

Investigation into the Role of Research and Development Tax Credit Boutique firms in the UK.

1. Introduction

1.1 Research Background

The R&D tax credit scheme was introduced by the government to encourage scientific and technological innovation within the United Kingdom (hmrc.gov.uk). During the Finance Act 2013, The Research and Development Expenditure Credit (RDEC) scheme was brought in to benefit loss making companies through a cash back scheme or a reduction of tax or other duties due. (hmrc.gov.uk)

The UK SME **R&D** relief is developed to enable Small and Medium Scale Companies to invest in research activities. Companies can deduct an extra 130% of their qualifying costs from their yearly profit in addition to their normal 100% deduction. The surrenderable loss is the lower of the trading loss after the additional deduction and the enhanced expenditure (Qualifying costs plus the additional deduction which is 230% of the qualifying costs). A **surrenderable loss** allows **loss**-making companies to claim an immediate cash payment or to carry the credit over to a future year of profit.

1.2 Research Rationale

Boutique R&D tax credit firms have multiplied in the UK in recent years. These small finance companies do not reveal their identity much. There is only unreliable (anecdotal) evidences to prove their impact and worth. Many of these companies were exchanged to foreign buyers at a substantial price.

Boutique R&D tax credit firms have multiplied in the UK and claim glory for having helped many firms to claim their R&D tax credit. They claim to have made good relationship with HMRC. The anecdotal nature of their success stories create doubts about their true success. They also price their businesses at exorbitant level on unclarified claims and success stories. Even big firms in the UK caved into their unfounded or unproved stories. Recently, Research and Development Tax Credit Boutique firms are scrutinised by the Government and Financial Conduct Authority. The public also is curious to know more about their activities and reliability of their operations.

1.3 Research Aim- The research aim is to investigate into the role of Research & Development Tax Credit Boutique firms in the UK in providing additional fund for growing and improving SMEs.

The ultimate goal of this project is to increase our knowledge about boutique firms in relation to their functions of providing tax credit services to SMEs in the UK. In order to achieve the ultimate goal this proposal will emphasise on the ensuing objectives.

1.3.1 Research Objectives:

- a. To increase public knowledge about the role of R&D Tax Credit Boutique firms in the UK.
- b. To inform the UK Government about the significance of Boutique firms and the reasons behind the huge offers made by overseas buyers and large financial firms for such boutique firms.
- e. To provide recommendations for the improvement in Corporate Governance & Social responsibilities of R&D Tax Credit Boutique firms in the UK.

1.3.2 Research Questions:

- I. What is the role played by R&D Tax Credit Boutique firms in the financial sector of the UK?
- II. How much is the average amount of R&D Tax Credits obtained by UKs Small and Medium Scale Enterprises through such financial Boutique firms since 2015?
- III. Why overseas buyers and very large financial firms in the UK show huge interest and pay very high price for buying the ownership of Boutique firms?
- IV. Are the R&D Tax Credit Boutique firms in the UK being advised by UK Corporate Governance Code and controlled by Financial Conduct Authority?

2. Literature Review and Rationale

The main purpose of this tax credit to SMEs is to make available enough fund for innovation and product development. R&D tax credit is an incentive to reward companies engaged in innovation (Invennt.com).

Tax credit is a way of claiming back money from HMRC. Tax credit can either reduce the tax bills of the company or can increase your taxable losses. Only a UK registered company which is applying the HMRC tax rules can apply for R&D tax credit in the UK. The company should have R&D activities and the expenses must have been paid by the company.

2.1 Role of Boutique firms in the UK

Boutique consulting firms are providing financial advices to people as well as corporations. The word boutique is used for small shop or a business. In our financial context the term is used to represent consulting firms. They are specialized in a specific niche and don't offer general consulting to their clients(trafft.com). Boutique consulting firms with their senior staff offer exceptional expertise to their clients(trafft.com).

Hundreds of companies in the UK are providing R&D tax credit services. There are three types of R&D special service boutiques

in the UK. They are Specialists, Accountants and Simplified Services specialists. Specialists use their expertise only for generating income from R&D Tax Credit claims. Accountants provide the service as a package or bundle of services. They charge a fixed % of the amount received as tax credit for their clients. Simplified Service specialists are firms which facilitate claiming tax credits.

The R&D Tax Credit regime has been around since April 2000 but in the intervening 17 years the conditions and levels of tax relief have been altered many times(Jollieffecork.co.uk).

According to Andrea Rodney, Managing Director of Hone- All Precision Ltd, trading as GovGrant, this government scheme is designed to boost innovation. SMEs get back 33% of the amount they spent on qualifying Research and Development. Research and Development Expenditure Credit(RDEC) is given only to qualifying companies.

Boutique tax businesses exploit the provisions of the government to provide tax credit given for genuine scientific development or innovation(R&D4U). UK Government acknowledges the misuse of R & D Tax credit provisions by small companies with the help of boutiques. However, HMRC do not have the resource to stop such claims as the boutique companies submit technical details of R&D activities. Boutiques

firms are also facing heavy fines and penalties for wrongful claims. HMRC has declared restrictions from 1st April, 2021(Johnson).

2.2 Average amount of Research and Development Tax credit obtained through Boutique Companies in the UK since 2015.

In November 2015, HMRC introduced Advance Assurance for companies that claim R&D tax relief in November 2015. For the first three accounting periods of claiming for R&D tax relief, HMRC will allow the claim without further enquiries (Gov.UK). Total tax credit claim by SMEs were about £ 5.7 billion pounds during the same year.

Many Boutique companies are members of HMRC's R&D Consultative Committee. They charge different fees from the customers. The fees for boutique companies range from £3,000 for a claim to 5% of the total claim. Many new financial boutique firms kick started in London since 2010, where big financial organisations struggled to exist due to the financial crisis. In the year 2010, around 35 small financial firms were established. Since then similar number of financial firms were established and many of them specialised in R&D Tax credits (financial careers, UK).mpa R&D Tax credit is offering and average amount of £63,000 and most of the firms are offering 33% of the investment

in R&D as tax credit. Most of the boutique firms are offering to get the tax credit or cash back within a period of four weeks. Overseas and Local large financial firms absorb Boutique Tax Credit Firms in the UK.

“Being able to advise clients from the SME market up to large businesses on R&D reliefs, really sets us apart from our competitors” (Frank Buffone).

The above statement was made by the founder partner of EY, one of the biggest four Accounting firms after purchasing Breakthrough Funding Ltd, a Boutique R&D firm. The reasons behind big firms buying such Boutique firms are cultural fit and customer first philosophy. Small firms also get a chance to expand its business by using the resources of the big firms. Many foreign investors also invest money in the home grown Boutique R&D financial firms due to the three reasons mentioned above.

2.3 Unprofessional behaviour by Boutique firms

Boutique firms claim to translate ideas and innovation into the language of HMRC. (Tragner, J. 2020). Most of these firms use the word ‘processed’ instead of the word ‘approved’ which is of great importance. Until now the HMRC rules are weak though penalty can be charged for wrong submissions (Low Income Tax Reform Group, 2017).

2.4 R&D Boutique firms and FCA

According to FCA guidelines, an Incorporated company should be controlling the spending for research (fca.org.uk). The guidelines from FCA also stipulates that firms advising companies for R& D tax credit must not receive undue inducements, other than their stipulated fees.

2.5 Preventing abuse of the R&D tax relief for SMEs:

The UK Government aims at spending 2.5% of the GDP on Research and Development research by the companies. Though the scheme was working very well, some fraudulent activities were also detected by HMRC. It has identified false claim of £300 million in the name of SMEs. Some companies were set up only for claiming R&D cash credit, there were no noticeable business activities or employment.

In 2018, the government brought changes in its budgets and now the amount of tax credit a qualifying business can claim is limited to three times of its combined PAYE & NICs liabilities for that year. The implementation date is from April 2020 (HM Treasury,2019).

The UK government consulted SMEs for identifying steps to be taken not to disadvantage genuine organisations doing R&D with

limited number of employees. HMRC and the government are aware of the need for regulating R&D Boutiques. The UK government introduced R&D tax credit to promote research for new products or for improvement of existing product or services. Most of the boutique R&D are helping the country wide project of encouraging science, technology and services. However, some firms, even without actual R&D or by not employing people are claiming R&D tax credit through Boutique firms in the UK. Wider research is needed for understanding the way of functioning, intentions, remunerations and their impact on UKs R&D projects and innovation supports.

3. Methodology

The research aim is to investigate into the role of Research & Development Tax Credit Boutique firms in the UK in providing additional fund for growing and improving SMEs. R&D Tax Credit Boutique firms make big claims about the utility of their services in increasing the investment by SMEs in improving their process or product. Such firms also invite attention from big audit and financial firms. Moreover, the ownership of Boutique firms is changed frequently and foreign buyers pay huge prices for these established, but small specialists.

Data related to the extent of the services of Boutique firms, utilised by registered companies, in the UK and the amount of

tax credit received by SME's as R&D Tax credit, for the last 5 years, in the UK will have to be gathered. The reasons behind the huge investment made by foreign financiers and individual investors in R&D Tax credit firms are to be examined. The success or otherwise of the FCA regulations and compliance procedures for Boutique Financial firms in the firm of R&D tax credit and the use of clone firms must be studied.

The ultimate goal of this project is to increase our knowledge about boutique firms in relation to their functions of providing tax credit services to SMEs in the UK.

3.1 Research Philosophy- Positivism, Interpretivism

The researcher will be using both Positivism and Interpretivism for this study as necessary data will be gathered from existing Boutique firms doing R&D Tax returns and will be analysed and interpreted. However, data will be collected from published sources too.

3.2 Research Approach- Inductive Approach & Deductive approach

For the purpose of this research, inductive approach is important as the assimilation of data from different sources can give wider

picture of the amount and extent of the role played by Boutique firms' in the UK.

3.3 Research Design- Explanatory, descriptive, experimental

There is less scope for Experimental research for studying about the role played by Boutique R&D Tax Credit firms in the UK. The research design is the blue print for the research. It is a logical plan for carrying out the research. Explanatory and descriptive research design will be adopted for this research.

3.4 Research method- primary – Secondary

Surveys, questionnaires, interviews, case studies and Delphi method are the methods that will be used for carrying out this research. Primary data will be gathered by interviewing Boutique R&D firms. Secondary data will be gathered from different published documents, including HMRC.

3.5 Data collection method- Qualitative, Quantitative.

For the purpose of this research, both qualitative and quantitative data will be used. The researcher will interview ten to fifteen R&D Tax credit firm managers. Semi structured interviews will be used for gathering primary information. Existing online texts,

published materials in Financial Times, FCA websites, HMRC Websites, Fame & Bloomberg will be used for gathering secondary data.

3.6 Data Analysis-

Quantitative data gathered will be prepared and analysed. Outlier labelling rule will be used for finding out the missing data. All values outside the calculated range were considered outliers (Hoaglin & Iglewicz, 1987). Similarly, statistical methods as well as SPSS and Stata will be used for analysing numerical data.

Thematical analysis and Narrative analysis will be used for interpreting the meaning of qualitative data. The interviews and qualitative information gathered from secondary sources will be transcribed and open coded to categorise key themes and to identify patterns.

3.7 Ethical Consideration

According to Bryman and Bwell (2007), ten points represent the most important principles related to ethical considerations. This research work will strictly follow all ten ethical points:

1. No harm to the research participants.
2. Respect for the dignity of the research participants.

3. Full consent from the participant, before the study.
4. Protection of privacy of the participants will be ensured.
5. Confidentiality of the research data will be ensured.
6. Anonymity of individuals and organisations will be maintained.
7. Aims and Objectives of the research will be clearly mentioned to the participants.
8. Will declare conflict of Interest like affiliations and sources of funding.
9. Honesty and transparency in communication in all matters related to the research will be followed.
10. No misrepresentation, misleading information and bias will be used or applied for collecting primary data.

3.8 Limitations of the approach.

Wide range of misleading and inaccurate information are published and included in the websites of Boutique firms. Most of the firms claim that they have 100% success rate.

They also tend to mislead customers by stating that their procedures are full in compliance with that of HMRC.

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