden of proving that qualifying R&D has taken place for the purpose of relief and must evidence that the requirements stipulated in HMRC's R&D Guidelines have been satisfied. For example, the requirement for a project to address a scientific or technological uncertainty imports a burden on a claimant for relief to provide evidence from a "competent professional" in support of the relevant contention. In *Flame Tree Publishing Limited v HMRC* [2024] UKFTT 349 (TC), it was held that the claimant company had failed to satisfy this evidential burden, as the "competent professionals" put forward by the claimant were deemed to have insufficient expertise to assess whether the technological problem purportedly addressed by the claimant's R&D project was in fact an "uncertainty", as defined by HMRC's R&D Guidelines.

## Why is HMRC taking action?

In recent years, the value of claims for R&D relief has steadily increased. In the tax year 2022-2023, the total relief claimed is estimated by HMRC to be £7.5 billion.[7]

The issue of fraudulent abuse of the scheme first appeared meaningfully on HMRC's radar in 2021, when a comprehensive analysis of claims paid out under the R&D relief scheme concluded that 17.6% of the total R&D tax relief expenditure was incurred as a result of error or fraud.[8] This high figure is in contrast to an estimated total loss of approximately 4.8% of tax liabilities due across the tax system as a whole.[9]

During parliamentary consultations in 2022, it was suggested that the scheme is susceptible to misuse because of a historic lack of scrutiny within HMRC in reviewing applications for relief. This inattentiveness coincided with a boom in the number of specialist R&D tax advisors marketing their ability to achieve

[2] Charities, higher education institutions, scientific research associations, health service bodies, such as NHS trusts, and any other body prescribed, or of a description prescribed, by Treasury order, are ineligible companies pursuant to Section 1142(1), Corporation Tax Act 2009.
[3] *HMRC: Corporate Intangibles Research and Development (CIRD) Manual: CIRD81910*, [3-4]
[4] *HMRC: Corporate Intangibles Research and Development (CIRD) Manual: CIRD81910*, [13]
[5] *HMRC: Corporate Intangibles Research and Development (CIRD) Manual: CIRD81910*, [6]
[6] *HMRC: Corporate Intangibles Research and Development (CIRD) Manual: CIRD81910*, [38]
[7] https://www.gov.uk/government/statistics/corporate-tax-research-and-development-tax-credit/research-and-development-tax-credits-statistics-september-2024
[8] https://assets.publishing.service.gov.uk/media/66a8ebc349b9c0597fdb0784/HMRC_annual_report_and_accounts_2023_to_2024.pdf
[9] https://www.gov.uk/government/statistics/measuring-tax-gaps/1-tax-gaps-summary

success on behalf of clients who seek to claim R&D relief, with some reportedly describing the scheme as akin to "free money from HMRC."[10]

Giving evidence to the Treasury Select Committee in October 2023, HMRC Chief Executive Jim Harra placed the blame on tax advisors as responsible for the disproportionate rate of non-compliance:

> [R&D] is a very generous tax relief. It is intended to be generous, and it has become more generous over the years because it is intended to incentivise R&D. That then makes it a honeypot, I am afraid, for people for whom it is not intended, and an industry has grown up around tax advisers helping people to make claims that are not compliant. It is partly, I think, the attractiveness of the scheme that attracts those people.

It seems that HMRC is now intent on ramping up enforcement against suspected bad actors in the R&D tax advisory sector. In September 2024, it was reported that 11 arrests had been made in connection with an investigation into R&D tax fraud following raids on several businesses, including Green Jellyfish, a tax consultancy specialising in R&D tax relief. An investigation by *The Times* newspaper into the consultancy raised the question as to whether the majority of Green Jellyfish's clients were operating in industries which, on their face, seem unlikely to qualify for the R&D relief scheme, such as a horse-stud business and a butcher. A spokesperson from HMRC stated that increased action against "dishonest tax agents who encourage or facilitate customers making false claims for expenses, rebates or tax credits" should be expected.[11]

In the past year, HMRC has implemented several changes to the R&D tax relief scheme, including requiring that all R&D relief claims are submitted digitally and are endorsed by a named officer of the company. HMRC requires that details of any agent connected to relief claims are disclosed and has terminated the practice of making payments of R&D relief to agents. In the Budget, the Government announced plans to "publish a consultation in early 2025 on options to enhance HMRC's powers and sanctions to take swifter and stronger action against tax advisers who facilitate non-compliance." The Budget also revealed that the Government is considering options "to strengthen the regulatory framework of the tax advice market."

This significant tightening of the rules has been accompanied by an increase in HMRC inspection activity. Since August 2023, the number of compliance checks for R&D tax relief claims carried out by HMRC has increased to over 20% of claims, compared with around 1% previously.[12]

While tax advisors would seem to be the current focus of HMRC, it may not be long until taxpayers, are pursued in respect of non-compliant claims made on advice of an agent. A tax return is the responsibility of the taxpayer and, as demonstrated in a recent judgment of the First-Tier Tribunal Tax Chamber, reliance on an "unchecked assumption" by a company that it is being "appropriately advised" may be argued to fall short of the standard incumbent on taxpayers to take reasonable care in submitting claims to HMRC.[13]

[10] https://committees.parliament.uk/oralevidence/11556/html/
[11] https://www.thetimes.com/business-money/technology/article/green-jellyfish-consultancy-accused-of-fraud-in-r-and-d-tax-credits-scheme-nvtv9wfdl
[12] https://committees.parliament.uk/publications/43549/documents/216398/default/
[13] David Hill & Anor v The Commissioners for HMRC [2024] UKFTT 844 (TC)

Statistics published by HMRC show that businesses operating in professional, scientific and technical areas are the least compliant when making R&D relief claims. This finding may provide a strong indication of the direction that HMRC intends to take.

## Future of HMRC enforcement more broadly

The new Government has promised significant reforms to the UK's tax system to help "fix the foundations for the UK economy," including by investing "£1.4 billion over the next five years to recruit an additional 5,000 HMRC compliance staff" to help close the tax gap.[14] Inevitably, these additional resources will result in increased investigative and enforcement activity by HMRC across the UK tax system as a whole in the coming months and years.

HMRC's criminal investigation guidance states its policy of reserving criminal enforcement for cases where HMRC needs to "send a strong deterrent message" to taxpayers in response to abuse of the UK's tax system.[15] The recent activity in the area of R&D relief claims, when set against the scale of the potential loss to the UK in terms of revenue, may be seen to be designed to pursue and enforce this policy.

One other possible area of enforcement focus may finally be the "failure to prevent the facilitation of tax evasion" offences, which were introduced in 2017 by the enactment of the Criminal Finances Act 2017 (the "CFA"). Under the CFA, companies and partnerships can be held criminally liable when an associated individual is found to have committed either a UK tax evasion facilitation offence (pursuant to section 45 of the CFA) or a foreign tax evasion facilitation offence (pursuant to section 46 of the CFA) (the "Corporate Criminal Offences").

The fact that no prosecutions have been brought to date in respect of the Corporate Criminal Offences has attracted increased criticism in recent months. The failure to prosecute under the CFA may be because the purpose of its enactment was to compel cultural and behavioural changes within businesses to encourage the implementation of procedures to prevent the facilitation of tax evasion. However, in light of the new Government's purported increased attention on tax fraud, it seems likely that any "grace period" for compliance is now over. As of 30 June 2024, HMRC was conducting 11 investigations into the Corporate Criminal Offences and had a further 28 possible investigations under review.[16] It is possible that the first prosecution under the CFA is imminent.

## Conclusion

Businesses ought to pay close attention to HMRC's recent enforcement action concerning suspected R&D fraud. With the new Government promising to prioritise tax compliance, companies should be prepared for increased HMRC investigation and enforcement activity, and would be well advised to take proactive steps to assess and strengthen compliance measures to mitigate potential risks to safeguard against future liabilities.

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[14] https://assets.publishing.service.gov.uk/media/672232d010b0d582ee8c4905/Autumn_Budget_2024__web_accessible_.pdf
[15] https://www.gov.uk/government/publications/criminal-investigation/hmrc-criminal-investigation-policy
[16] https://www.gov.uk/government/publications/number-of-live-corporate-criminal-offences-investigations/number-of-live-corporate-criminal-offences-investigations

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