



TC06272

Appeal number: TC/2017/05281

Claim for R & D costs - Application for Closure Notice – Schedule 36 Notice outstanding – enquiry started 2010 and still ongoing – Appellant has provided all information it can – Application granted

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

HADEE ENGINEERING CO LTD

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE & CUSTOMS**

Respondents

**TRIBUNAL: JUDGE ALASTAIR J RANKIN
MRS RAYNA DEAN**

Sitting in public at Court 12, Leeds Magistrates' Court and Family Hearing Centre, Westgate, Leeds, LS1 3BY on Thursday 30 November 2017 at 10:00 AM

Mr Gary Brothers of Independent Tax for the Appellant

Ms Sophie Rhind, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an application by Hadee Engineering Co Ltd (the Company) for a closure
5 notice to be issued by HMRC in respect of their enquiries into a claim for a refund in
respect of qualifying expenditure for research and development (R & D) of
£182,377.00 for 2009 and 121,317.00 for 2010. These figures if allowed would result
in tax repayable of £51,065.00 for 2009 and £33,969.00 for 2010.

Background

10 2. On 7 May 2010 HMRC issued an opening letter to Mr Lowe, the Company's
director, under HMRC's Code of Practice 9 "Civil Investigation into cases of
Suspected Serious Fraud" (COP9). There were existing enquiries into the year ending
30 April 2008 for a number of Mr Lowe's companies. An opening meeting was held
on 15 June 2010.

15 3. In April 2011 Mr Lowe submitted amended returns claiming R & D tax credit for
the years ending 30 April 2009 and 2010 on behalf of the Company. On 6 February
2012 HMRC opened an enquiry under Paragraph 24 of Schedule 18 of the Finance
Act 1998 into the two amended returns. A number of queries were raised in relation to
the claim and at the request of the Company HMRC wrote to MSC Business
20 Innovation (Development) Ltd (MSC) requesting some information. MSC replied
stating that all the documents were in the Company's possession.

4. In support of the claim for R & D tax credits the Company made a number of
submissions in relation to specific projects. However HMRC felt these submissions
did not provide sufficient information to show that each project included in the claim
25 met the criteria for R & D. HMRC met with Mr Lowe in May 2013. This was
followed by a letter from HMRC to the Company's agent, Mr Gary Brothers, dated 29
May 2013 which covered several areas of HMRC's enquiries and included twelve
points in relation to R & D.

5. In order to qualify for a refund in respect of R & D the R & D must fall within the
30 definition of R & D for tax purposes pursuant to section 1138 of the Corporation Tax
Act 2010 which states:

(1) This section has effect for the purposes of the provisions of the Corporation
Tax Acts which apply this section.

35 (2) "Research and development" means activities that fall to be treated as
research and development in accordance with generally accepted accounting
practice.

This is subject to subsections (3) and (4).

40 (3) Activities that are "research and development" for the purposes of section
1006 of ITA 2007 as a result of regulations under that section are "research and
development" for the purposes of this section.

(4) Activities that are not “research and development” for the purposes of section 1006 of ITA 2007 as a result of regulations under that section are not “research and development” for the purposes of this section.

5 (5) Unless otherwise expressly provided, “research and development” does not include oil and gas exploration and appraisal.

6. In order to support its claim the Company must clearly identify the particular advance in science or technology that its R & D project is seeking to achieve. It must directly contribute to seeking an advance in science or technology. Regulations
10 prescribe activities that fall within the definition of R & D by reference to Guidelines issued by the Secretary of State for Trade and Industry.

7. The Guidelines provide for general exclusions including the production and distribution of goods and services. Staff and consumables associated with the production activities will not be eligible for tax relief.

15 8. The Company must produce evidence in support of its claim and in particular evidence to demonstrate that it undertook R & D activities in accordance with the relevant legislation and regulations.

Evidence

20 9. Mr Mark Reilly, a Grade 7 Officer in the Fraud Investigation Service of HMRC was called as a witness by HMRC. His witness statement dated 24 August 2017 was accepted as his evidence. He was not cross-examined.

The Company’s arguments

10. Paragraph 33 of Schedule 18 of the Finance Act 1998 states:

25 (1) The company may apply to the [Tribunal] for a direction that [an officer of Revenue and Customs] give a closure notice within a specified period.

(2) Any such application shall be heard and determined in the same way as an appeal.

30 (3) The [Tribunal] hearing the application shall give a direction unless they are satisfied that the Inland Revenue have reasonable grounds for not giving a closure notice within a specified period.

11. Mr Brothers stated that the Company had two grounds upon which to seek a closure notice. First the enquiry has been unreasonably and unnecessarily prolonged and required closure to give finality. Alternatively the evidence shows that HMRC
35 has reached a conclusion and therefore should issue a formal conclusion of its enquiries.

12. On 20 April 2011 the Company’s accountants submitted revised corporation tax computations for the years ending 30 April 2009 and 30 April 2010. These included

costs of R & D of £182,377.00 and £121,317.00 respectively. HMRC replied by letter dated 6 February 2012 raising queries under five headings none of which according to Mr Brothers were correctly focused on the right areas. In other words Mr Brothers claims the enquiry started on the wrong footing. A COP9 investigation is in respect of suspected fraud yet over seven years later no fraud has been discovered.

13. Mr Brothers maintained that the R & D claim has not been processed quickly as HMRC view it as being wrapped up in a fraud investigation. Much correspondence has taken place between Mr Brothers and HMRC. Several schedule 36 Notices were issued by HMRC to the Company and others. A meeting was held on 16 May 2013. While Mr Brothers disagreed with part of the minute of this meeting it is clear he asked HMRC to provide clear statements of what was missing to allow consideration of the R & D claim. HMRC duly wrote to Mr Brothers on 29 May 2013 raising 12 points in relation to R & D. Mr Lowe signed mandates authorising HMRC to write to third parties seeking further information.

14. Further meetings and correspondence ensued and ultimately HMRC wrote to Mr Brothers on 14 January 2016. In this letter HMRC stated that the starting point for any claim has to be whether the Company has a valid claim for R & D tax credit in its own right. There are five points to be considered:

- The Company must have incurred expenditure on R & D.
- It must be relevant to the company's trade
- The Company must be seeking an advance in science or technology and be able to demonstrate what the advance is – it must constitute an advance in overall knowledge of capability in the field
- The Company must be seeking this through resolution of scientific or technological uncertainty (and again be able to demonstrate this)
- There must be qualifying expenditure which is allowable as a deduction in calculating the profit of the period.

HMRC's letter dated 14 January 2016 continues:

“To date we have still not had the 1st to 4th bullet points, in particular the 3rd and 4th, demonstrated in any way such that any claim must fail as a result of that failure. That is the starting point for any consideration of the validity of the claim and, if the claim fails at this point there is no need for further consideration.”

Mr Brothers pointed out that this letter, over four years after the start of the enquiry, was the first time that HMRC had raised the appropriate questions.

15. HMRC issued a Schedule 36 Notice to the Company on 12 April 2016. Mr Brothers advised the Tribunal that of the 12 points raised in the letter only item six requested information concerning the scientific or technological process undertaken. Mr Brothers replied with a seven page letter on 6 May 2016 which included a formal

appeal against the Notice. HMRC responded by letter dated 17 August 2016 stating that their view remained as explained in previous letters and at a meeting on 16 May 2013. This letter offered the Company a review of HMRC's decision.

5 16. Mr Lowe and Mr Brothers then attended a meeting with HMRC on 15 November 2016. As Mr Brothers did not know what information had been supplied by the other recipients of Schedule 36 Notices he queried what issues HMRC had with the claim for R & D expenditure. HMRC maintained that their view contained in their letter dated 17 August 2016 had gone unchallenged. HMRC wrote to Mr Brothers on 9
10 December 2016 requesting a copy of a letter dated 7 September 2016 which Mr Brothers had claimed to have sent to HMRC requesting a review of the Schedule 36 Notice penalty.

17. Further correspondence ensued between HMRC and Mr Brothers culminating with a letter dated 20 March 2017 from HMRC in which HMRC stated:

15 “To date your client has not demonstrated that any of the projects meet the criteria for R & D Tax Credits which is the starting point of the claim. Until your client can demonstrate that the claim meets those criteria, the quantum of the claim and the potential subcontract nature do not need to be addressed.”

18. Mr Brothers referred to a First-tier Tribunal decision – *Steven Price* [2011]UKFTT624 – which stated at paragraph 40

20 “We recognise that it may be appropriate to order a closure notice without full facts being available to HMRC where, for instance, HMRC have unreasonably protracted the enquiry. HMRC should not open an enquiry and then first ask for documents 3 years down the line without a reasonable explanation.”

25 19. Mr Brothers also referred to another First-tier Tribunal decision – *Eastern Power Networks PLC and others and The Commissioners for Her Majesty's Revenue and Customs* [2017] UKFTT0494 where at paragraph 123 counsel for the appellants stated

30 “...it cannot be right that an outstanding information notice always blocks the issue of a closure notice. The closure notice provisions are designed to provide a balance between the taxpayer's right to certainty and finality and HMRC's right to make legitimate enquiries into a taxpayer's tax position. To say that the issue of an information notice automatically bars the taxpayer from seeking a closure notice would negate that balance as it would enable HMRC to thwart a closure notice application by issuing an information notice as soon as the application is made.”

35 20. Mr Brothers then informed the Tribunal that the Company had no further information or documentation to provide to HMRC. The Company is prepared for the possibility that if a closure notice is issued it may well contain a refusal to admit the R & D claim.

HMRC's arguments

21. HMRC maintain that a lot of information is still required and without this information the enquiry cannot be closed. HMRC has tried to obtain information from third parties but while they have co-operated the information provided has not greatly
5 assisted HMRC with its enquiry.

22. Although the Company had complied with previous information notices by 12 April 2016 HMRC felt it worthwhile to issue a further information notice to clarify what was still required. HMRC cannot look at just one point. It is entitled to get the full picture before it can issue a closure notice.

10 23. Mr Reilly's witness statement gave some useful background to the history of the enquiry. In particular his statement explained that the COP9 investigation involves a number of enquiries and there has been a large amount of work involved in the complex issues that have arisen.

15 24. Ms Rhind on behalf of HMRC stated that there is a statutory presumption that the Tribunal can order closure in the absence of reasonable grounds for not doing so. As information requested as long ago as 2012 has still not been produced HMRC has reasonable grounds for not closing the enquiry. While there may have been some delay this was due to the fact that a number of different enquiries were going on at the same time.

20 Decision

25 25. The Tribunal has decided to allow the application for a closure notice on the grounds that Mr Brothers has during the hearing indicated that the Company has no further information or documentation to produce. The Tribunal believes this fact has not been clear until now. There is therefore no point in HMRC continuing with its
25 enquiries.

26. HMRC has stated on more than one occasion that "to date" they have not received sufficient information or evidence to enable a claim for R & D to get past the first hurdle of meeting the criteria laid down by statute and regulation.

27. HMRC no longer has reasonable grounds for not giving a closure notice.

30 28. Having decided to allow the appeal on this ground we have not considered the other arguments put forward by Mr Brothers.

35 29. Accordingly, this Tribunal directs that an officer of HMRC issue a closure notice within 30 days of the date of release of this decision, informing the Company that it has completed its enquiries into the periods of account ending 30 April 2009 and 30 April 2010 and stating HMRC's conclusions.

30. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

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**ALASTAIR J RANKIN
TRIBUNAL JUDGE**

RELEASE DATE: 15 DECEMBER 2017

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