



Neutral Citation: [2024] UKFTT 00951 (TC)

Case Number: TC09332

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Taylor House, London

Appeal reference: TC/2022/11690

CORPORATION TAX – relief for expenditure on research and development – Whether “subsidised expenditure” under section 1138 of the Corporation Tax Act 2009 (‘CTA 2009’) – no – Whether “carrying on activities which are contracted out” for the purposes of sections 1052 and 1053 CTA 2009 – no – appeal allowed

Heard on: 12-13 December 2023

Judgment date: 21 October 2024

Before

**TRIBUNAL JUDGE KIM SUKUL
TRIBUNAL MEMBER SONIA GABLE**

Between

COLLINS CONSTRUCTION LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY’S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Edward Hellier of counsel, instructed by Fiscale Ltd

For the Respondents: Francis Fitzpatrick KC and Sarah Black of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. Collins Construction Limited ('Collins') appeals against closure notices issued by the Respondents ('HMRC') on 28 September 2021, for the accounting periods ended 30 June 2018 and 30 June 2019, which denied Collins research and development ('R&D') tax relief. The closure notice for the 2018 period resulted in the rejection of the claim for repayment of £573,056.72 and additional tax payable of £471.99. The closure notice for the 2019 period rejected the claim for payment of an R&D tax credit of £2,670,972.94 with no additional tax to pay.
2. The grounds for the appeal are that, contrary to the reasons given by HMRC for denying the relief, the expenditure is qualifying expenditure and not subsidised expenditure or expenditure incurred in carrying out sub-contracted R&D activities.
3. The hearing was conducted over 2 days. The documents to which we were referred were contained within the 2,557-page hearing bundle, 25 additional document bundles, authorities bundle (933 pages) and skeleton arguments from both parties. We also had the benefit of transcripts of the 2 hearing days (totalling 103 PDF pages), and we were provided with a table from Collins showing details of the activity for which the tax relief had been claimed.
4. Having carefully considered the evidence and the submissions made by both parties, we allow this appeal. Our conclusions regarding the key arguments are set out below.

LEGISLATION

5. The Corporation Tax Act 2009 ('CTA 2009') includes provision for R&D relief for a small or medium sized enterprise ('SME'). The sections of the legislation relevant to this appeal are:

“Part 13 Chapter 1

1039 Overview of Part

(1) This Part provides for corporation tax relief for expenditure on research and development.

(2) Relief under this Part is in addition to any deduction given under section 87 for the expenditure.

(3) Relief under Chapter 2 is available to a company which is a small or medium-sized enterprise, in particular—

(a) Chapter 2 provides for relief where the cost of in-house direct research and development or contracted out research and development is incurred by the company.

...

(7) Chapter 2 also provides for the payment of tax credits (“R&D tax credits”) where a company which is a small or medium-sized enterprise—

(a) obtains relief under Chapter 2, and

(b) makes, or is treated as making, a trading loss.

...

Part 13 Chapter 2 Relief for SMEs: Cost of R&D incurred by SME

1043 Overview of Chapter

(1) This Chapter provides for relief for companies which are small or medium-sized enterprises for expenditure on—

- (a) in-house direct research and development, or
- (b) contracted out research and development,

where the cost of the research and development is incurred by the company.

(2) The reliefs available are—

- (a) an additional deduction under section 1044, or
- (b) a deemed trading loss under section 1045.

(3) Sections 1046 to 1053 contain provision relevant to the reliefs available under this Chapter, namely—

...

(f) provision about when a company's expenditure is “qualifying Chapter 2 expenditure” for those purposes (see sections 1051 to 1053).

...

1044 Additional deduction in calculating profits of trade

(1) A company is entitled to corporation tax relief for an accounting period if it meets each of conditions A to D.

...

(5) Condition D is that the company has qualifying Chapter 2 expenditure which is allowable as a deduction in calculating for corporation tax purposes the profits of the trade for the period.

...

(10) For the meaning of “qualifying Chapter 2 expenditure” see section 1051.

...

1051 Qualifying Chapter 2 expenditure

For the purposes of this Part a company's “qualifying Chapter 2 expenditure” means—

- (a) its qualifying expenditure on in-house direct research and development (see section 1052), and
- (b) its qualifying expenditure on contracted out research and development (see section 1053).

1052 Qualifying expenditure on in-house direct R&D

(1) A company's "qualifying expenditure on in-house direct research and development" means expenditure incurred by it in relation to which each of conditions A, B, D and E is met.

(2) Condition A is that the expenditure is—

(a) incurred on staffing costs (see section 1123),

(b) incurred on software or consumable items (see section 1125),

(c) qualifying expenditure on externally provided workers (see section 1127), or

(d) incurred on relevant payments to the subjects of a clinical trial (see section 1140).

(3) Condition B is that the expenditure is attributable to relevant research and development undertaken by the company itself.

...

(5) Condition D is that the expenditure is not incurred by the company in carrying on activities which are contracted out to the company by any person.

(6) Condition E is that the expenditure is not subsidised (see section 1138).

...

1053 Qualifying expenditure on contracted out R&D

(1) A company's "qualifying expenditure on contracted out research and development" means expenditure—

(a) which is incurred by it in making the qualifying element of a sub-contractor payment (see sections 1134 to 1136), and

(b) in relation to which each of conditions A, C and D is met.

(2) Condition A is that the expenditure is attributable to relevant research and development undertaken on behalf of the company.

...

(4) Condition C is that the expenditure is not incurred by the company in carrying on activities which are contracted out to the company by any person.

(5) Condition D is that the expenditure is not subsidised (see section 1138).

...

1138 "Subsidised expenditure"

(1) For the purposes of this Part a company's expenditure is treated as subsidised—

(a) if a notified State aid is, or has been, obtained in respect of—

(i) the whole or part of the expenditure, or

- (ii) any other expenditure (whenever incurred) attributable to the same research and development project,
 - (b) to the extent that a grant or subsidy (other than a notified State aid) is obtained in respect of the expenditure,
 - (c) to the extent that it is otherwise met directly or indirectly by a person other than the company.
- (2) In this section “notified State aid” means a State aid notified to and approved by the European Commission.
- (3) For this purpose the following are not State aids—
- (a) relief under this Part,...
 - (b) R&D tax credits under this Part.
 - (c) R&D expenditure credits under Chapter 6A of Part 3.
- (4) For the purposes of this Part a notified State aid, grant, subsidy or payment that is not allocated to particular expenditure is to be allocated to expenditure of the recipient on a just and reasonable basis.”

The purpose of the legislation

6. HMRC submit that when the legislation is considered as a whole, the purpose is to provide a very generous level of R&D relief for SME companies undertaking ‘stand alone’ R&D as principals. This prevents large companies from indirectly accessing the relief by contracting out work to SMEs, as what is in economic substance expenditure of a large company is not intended to be within the scope of the relief, and where SMEs are being funded to carry out R&D, there is no market failure. If such companies were entitled to enhanced R&D relief, this would distort the market and would favour those companies whose R&D was paid for by another as compared to companies undertaking ‘stand alone’ R&D.

7. Collins submits that the purpose of SME R&D relief is to incentivise R&D expenditure. It operates, along with the relief provided to large companies in CTA 2009, by incentivising companies to spend on R&D and so improve their productivity as they operate within their given industry or market.

8. We consider the purpose of the legislation is to provide relief for R&D expenditure in accordance with the requirements as set out in the relevant statutory provisions.

Statutory interpretation

9. When interpreting the statutory provisions, we are mindful that the ultimate question is whether the provisions, construed purposively, were intended to provide the relief, viewed realistically (see *Balhousie Holdings Limited v HMRC* [2021] STC 753 at [24]). Seeking the meaning of the words which Parliament used requires identifying the meaning borne by the words in question in the context of the legislation. This involves an objective assessment of the meaning which a reasonable legislature as a body would be seeking to convey in using the statutory words which are being considered (see *R (Project for the Registration of Children as British Citizens) v Secretary of State for the Home Department* [2023] AC 255 at [29] and [31]).

BACKGROUND

10. The relevant expenditure was incurred by Collins pursuant to construction contracts under which Collins was engaged in bespoke construction projects.

11. Collins claimed for expenditure in relation to 27 projects undertaken during the relevant period.

ISSUES FOR DETERMINATION

12. The issues for determination in this appeal are:

(1) Whether the expenditure was “subsidised expenditure” for the purposes of sections 1052(6) and 1053(5) CTA 2009 (‘the Subsidised Condition’); and

(2) Whether the expenditure was “...incurred by the company in carrying on activities which are contracted out to the company by any person” for the purposes of sections 1052(5) and 1053(4) (‘the Contracted Out Condition’).

13. It is not in dispute that Collins is an SME and that they satisfied all of the other conditions for relief.

BURDEN OF PROOF

14. The burden of proof rests with Collins to show that the statutory requirements for the provision of the relief were met and therefore the denial of that relief by HMRC was wrong. The standard of proof is the civil standard, namely on the balance of probabilities.

15. To succeed in their appeal, Collins therefore must prove, on the balance of probabilities, that the expenditure was not “subsidised expenditure” and that the expenditure was not “incurred by the company in carrying on activities which are contracted out to the company” for the purposes of the relevant statutory provisions.

EVIDENCE

16. The documentary evidence before the Tribunal has been referred to at [3] above.

Contracts

17. The evidence before us includes 25 different contractual sets of documents. The contracts are based on one of four types of standard contract: JCT Design and Build 2011, JCT Design and Build 2016, JCT Standard Building Contract 2011 and JCT Standard Building Contract 2016. During the hearing, we were taken through an example contract based on a JCT Design and Build Contract 2011 template and we were shown how those contracts compare to the others. We are satisfied that there are no fundamental differences in the contracts for the purposes of these proceedings.

18. The example contract (and amendments) includes provisions setting out:

(1) that Collins shall carry out and complete both the design and the construction of the works;

(2) that in return for those works Collins is to be paid the contract sum;

(3) an analysis of the contract sum;

(4) documents describing the proposals by Collins for the design and construction which they are satisfied will meet in all respects the client’s requirements;

- (5) that copyright in all the design documents remains vested in Collins, with a waiver provided for the client;
- (6) very limited circumstances in which the Contract Sum may be adjusted, none of which were pertinent to the R&D activity.

Witnesses

19. We also had before us the witness statement of HMRC Officer Philip Hamblin, a technical advisor in HMRC's R&D Policy Team. His unchallenged evidence concerned the history of the statutory provisions, consultation process and HMRC's view of the aims and purpose of the statute. In addition, we heard evidence from HMRC Officer William Innes, who set out the factual context and background to the making of the assessments. The evidence of the HMRC officers did not assist us in determining the relevant factual matters regarding the way in which Collins conducts its business or operates its contracts, and was therefore of limited evidential value.

20. We also heard the evidence of Mr Chris Bartram, a trained quantity surveyor and managing director at Collins during the period in question. We found Mr Bartram to be a credible and reliable witness and we accept the evidence set out in his witness statement, which gives an overview of the business operations as follows:

“12. When a client wants refurbishment work done, they put the job out for tender. When that comes to Collins it is given to Collins' pre-construction team who are involved in creating the bid for the job. Once won, the onsite team will make sure the job runs to schedule and cost, and that the project is properly delivered. There is then aftercare with the client for any snagging issues or other problems that arise.

Tender Stage

13. The first stage in a project is the tender stage. Our clients usually provide tender documents that try to take the design to RIBA stage 3, which is the concept design and spatial coordination (although spatial coordination usually has to change once the project starts once the realities of the work become more clear). At this stage there is no technical design. Collins will prepare a tender proposal which will delve into the how the concept might be taken forward to the construction stage. This all takes place in a limited time frame, usually 4 to 6 weeks.

14. Before going to tender a client will have usually engaged the following consultants:

(1) Architect – The Architect will develop a set of tender drawings and work with the consultant services engineer and structural engineer to ensure the scheme works in principle. They will develop a set of Employer's Requirements which would include the drawings, specifications for materials, and preliminary requirements the contractor should consider when tendering. Dependent on the contract requirements the architect may or may not be novated as part of the contract to the successful contractor.

(2) Structural Engineer - The structural engineer will carry out initial designs to confirm that the architect's intent will structurally work and then provide a suit of structural drawings and a specification to compliment the architects

design concept. Structural engineers are often novated to the successful contractor

(3) Services Engineers - services engineers work with the Architect and Structural engineer to produce RIBA Stage 3 drawings and a performance specification for the contractor to price.

15. This work is usually at a high-level. The architect will provide a scheme/design of how the building should look and feel, and the engineers will note whether it works or not. They will generally undertake feasibility study at this point to get an idea of the cost of a project.

16. When costing a project Our tenders are an estimate of our expert management costs, which is time sensitive and built around our methodology for the project and the proposed programme of works. Both the methodology and the programme are generated in house by our technical staff and form the basis of our tender. The programme and methodology are entirely 'at our risk'. During the tender period we also break down all the clients concept requirements and then send them out in packages to subcontractors to price. Our final tender sum is a combination of the preliminary costs, and the actual cost of the works from the subcontract packages, with our overheads and profit margin. The clients do not share any risk or subsidise any works, the risk and cost of the works sit solely with Collins.

17. At the time of tender we have no anticipation that research and development ("R&D") work will be necessary to achieve a particular design. Indeed, a large number of projects in any financial year are completed without any R&D taking place, with a comparable level of information available at tender stage for both R&D and 'non-R&D' projects.

When R&D Issues arise

18. Given the type of buildings we often work on, it is normal for there to be no 'as built' record drawing available for us or the Client to consider. It is only once the building is opened up that we have a chance to see whether any R&D work will be needed to carry out the project.

19. The curtain walling at Worple Road is a good example of this, the need for R&D arising as a result of the stripping out works and discovery of the existing building conditions that R&D will be required, but at the time of contracting it is unknown.

20. Although the designs provided by the client are meant to be at RIBA Stage 3, in reality the spatial co-ordination is often wrong. Points need changing because it is not until strip-out work commences that we can really see what is possible.

21. In short, the need for R&D will usually only arise after the project has been won. We encounter a difficulty in delivering a project and develop a solution to solve the problem.

Client involvement

22. During the project we have high level meetings with clients but they are generally not interested in the technical side of projects. A lot of clients don't have the technical knowledge to understand the technical changes and R&D we carry out. Neither would they be in a position to provide the level of

detail necessary to claim for a project themselves. Clients just want to make sure that they don't have to pay any more and that the finished building has the look and feel they want.

23. There is a procedure by which clients have an opportunity to approve changes put forward in the design process. In reality a rubber stamp procedure. Usually there are no comments from clients or they simply state "no adverse comments" which means Collins proceeds at its risk. The clients are in any event not concerned with the detail. In fact, if Collins thinks that design changes meet the Employer's Requirements in the contract, then there is in fact no need for the clients' approval as we can continue on that basis.

Risk

24. Collins takes the risk in undertaking projects, specifically the economic risk, and in the R&D work carried out. In the High Holborn project Collins made significant loss. The issue was that the sub-contractor making the bespoke panels for the external cladding went bankrupt during the project. Collins managed to buy the panels that had been manufactured and completed the manufacturing of the outstanding panels, along with directly employing a separate site team to install them."

21. In cross-examination, it was suggested to Mr Bartram that he has used the term "R&D" to mean developing a solution to solve a problem which may or may not turn out to be R&D for tax purposes. Mr Bartram agreed and stated that, when collating a claim with their advisors, they "go through all the projects and lots of the projects will be discounted because it's not R&D. They would challenge us and say is that R&D or isn't it R&D, can you give us some more detail about what you actually did. Lots of times that's not R&D". Mr Bartram was also challenged on the accuracy of his statement that it was unknown what innovative solutions would be required at the time of contracting, as certain contracts were signed after the work had been completed when they knew the difficulties that had been encountered and solved. Mr Bartram's response was: "At the point you sign a contract, yes, but we actually signed a letter of intent which is a contract, a binding contract which is at the beginning, so it's irrelevant, I would say. The letter of intent is the binding contract which is signed before you get on site."

22. Mr Richard Harrison also gave evidence which we considered to be credible and reliable. He has worked for Collins for ten years as a project director and has involvement from tender stage, through delivery and into aftercare. We accept the evidence set out in Mr Harrison's witness statement, which gives some examples of the type of work carried out in relation to a specific project, as follows:

"4... The project involved a CAT A fit-out of an existing office building in High Holborn, the addition of two stories, terrace areas and an expanded entrance reception area. The majority of the façade of the building was replaced, and a new central core, welcome and changing facilities, as well as two new shell and core retail units, were built. The plan resulted in a 30% increase in floor area, from 39,848 sq. ft. to around 53,000 sq. ft. of lettable space for the commercial office market.

5. There was no contractual requirement to undertake and/or develop works related to R&D. Collins was responsible for delivering the project in line with the contract.

6. However, and as the project progressed it became clear that R&D would be needed. Collins had received a design at RIBA Stage 3 which was information constrained and predicated on a conceptual notion that required additional investigation and development with the pertinent supply chain (Designers and/or Sub-Contractors) to complete the design to a standard ready for construction. The project required R&D in a number of areas. Set out below are explanations of two pieces of R&D work carried out in relation to this project.

7. Before that, I should note that in this project Collins sustained a significant loss. The issue was that the sub-contractor doing the making the bespoke panels for the external cladding went bankrupt during the project. Collins managed to buy the panels that had been manufactured and get a separate team to install them, but this caused delays and losses on the project.

The Reverberation Issue

8. One of the pieces of R&D work that had to be carried out was in identifying and resolving a reverberation issue that arose towards the end of the project.

9. The mechanical specifications that formed part of the Employer Requirements in this project included specifications for sound levels in the office. On near finishing of the project we discovered that this requirement was not met because of noise created by internal building services (such as ventilation and air conditioning systems).

10. In light of this issue, we developed an acoustic encasement for the mechanical plant in the building which resolved this issue which ensured that the noise levels were kept to an acceptable level.

11. The client was not involved in the R&D of this issue, and it was not known as an issue that would create a need for R&D at the time of contract.

Zig-zag brickwork

12. Another area which required R&D work on this project was in the development of a zig-zag brick pattern at the back of the building.

13. Originally, it had been intended that this would be done in a Sto render cladding. However, once Collins obtained the project it had become impossible to get Sto render cladding in time due to the fire at Grenfell changing the demand for different types of cladding.

14. As such, we had to look to a different solution to get the look that the client wanted, but in a different product. To do this we had to undertake R&D work to develop a zig-zag pattern in brick.

15. Again, this R&D was not specified in the contract and we did not know at the time of tender that it would have to be undertaken.”

23. In cross-examination, Mr Harrison stated that his references to “R&D” meant where Collins had undertaken activity to find a bespoke solution where there was not a readily available solution on the market for various reasons. In re-examination, he stated that neither Collins nor their clients were aware going into the project that they would have to innovate in order to resolve those problems.

THE FACTS

24. There is no significant dispute between the parties regarding the facts. Having considered the witness evidence and the documents before us, including tender documents and those contracts between Collins and their clients which were adduced, we find as follows:

- (1) Collins is a specialist refurbishment and fit out contractor, who undertake 'cut and carve' projects of 1960s and 1970s buildings, high end commercial fit outs, leisure projects, and medical refurbishment work.
- (2) Collins provides specified works to its client in return for payment of an agreed price for those works.
- (3) The agreement between Collins and the clients is subject to the detailed terms and conditions set out in the construction contracts.
- (4) Many of their projects involve taking concept designs through to construction.
- (5) Clients come to Collins with concept ideas and Collins price the concept, providing the client with cost certainty before they embark on the scheme.
- (6) Collins agrees to undertake the financial and development risk in delivering the project.
- (7) Sometimes during the delivery of a project, it becomes apparent to Collins that they will need to undertake activities to develop new solutions to enable the concept design to be delivered.
- (8) Their clients are not involved with the technicalities of a project.
- (9) It falls to Collins to innovate and find solutions to overcome any difficulties in delivering the project.
- (10) The contract between Collins and their clients requires Collins to deliver a specified product in return for an agreed sum and design the way in which to provide the end product. There is no contractual requirement or provision for R&D activities. Collins retains any intellectual property rights relating to their innovations during a project (subject to the client's right to specific use) and takes the economic risk in producing those innovations. There is no provision for adjustments to provisionally agreed sums for such innovations.
- (11) The terms of the agreement are initially reflected in a letter of intent and subsequently incorporated into a formal contract.
- (12) Contracts are sometimes signed after the completion of a project.

THE ISSUES

25. In considering the issues for determination, we address the Subsidised Condition before considering the Contracted Out Condition.

Subsidised Condition

26. The dispute between the parties in relation to the Subsidised Condition turns on whether the material expenditure falls within section 1138(1)(c) CTA 2009 as being expenditure "met directly or indirectly by a person other than the company".

HMRC's Submissions

27. HMRC submits that section 1138(1)(c) should be interpreted in the light of its ordinary meaning in the context of a provision which forms part of a detailed, prescriptive and meticulously drafted code, being a generous relief which is given in addition to an ordinary trade deduction. The meaning of subsidised is not delineated by the ordinary meaning of that term, rather an elaborate rule is given for when expenditure will be treated as subsidised for the purposes of Part 13 and it is necessary to consult those rules to establish whether expenditure is subsidised for those purposes. The result should not be rejected because it might be “unexpected or unlikely” having regard to the ordinary meaning of “subsidised”.

28. Section 1138(1)(c) specifies three situations in which expenditure is treated as subsidised for the purposes of Part 13. First, if a notified State Aid has been obtained in respect of the whole or part of the expenditure of any other expenditure (whenever incurred) attributable to the same research and development project. Second, to the extent that a grant or subsidy (other than a notified State Aid) is obtained in respect of the expenditure. There is no definition in the legislation of ‘grant’ or ‘subsidy’ so they prima facie bear their ordinary meaning of, for grant, the conferment of a privilege, right or possession, and with respect to subsidy, a donation of money to provide assistance. It is evident that such grant or subsidy can have as its source a state or non-state entity and can include an unnotified State Aid. Third, to the extent that the expenditure is “otherwise met directly or indirectly by a person other than the company”. The word “otherwise” here means in circumstances different from those present or considered. Hence the use of “otherwise” indicates that section 1138(1)(c) is concerned with something other than a notified State Aid or grant or subsidy, so a third category which has its own specific test and ambit. Accordingly, the legislation is treating as a subsidy something which is: not a notified State Aid; not a grant; and not a subsidy (so something which is not a grant or subsidy as a matter of ordinary English usage).

29. There is no scope for the application of the ‘ejusdem generis’ principle to restrict section 1138(1)(c) to something having the nature of a State aid, grant or subsidy. That is not the case here. Rather the draftsman has created three distinct and defined categories, the final one, section 1138(1)(c), having its own rules prescribing the ambit of the category. The draftsman uses the word “otherwise” to make it clear that something within either (a) or (b) does not fall within (c), and that (c) is dealing with an additional category as defined.

30. Section 1138(1)(c) applies where the expenditure is met “directly or indirectly”. This wording covers at least two scenarios: first where the third party pays, discharges or satisfies the expenditure directly so the company does not have to pay anything; and the second where the third party pays the expenditure indirectly as where the company pays the expenditure, but is reimbursed by the third party. Were it not for these words, it would be absurdly easy to circumvent the rule by ensuring the expenditure was paid by the company and then reimbursed by a third party. This is precisely what occurred in the present case. Collins incurred the material expenditure in the course of providing construction services to its clients in respect of which it was entitled to payment and was in due course paid. Collins seems to suggest that the contract sum is determined at tender stage, when Collins has limited information. However, it is clear from the contractual documents that there are further changes to the contractual sum on entering into the contract for “post tender adjustments” and contracts are dated after the key delivery dates for possession and completion of different stages.

31. It follows that the clients indirectly ‘met’ the expenditure by paying Collins for the works. There is nothing absurd or surprising in this result. The plain interpretation is in accord with the logic of the statutory scheme which is to provide enhanced R&D relief for expenditure which is not reimbursed by grant, subsidy or otherwise.

32. HMRC’s interpretation is also consistent with the Explanatory Notes to the Finance Act 2000 (‘the Explanatory Notes’) accompanying the predecessor provisions of section 1052 and 1138 CTA 2009 in Schedule 20 of the 2000 Act, being paragraph 3(7) and paragraph 8(1)(c). Paragraph 19 of the Explanatory Notes states that sub-paragraph (7) provides that “the expenditure must not be ‘subsidised’. This stops a company claiming R&D Tax Relief on R&D paid for by someone else”.

The Appellant’s Submissions

33. Collins submits that the contractual bargain between them and their clients is for Collins to provide specified works to its client in return for payment of an agreed price for those works from the client. The price agreed may or may not in fact be sufficient to cover the costs Collins actually incurs in fulfilling the terms of the relevant contract. The bargain made between the parties is not for Collins to incur specific costs such as the claimed expenditure in return for the clients agreeing to pay those specific costs. Therefore, on the correct interpretation and application of the legislation, the claimed expenditure was not “subsidised expenditure” for the purposes of section 1138(1)(c).

34. Collins further submits that this issue can be disposed of on the basis of *Quinn (London) Ltd v HMRC* [2022] SFTD 122 (TC) (‘*Quinn*’), a decision of the First-tier Tribunal (‘FTT’) concerning whether expenditure on R&D activities carried out in the course of various construction projects was “subsidised expenditure” for the purposes of CTA 2009 section 1138(1)(c), where the projects in question were carried out under contracts based on the JCT Standard Building Contract 2011 and the FTT concluded that the Appellant’s expenditure was not subsidised. HMRC accepted that conclusion and did not appeal the decision. *Quinn* has since been endorsed by the Upper Tribunal (‘UT’) in *HMRC v Perenco UK Ltd* [2023] UKUT 169 (‘*Perenco*’). HMRC are seeking to re-argue points already determined by the Tribunal in *Quinn* and are wrong for the reasons set out in that decision.

The decision in Quinn

35. This Tribunal has considered similar arguments, concerning similar circumstances, in the case of *Quinn*. In that case, Judge Morgan commented as follows regarding the Tribunal’s decision on this issue:

“43. The sole issue is whether the expenditure fails to qualify for enhanced R&D relief on the basis that it is “subsidised” for the purposes of s 1052(6) (Condition E). HMRC argue that under the comprehensive code for determining when expenditure is to be treated as subsidised in s 1138, it was “met directly or indirectly” by a person other than Quinn, namely, Quinn’s Clients.

44. There is no authority directly on this point which is binding on the tribunal although Harman J’s decision in relation to similar provisions in the Capital Allowances Acts is informative and helpful.

45. To recap:

(1) The main conditions for a company to be able to obtain enhanced R&D relief for an accounting period are, under s 1044, that (a) it is an SME in the period (condition A), (b) it carries on a trade in the period (condition C), and (c) (i) it has incurred “qualifying Chapter 2 expenditure”, namely, R&D which, amongst other conditions, is not “subsidised” (see s 1052(6)), (ii) which is allowable as a deduction in calculating for corporation tax purposes the profits of the trade for the period (condition D). It is integral to and underpins the highlighted conditions that the SME is expected to utilise and to seek to exploit the relevant R&D for the purposes of its trade.

(2) Section 1138 is headed “Subsidised expenditure” and sets out a comprehensive set of rules for determining when expenditure on R&D is “subsidised” for the purposes of s 1052(6). In summary, under s 1138(1), there are three sets of circumstances in which for the purposes of the SME scheme a company’s expenditure is treated as subsidised: (a) “if a notified State aid is, or has been, obtained in respect of - (i) the whole or part of the expenditure....”, (b) “to the extent that a grant or subsidy (other than a notified State aid) is obtained in respect of the expenditure” ,and (c) “to the extent that it is otherwise met directly or indirectly by a person other than the company”.

(3) Section 1138(1)(c) applies, therefore, on the face of it if:

(a) A person other than the SME met the expenditure. On its natural meaning, as used in the context of financial obligations, I take this to mean, broadly, that the other person provides the money that is needed to pay, fulfil, satisfy or discharge the cost of the relevant R&D with the effect that the SME is not subject to or is relieved of that cost.

(b) That other person met the expenditure otherwise than by way of “notified State aid”, or a “grant or subsidy (other than notified State aid)” falling within ss 1138(1)(a) or (b).

(c) That other person does so either directly, such as by paying the relevant cost direct to the person charging it or, indirectly, such as by reimbursing the SME for sums it has already paid. I have commented further on the meaning of this provision below.

46. HMRC argued, in effect, that, on the plain meaning of the provision, expenditure falls within s 1138(1)(c) solely as a result of an SME, such as Quinn, undertaking ordinary commercial transactions in the course of its trade under which the SME receives from its Clients an agreed price for a service or product which the SME provides using the relevant R&D on the basis that the SME can use the price to cover its expenditure on the R&D. Their analysis relies on the view that the interpretation of s 1138(1)(c) is not in any way to be constrained, coloured or shaped by reference to the scope of the preceding provisions in ss 1138(1)(a) or (b) or the fact that s 1052(6) refers to “subsidised”, expenditure seemingly as a generalised description of what is intended to be caught (as reflected in the heading to s 1138).

47. However, in my view, on the natural interpretation of these provisions as viewed in the overall context of the SME scheme, it is apparent that s 1138(1)(c) is not intended to apply in circumstances such as those in this case, in the absence of a clear link between the price paid by the Client/customer and the expenditure on R&D:

(1) The reference in s 1138(1)(c) to a person other than the SME otherwise meeting the SME's expenditure, following on as it does from ss 1138(1)(a) and (b), is clearly based on the premise that "notified State aid" or "a grant or subsidy.." which is "obtained...in respect of" the whole or part of the relevant expenditure (within the meaning of those preceding provisions) "met" or meets that expenditure.

(2) It seems to me that the further implication of the "otherwise" wording is that s 1138(1)(c) is intended to operate, in effect, as a form of sweep up provision to capture cases (a) where expenditure is not "met" by "notified State aid" or "a grant or subsidy..." (under the preceding provisions in ss 1138(1)(a) or (b)) but (b) is "met" in a similar sense to that in which expenditure may be said to be "met" by "a notified State aid" or "a grant or subsidy...". In my view, that this is the correct interpretation is reinforced by the use of the term "subsidised expenditure" in s 1052(6). The use of that particular term indicates the scope of Condition E in general terms as then further explained in s 1138, albeit that the use of that term in the heading to that section does not control the operation of the substantive provisions in that section.

(3) I note that:

(a) Whilst it is difficult to postulate all the circumstances in which there may be "a subsidy or grant", according to the normal meaning of those terms, like the provision of "State aid", the making of "a subsidy or grant" generally involves the provision of funds to a recipient who either provides nothing in return or provides something which, viewed from the perspective of parties acting on an arm's length basis, does not represent a commercial return commensurate with the value of the funds provided (albeit that in some cases, such as where a public or government body provides the funds, that body may consider it is in the wider public interest to fund the relevant R&D).

(b) In ss 1138(1)(a) and (b) the requirement that the relevant funding must be "obtained...in respect of" the relevant expenditure reinforces that there must be a clear link between the funding and the use of the funds for the payment or discharge of the relevant R&D costs. I say reinforces as, in my view, the use of the word "met" in s 1138(1)(c) of itself suggests that there must be such a link.

(4) Overall, it seems to me that the circumstances of this case are far removed from those which are intended to be captured by s 1138(1)(c) on a fair reading of it in the context of the whole of s 1138 and the overall SME scheme. I note that:

(a) The contractual bargain between Quinn and its Clients is for Quinn to provide specified "Works" to the Client in return for payment of an agreed price for those Works from the Client, subject to the detailed terms and conditions set out in the construction contracts.

(b) For all the reasons set out in Mr Wells' evidence (and as shown in the documents produced in the bundles) the price which is then agreed may or may not in fact be sufficient to cover the costs Quinn actual incurs in fulfilling the terms of the relevant contract. Quinn simply factors costs such

as those relating to R&D into the price it wishes to charge in order to seek to achieve its desired commercial return.

(c) It is plain, therefore, that under the contracts, Clients do not agree to pay or reimburse Quinn for particular costs, such as the claimed expenditure, and Quinn does not agree to carry out the relevant R&D on being paid or reimbursed by the Client for doing so. In other words, the bargain made between the parties is not for Quinn to incur specific costs such as the claimed expenditure in return for the Clients agreeing to pay those specific costs.

(5) Moreover, it would be wholly out of kilter with the overall SME scheme, if an SME were to be denied enhanced R&D relief solely because, in doing what is envisaged by the legislation (namely, utilising the relevant R&D for the purposes of its trade), as is usual and to be expected of an entity carrying out a trade on a commercial basis, it seeks to recover some or all of the relevant costs of the R&D under its commercial contracts with its Clients entered into in the course of its ordinary trading activities. Indeed, if HMRC's approach were to be adopted, the circumstances in which an SME could claim enhanced R&D relief would seem to be confined to those where it has no prospect of exploiting the R&D for commercial gain.

48. In my view, the comments of Henderson J (as he then was) in *Gripple* do not support HMRC's contentions. The full passage on which HMRC rely is as follows, at [12]:

“It is unnecessary for me to cite any further provisions of Sch 20. I would, however, make the general point that the provisions form a detailed and meticulously drafted code, with a series of defined terms and composite expressions, and a large number of carefully delineated conditions, all of which have to be satisfied if the relief is to be available. The schedule runs to 26 paragraphs and occupies ten pages in Tolley's Yellow Tax Handbook for 2005–06. I emphasise this point because one of Mr Gordon's submissions for *Gripple* is that the schedule evinces a general intention to provide enhanced relief for expenditure on R & D, and that a generous construction should where possible be adopted in order to further that general aim. I am unable to accept this submission. It seems to me, on the contrary, that a detailed and prescriptive code of this nature leaves little room for a purposive construction, and there is no substitute for going through the detailed conditions, one by one, to see if, on a fair reading, they are satisfied. It also needs to be remembered, in this context, that the relief is a generous one, which grants a deduction for notional expenditure which has not actually been incurred. Even if the relief is not available, there will be nothing to prevent the company from deducting its actual R&D expenditure in full in the computation of its trading profits, provided only that the normal ‘wholly and exclusively’ test is satisfied.”

49. Henderson J rejected the proposition that a generous construction of the SME scheme should where possible be adopted and the related notion that the SME scheme evinces a general intention to provide enhanced R&D relief. However, he did not thereby suggest that a narrow or restricted interpretation should be adopted (as is the effect of HMRC's approach) but simply pointed out that the relief only applies where the detailed conditions are, on a fair reading, satisfied. He was plainly not advocating an approach

of assessing whether the conditions are satisfied by interpreting them without any regard to context.

50. HMRC argued that their approach does not give rise to odd results on the basis that it does not follow from their analysis that s 1138(1)(c) applies where a taxpayer incurs “standalone” R&D expenditure and seeks to recover the cost of that expenditure through its ordinary trading transactions at some later point in time as opposed to, as is the case here, under transactions which take place when the expenditure is incurred. However, I cannot see what basis HMRC have, on their own analysis, for drawing a distinction on the basis of the timing of the relevant ordinary trading transactions. In each case, the payments made by the customers or Clients for the relevant services or products provided by the taxpayer could be used by the taxpayer to cover its expenditure on R&D which it uses for the purposes of that trading transaction. Moreover, from its terms, I can see no justification for the view that the application of s 1138(1)(c) is to be based on such fine and difficult distinctions.”

36. With regard to this decision, HMRC submit that the Tribunal in *Quinn* erred in law, including, in that -

(1) at [47(2)], the Tribunal stated that the word “otherwise” is intended to operate “as a form of sweep up provision to capture cases (a) where expenditure is not ‘met’ [by (a) or (b)]...but (b) is ‘met’ in a similar sense to that in which expenditure may be said to be ‘met’ by ‘a notified State aid’ or ‘grant or subsidy...’.” HMRC submit that the use of the word ‘otherwise’ creates a new and separate category, and this is supported by *R v Uddin* [2018] 1 AER 1073 at [34] (“*Uddin*”);

(2) at [47(2)], the Tribunal takes support for the incorrect analysis from the use of the term ‘subsidised expenditure’ in section 1052(6) and in the heading of section 1138. The Tribunal acknowledges that the heading cannot control the meaning of the substantive provision but seemingly does attribute significance to it. Whilst a heading can be considered, its function is merely to serve as a brief guide to the material to which it relates, and may not cover everything falling within the provision to which it relates;

(3) at [47(3)], the Tribunal notes that there must be a ‘clear link’ between the funding and the use of the funds in section 1138(1)(a) and (b) because of the phrase “obtained in respect of”. However, the Tribunal then says this reinforces its conclusion on section 1138(1)(c) which uses the word “met”, seemingly in the Tribunal’s view to mean the same thing. With respect, that logic does not follow. If the draftsman intended to mean the same thing, they would have used the same wording. The fact that they chose to draft (c) differently should be respected in its interpretation. The ordinary meaning of ‘meet’ or ‘met’ in the Oxford English Dictionary encompasses being able to or sufficient to discharge or satisfy or fulfil a financial obligation. In the context of section 1138(1)(c) ‘met’ is equivalent to ‘discharged’ or ‘satisfied’ or ‘fulfilled’;

(4) at [47(4)], it is not clear from the Tribunal’s analysis what would fall within (c), and whether it must be something akin to a grant or subsidy (i.e. something given without full consideration being given in return but which is not a grant or subsidy, which is difficult to envisage), or whether all that is required is that there is a ‘clear

link' between that which is given and that which is expended, so that it could include a payment made under a commercial contract. Taking the judgment as a whole, it appears the learned Judge considered that a payment made under a commercial contract could fall within (c) but that in the words of the learned Judge, there had to be a 'clear link' between the payment and the expenditure being met;

(5) if the provision is limited to a payment akin to a grant or subsidy, then (c) is rendered otiose which would be a surprising outcome given the trouble the draftsman has gone to in crafting (c);

(6) if the latter, payments under commercial contracts where there is a 'clear link', then it becomes a question of fact as to whether there is a 'clear link' in each case, bearing in mind this is a gloss on the statutory wording which refers to expenditure being met directly or indirectly. If this is correct then the condition should be met, in HMRC's submission, if R&D costs are incurred in delivering a project to a customer pursuant to a contract whose payments, pursuant to that same contract, cover the R&D costs incurred for the project. A requirement that there has to be specific provision as to R&D in the contract in order for there to be 'a clear link' would be easy to circumvent with the availability of this very valuable and carefully targeted relief being subject to how the parties choose to word their contract.

(7) at [47(5)], the Tribunal mischaracterises HMRC's analysis. HMRC's position does allow for exploitation of the R&D for commercial gain. If, for example, a taxpayer undertakes R&D in January and then in April is able to exploit the expenditure in the context of a commercial contract with a customer, that would qualify for relief on HMRC's analysis. There is, in HMRC's submission, a clear distinction between a trader who incurs R&D in the course of carrying out a contract, and the sums from the contract cover those costs – where it can naturally be said the customer has 'met' the costs of the expenditure; and the example above where it could not be said that the expenditure incurred in January is 'met' by the sums received from the contract in April.

The decision in Perenco

37. In *Perenco*, a case concerning the identification of subsidised expenditure under the Oil Taxation Act 1983, the Upper Tribunal adopted a very similar approach to that taken in *Quinn*. The Upper Tribunal commented:

“[73] Nevertheless, the heading of para 8 taken together with the emphasis in para 8(1) on payments by state or public entities indicates that – as Harman J found in relation to s 84 – para 8 is directed to payments by way of, or akin to, government or public authority grants or subsidies. We agree with Mr Brinsmead-Stockham that the words 'or by any person other than the first-mentioned person' at the end of para 8(1) should be construed consistently with the preceding examples, all of which refer to state or public bodies. If para 8 had been intended to refer to any arrangement, of whatever nature, the effect of which is that funds are provided by anyone other than the claiming taxpayer which help the taxpayer to meet a particular cost, then it could have been drafted to say, simply, 'in so far as it has been or is to be met directly or indirectly by any person other than the first-mentioned person'. The fact that the provision is not drafted in those terms, but specifically starts by referring

to payments by state or public bodies, therefore provides guidance as to the type of payment that is envisaged.

[74] It follows that, in our judgment, para 8 does not encompass a payment made in return for the provision of goods or services. The essence of Harman J's analysis was that a financier who loaned money to meet a taxpayer's bills, as part of an arrangement under which it acquired a valuable asset for full consideration, was not 'meeting' the expenditure of the taxpayer on creating that asset. Likewise, we consider that, in principle, if A pays a sum of money to B in order to receive goods or services in return, on the basis of an arm's length commercial contract, A's payment is properly to be regarded as consideration for what A receives and not as a way of meeting B's expenditure, even if A's payment is calculated to reflect B's expenditure attributable to those goods or services (with or without the addition of a profit margin).

[75] Our approach to this point is very similar to that of the FTT in *Quinn (London) Ltd v Revenue and Customs Comrs* [2021] UKFTT 437 (TC), [2022] SFTD 152. That case concerned a company's claim to enhanced research and development ('R&D') allowances under Pt 13 of the Corporation Tax Act 2009. HMRC argued that the company's expenditure was subsidised expenditure within s 1138(1) of that Act, which provides that expenditure is subsidised if a notified state aid is obtained in respect of it or to the extent a grant or subsidy is obtained in respect of it or 'to the extent that it is otherwise met directly or indirectly by a person other than the company'. HMRC's argument was that the company carried out the R&D in the course of providing construction services to Clients, for which it was entitled to payment which covered the claimed expenditure. The FTT regarded the relevant words in s 1138(1) as operating as a form of sweep up provision to catch cases where expenditure is not 'met' by notified state aid or some other grant or subsidy but is met 'in a similar sense'. In that context the FTT observed (at [47](3)) that a subsidy or grant 'generally involves the provision of funds to a recipient who either provides nothing in return or provides something which, viewed from the perspective of parties acting on an arm's length basis, does not represent a commercial return commensurate with the value of the funds provided (albeit that in some cases, such as where a public or government body provides the funds, that body may consider it is in the wider public interest to fund the relevant R&D)'."

38. HMRC argue that any support for the FTT's analysis in *Quinn* sought from the UT decision in *Perenco* is misplaced for four reasons.

39. First, *Perenco* concerned a completely different statutory regime. The material provision being considered by the UT, paragraph 8 of Schedule 3 Oil Taxation Act 1975 ('OTA'), is structured differently to section 1138, and drafted differently. The UT's comments on *Quinn* are clearly obiter and were without the benefit of full argument.

40. Second, there are little or no State Aid considerations underpinning the OTA and its drafting, as compared to the importance of the State Aid considerations in the context of Part 13.

41. Third, the policy incentives and drivers behind the two regimes are also very different. Paragraph 8 of Schedule 3 to the OTA is concerned with allowable expenditure. The

enhanced R&D relief provisions on the other hand provide access to a very valuable, generous, and therefore carefully targeted, statutory regime that confers tax credits and relief.

42. Fourth, the suggestion in [73] that, if HMRC's analysis is correct, the draftsman could have drafted the provision in simpler terms is not an appropriate approach to the statutory construction here. As noted above, Part 13 is a meticulously drafted and highly prescriptive regime. In drafting these provisions, Parliament had to ensure there was no additional State Aid, and had to do so in express and emphatic terms. The purpose, therefore, of section 1138(1)(a) and (b) is to inform the reader in clear terms of specific exclusions; and then (c) is an additional category to cover other expenditure met by third parties. Further, (a) works differently from (b) and (c): (a) prevents all expenditure incurred from benefiting from enhanced R&D relief; (b) and (c) do not exclude expenditure on the same project which is outside their scope. The fact that Parliament could potentially have achieved the same result with a differently drafted (c) does not mean it has no purpose. Even if there were a degree of surplusage, there are good reasons for it given the State Aid considerations.

43. In each of the contracts before this Tribunal, there was a 'clear link' between the R&D and the sums paid under the contract, which is to say that the material expenditure was met directly or indirectly by the payments made under the material contract. The only reasonable inference that this Tribunal can make from the evidence before it is that the expenditure was 'met' 'indirectly' by Collins' customers, and therefore the condition is not satisfied and relief is not available.

44. *Quinn* is not binding on this Tribunal as a matter of precedent and this case involves a different taxpayer and different facts. This Tribunal is not bound by either *Quinn* or *Perenco* on this point and there is no procedural or other bar to HMRC making the submissions set out above as regards the Subsidised Condition. Overall, therefore, HMRC invite the Tribunal to consider this point afresh.

The decision in Redevco

45. During the hearing, we invited the parties to provide their representation on *Redevco Properties UK 1 Ltd v HMRC* [2023] UKFTT 665 ('*Redevco*'). In this decision, the FTT considered the principle of judicial comity. Judge Brooks commented as follows:

"50. The principle of judicial comity was succinctly described by Judge Brown KC in the case of *The Executors of the Estate of Linington and another v HMRC* [2023] UKFTT 89 (TC). She said, at [177]:

"In summary, the principle requires that whilst courts of competent jurisdiction are not bound by the legal conclusions of one another's judgments, such conclusions will be highly persuasive and should be followed unless the second court is convinced that they are wrong. There was some debate as to the meaning of "convinced" (established by the Upper Tribunal to be the same as "satisfied" - see *Gilchrist v The Commissioners for Her Majesty's Revenue and Customs* [2014] UKUT 169 (TCC)), and whether the second court (or Tribunal) must consider them to be "plainly" or "clearly" wrong (as determined in *HMRC v Abdul Noor* [2013] UKUT 71 (TCC)).

51. *Linington* concerned IHT planning arrangements that were "broadly" the same as those in the case of *Salinger and Kirby v HMRC* [2016] UKFTT 677 (TC). Although the principle of comity was considered, the parties agreed

that Judge Brown should “simply” reach her decision on the law and facts of the case. If, as a result, she came to a different conclusion than the Tribunal had in *Salinger*, she should determine the appeal by reference to her own conclusions without considering whether she “was ‘convinced’ or ‘satisfied’ that *Salinger* was wrong” (see *Linnington* at [178]).

52. This is, in fact, exactly what she did saying, at [179]:

“I express no view on whether, in the light of the evidence available to it, the Tribunal in *Salinger* was wrong, but I have reached a different conclusion by reference to the evidence and legal arguments as they were presented to me.”

53. It is clear from an article in *Taxation* by the appellant in *Linnington* who had appeared in person – HMRC were represented by two counsel – that permission had been granted for an appeal against the decision *Salinger* which had initially been listed before the Upper Tribunal for 30 April 2018. However:

“... just a few days before the hearing I was told that it had been postponed. It was rescheduled for November 2018 and a few days before the hearing date HMRC informed me that it was now no longer going to take place. HMRC refused to give a reason for this, stating taxpayers’ confidentiality. However, my understanding is that the Salinger family pulled out due to concerns about costs.”

It was similar concerns about costs in *Linnington* that had led to the appellant acting in person in that case. She explained in the *Taxation* article, that she was “very mindful of the fact that even if we won at an FTT then HMRC would be likely to appeal and that we might have to pull out of a Upper Tribunal if there were any risks of incurring HMRC’s costs.” (See Bridget Jones, ‘A most uneven fight: me v HMRC’ (2023) Volume 191 (Issue 4487), *Taxation*, 11 May 2023)

54. Although there is no indication in the article that concerns about costs had any bearing on the agreement of the parties that Judge Brown should reach her own decision without reference to *Salinger*, that agreement is enough, in my judgment, to distinguish *Linnington* from the other authorities, particularly *Gilchrist v HMRC* [2014] UKUT 169 (TCC) which was cited by Judge Brown in *Linnington*.

55. Mr Elliott described *Gilchrist*, a decision of the Upper Tribunal, as being “still the binding authority, the latest word on judicial comity.” Mr Margolin also accepts that the position under *Gilchrist* is that a tribunal should as a matter of comity follow a prior decision unless satisfied that it is wrong. I agree.

56. Therefore, given the clear and obvious similarity between the almost identical statutory provisions considered in *Panayi* and those in the present case, I should follow *Panayi* unless I consider it to have been wrongly decided.”

46. Collins submits that the arguments in this appeal are exactly the same as the arguments made in *Quinn* and that HMRC have failed to show an error of law, or that the decision was wrong, by just reiterating the same points in identical circumstances.

47. HMRC’s submissions are that the test adopted in *Redevco* is that the Tribunal should follow the decision of a court of coordinate jurisdiction unless satisfied that it is wrong. The fact that the same or similar arguments are advanced should not be a relevant consideration. The Tribunal is either satisfied the decision is wrong or not satisfied. HMRC argues that simply disagreeing with the reasoning of the prior decision is sufficient for this Tribunal to find that there was an error of law and that the decision is wrong.

Conclusion on Subsidised Condition

48. We agree with the comments made by Judge Brooks in *Redevco* and therefore we should follow *Quinn* unless we consider it to have been wrongly decided. Having considered HMRC’s submissions regarding the approach that should be taken to the statutory construction of the relevant provisions, we are not satisfied that the decision is wrong.

49. Returning to the relevant provision, it states:

“1138 “Subsidised expenditure”

(1) For the purposes of this Part a company's expenditure is treated as subsidised—

(a) if a notified State aid is, or has been, obtained in respect of—

(i) the whole or part of the expenditure, or

(ii) any other expenditure (whenever incurred) attributable to the same research and development project,

(b) to the extent that a grant or subsidy (other than a notified State aid) is obtained in respect of the expenditure,

(c) to the extent that it is otherwise met directly or indirectly by a person other than the company.”

50. We have considered the submissions made by both parties in *Quinn* and in this appeal, as well as the facts and circumstances of both cases, and we do not consider it appropriate to distinguish that decision. In fact, we considered there to be striking similarities in both cases. Both appeals concern contractual bargains to provide specified works to the client in return for payment of an agreed price for those works from the client, subject to the detailed terms and conditions set out in the construction contracts. The price which is then agreed may or may not in fact be sufficient to cover the costs actually incurred in fulfilling the terms of the relevant contract, with the appellants simply factoring costs such as those relating to R&D into the price it wishes to charge in order to seek to achieve its desired commercial return. Clients do not agree to pay or reimburse the appellants for particular costs, such as the claimed expenditure, and the appellants did not agree to carry out the relevant R&D on being paid or reimbursed by the client for doing so. The bargain made between the parties is not for the appellants to incur specific costs such as the claimed expenditure in return for the clients agreeing to pay those specific costs. We therefore consider it appropriate to adopt the same approach as that taken by Judge Morgan in *Quinn*.

51. It is clear that HMRC disagree with that decision and have argued in this appeal, and in *Quinn*, that a different approach should be taken to the statutory construction of the relevant provisions. We do not consider the Tribunal to have erred in its interpretation of the word “otherwise” as intended to operate as a form of sweep up provision to capture cases where expenditure is met in a similar sense to the previously referred to categories. Such an

interpretation is supported by the UT in *Perenco*, and we are unconvinced that this interpretation is wrong on the basis of HMRC's submissions regarding *Uddin*, a criminal case concerning the provisions of the Domestic Violence, Crime and Victims Act 2004 which considers at [34] the meaning of words "or otherwise" (not used in the relevant provision in this case).

52. We also do not consider the Tribunal's reference to the heading of section 1138 means that the Tribunal wrongly attributes significance to it. As HMRC submits, a heading can be considered to serve as a brief guide to the material to which it relates, but it may not cover everything falling within the provision. We consider this was the approach taken by the Tribunal, as referred to explicitly at [47]: "The use of that particular term indicates the scope of Condition E in general terms as then further explained in s 1138, albeit that the use of that term in the heading to that section does not control the operation of the substantive provisions in that section."

53. We agree with the Tribunal's view that the requirement in sections 1138(1)(a) and (b) that the relevant funding must be "obtained...in respect of" the relevant expenditure reinforces that there must be a clear link between the funding and the use of the funds for the payment or discharge of the relevant R&D costs. We also agree that the use of the word "met" in section 1138(1)(c) of itself suggests that there must be such a link. We consider this view to be consistent with the definition of 'met' referred to by HMRC as including the fulfilment of a financial obligation.

54. We disagree with HMRC's view that it is not clear from the Tribunal's analysis what would fall within section 1138(1)(c), and whether it must be something akin to a grant or subsidy. The Tribunal at [47(2)] does not refer to something similar to a grant or subsidy. The Tribunal refers to the provision capturing cases where expenditure is not "met" by State aid or a grant or subsidy but is "met" in a similar sense to that in which expenditure may be said to be "met" by State aid or a grant or subsidy.

55. It is also clear from the decision, at [47], that the Tribunal considers that section 1138(1)(c) is not intended to apply in circumstances such as those in this case (namely, a commercial contract), in the absence of a clear link between the price paid by the Client and the expenditure on R&D. We do not consider this to amount to a gloss on the statutory wording which refers to expenditure being met directly or indirectly, as HMRC submit. We also do not consider this demonstrates that the case was wrongly decided.

56. The approach taken in *Quinn* was specifically referred to and adopted by the Upper Tribunal in *Perenco*. Our view is that the Upper Tribunal was fully aware that the cases concerned different statutory regimes, and we are not convinced by HMRC's submission that the Upper Tribunal did not take an appropriate approach to the statutory construction.

57. We do not disagree with the reasoning in *Quinn*, nor do we find that there was an error of law in that decision. We also consider that the circumstances of this case and *Quinn* are far removed from those which are intended to be captured by section 1138(1)(c) on a fair reading of it in the context of the whole of section 1138 and the overall SME scheme.

58. We are not satisfied that the case was wrongly decided and following that decision we have also concluded that the relevant expenditure was not subsidised expenditure for the purposes of section 1138.

Contracted Out Condition

59. The Contracted Out issue concerns whether the expenditure was “...incurred by the company in carrying on activities which are contracted out to the company by any person” for the purposes of sections 1052(5) and 1053(4).

60. HMRC submits that the expenditure was incurred by the company in carrying on activities where Collins had entered into contracts with clients under which it contracted to provide works including design, manufacture, and construction obligations, and it is common ground that the expenditure was incurred to fulfil those contractual obligations under each contract. Collins agreed to provide various works to its clients, subject to specifications and technical requirements. In order to design, develop, manufacture, install or otherwise provide those works, Collins had to incur expenditure some of which, as it turned out, fell within the definition of R&D expenditure as an R&D Project. This was clearly carried out to prepare the designs for the works, or to develop construction methods or processes for the works. Had the contracts not been in place, Collins would not have incurred the expenditure.

61. Collins argues that in order for the expenditure to have been incurred by Collins in carrying on activities which are contracted out to it for these purposes, the R&D activities would have to have been required by the terms of the contracts, or within the parties’ reasonable contemplation at the time of contract, which was not the case.

The legal rights and obligations of the parties

62. HMRC contends that the first step is to identify the activities contracted out to Collins, such as a contract for the refurbishment and fit-out for an office building to the client’s specifications. The ‘activities’ contracted out to Collins were the design and construction elements of the works. There is no reference in the statutory provision to “specific activities” or “R&D activities” having been contracted out. This step involves an identification of the Appellant’s obligations by reference to the contractual arrangements. The second is to identify whether the expenditure was incurred in carrying on that activity. This involves considering whether what occurred falls within the statutory description. The question is not resolved by the identification of the parties’ obligations as a matter of contract, rather once those have been identified one has then to go on and consider whether in the light of those obligations the relevant legal description in the statute is satisfied, see *AI Lofts Limited v HMRC* [2010] STC 214 (“*AI Lofts*”) at [40], and in so doing construe the provisions purposively and applying them to the facts viewed realistically. The test is an objective test and does not depend on the parties’ intentions or what was in their ‘reasonable contemplation at the time of contract’. There is simply no basis for this gloss on the statutory wording.

63. We consider it appropriate to adopt the approach set out in *AI Lofts* at [40], which states as follows:

“[40] What I understand Laws J to be saying is that the *identification* of the parties’ obligations is a matter of contract. But once their obligations have been identified, the *nature* or *classification* of those obligations, and in particular whether they answer a particular statutory description, is not necessarily concluded by the contract. It may well be, even in a tripartite situation, that they do; but it is not inevitable. Read in this way, it seems to me that Reed exemplifies a common method of reasoning. The court is often called upon to decide whether a written contract falls within a particular legal description. In so doing the court will identify the rights and

obligations of the parties as a matter of construction of the written agreement; but it will then go on to consider whether those obligations fall within the relevant legal description. Thus the question may be whether those rights and obligations are properly characterised as a licence or tenancy (as in *Street v Mountford* [1985] 2 All ER 289, [1985] AC 809); or as a fixed or floating charge (as in *Agnew v IRC* [2001] UKPC 28, [2001] 2 AC 710), or as a consumer hire agreement (as in *TRM Copy Centres (UK) Ltd v Lanwall Services Ltd* [2009] UKHL 35, [2009] 4 All ER 33, [2009] 1 WLR 1375). In all these cases the starting point is to identify the legal rights and obligations of the parties as a matter of contract before going on to classify them.”

64. We therefore consider the first step is to identify the legal rights and obligations of the parties as a matter of contract. In doing so, we have considered HMRC’s submission that the legislation and guidelines provide a lengthy, broad and complex definition of R&D, that on a practical level, it is unlikely to be evident what activities are R&D, that a client approaching a company to carry out a particular project may well not appreciate that the company will have to undertake activities qualifying to carry out the project or indeed that a commercial project may involve an R&D project, that this is a complex question of fact and, given that, it seems unlikely such a client would specifically ask the company to carry out activities qualifying as R&D under the R&D guidelines.

65. HMRC also submits that the expenditure was incurred in carrying on the activity contracted out to Collins on the basis that:

(1) The R&D Report prepared for Collins in relation to the 2018 accounting period states in relation to one project: “Although many of the Client specifications could be achieved using standard processes within the industry, many specifications could not be met using readily available solutions. This was because either an appropriate solution did not exist or a solution was not feasible in this context.”

(2) The Report goes on to list the R&D activities Collins undertook in order to meet the Client’s contractual specifications and there are examples within the projects where there was express reference within the contractual documents to something which has been claimed as R&D expenditure.

(3) In respect of the Euston Road project, the Architectural Information states in relation to ‘methodology’ for demolition works “mindful of the access limitations on Stephenson Way due to the HS2 works”.

(4) In the 2019 R&D Report, the list of R&D activities stipulated for this project included advances sought because of “road and traffic restrictions due to HS2”.

(5) In respect of the Coronet Street project, the expenditure on the doors was incurred in the course of carrying on activities contracted out to Collins by its customer. The ‘Fire Stopping Systems’ document provides the requirements and performance specification. The fire strategy drawings detail that the fire doors were required to have a fire rating of 30 minutes. Drawings specify for there to be a “bronze finish” to the doors and the fire doors are included within the contract sum analysis.

(6) The 2018 R&D Report lists a number of aspects of the Coronet Street project. In relation to ‘Fire Escape Doors’ it states “The Client wanted brass cladding to be

incorporated into the fire escape doors for aesthetics purposes. As a consequence of incorporating brass (an unconventional material to use in this context), the overall product would lose its fire rating and would not pass relevant health and safety regulations. CCL therefore sought to develop a method which would not only meet the aesthetic specifications from the Client, but also achieve a certified thirty-minute fire rating.”

66. Collins submit that, on the fact of this appeal, the R&D activities were not “contracted out to” Collins and in particular:

- (1) The terms of the contracts do not implicitly or explicitly require or envisage that Collins will have to carry out any R&D nor the specific R&D activities.
- (2) Collins entered into a number of contracts on the same broad terms and on the provision of similar information at tender stage, in which R&D activities were not carried out.
- (3) Further, and within projects, specifications of the contracts that ultimately led to the R&D activities are indistinguishable from those that did not lead to R&D being carried out. For example, the specifications for the doors in Coronet Street and those for the windows in the same project.
- (4) There was no provision for payment in respect of the R&D activities, and Collins undertook such work at its own economic risk.
- (5) At the time of tender, the parties were unaware whether R&D would have to be undertaken in order to carry out the project. In fact, the need for R&D would generally only be discovered once work had begun.
- (6) Clients generally do not have the technological expertise to understand the R&D issues.
- (7) In the vast majority of projects, Collins retained intellectual property it created in fulfilling the contract and was free to deploy any advances in its future work.

67. Having considered the submissions made by the parties, the evidence before the Tribunal and our findings on the facts, with regard to the legal rights and obligations of the parties, we find (similar to the findings made by Judge Morgan in circumstances concerning similar contracts in *Quinn* at [47(4)]) that:

- (1) The contractual bargain between Collins and its clients is for Collins to provide specified “works” to the client in return for payment of an agreed price for those works from the client, subject to the detailed terms and conditions set out in the construction contracts.
- (2) For the reasons set out in Mr Bartram’s evidence (and as shown in the documents produced in the bundles) the price which is then agreed may or may not in fact be sufficient to cover the costs Collins actually incurs in fulfilling the terms of the relevant contract.
- (3) The parties agree that Collins has the ownership rights to any fruits of the R&D.
- (4) It is plain, therefore, that under the contracts, clients do not agree to pay or reimburse Collins for carrying out the relevant R&D, and Collins does not agree to

carry out the relevant R&D on being paid or reimbursed by the client for doing so. In other words, the bargain made between the parties is not for Collins to undertake R&D activities on behalf of the client.

Whether those obligations fall within the relevant legal description

68. In determining whether those obligations fall within the relevant “contracted out” provision, it is helpful to return to the wording of the relevant provisions.

“1052 Qualifying expenditure on in-house direct R&D

(1) A company's “qualifying expenditure on in-house direct research and development” means expenditure incurred by it in relation to which each of conditions A, B, D and E is met.

...

(5) Condition D is that the expenditure is not incurred by the company in carrying on activities which are contracted out to the company by any person.

1053 Qualifying expenditure on contracted out R&D

(1) A company's “qualifying expenditure on contracted out research and development” means expenditure—

...

(b) in relation to which each of conditions A, C and D is met.

...

(4) Condition C is that the expenditure is not incurred by the company in carrying on activities which are contracted out to the company by any person.”

Purpose of the provisions

69. With regard to the purpose of the provisions, HMRC submits:

(1) a principal SME can claim if it meets the conditions in section 1053 (qualifying expenditure on contracted out R&D). The legislation quite deliberately does not limit the rule to where a contract specifically requires a person to incur expenditure qualifying as R&D expenditure, but rather excludes from relief in the hands of the contractor, any R&D expenditure incurred by it in the course of carrying on the activities contracted out to it. This is a broad prophylactic provision. Were it otherwise, the parties could effectively choose whether or not the Contracted Out Condition applied by the terms of the contract adopted;

(2) the Contracted Out Condition fulfils a key purpose of the legislation, being to confine the right to enhanced R&D Relief to the SME principal, who is funding the R&D and indeed to ensure that no enhanced Relief is given indirectly to what is, in economic substance, the expenditure of large companies who contract out work to SMEs. Its function is not to ensure that if it denies relief to one party, another party gets the relief;

(3) the legislation does not provide that there must always be a claim by someone for expenditure qualifying as R&D Expenditure. The right to claim enhanced R&D relief in

respect of R&D expenditure is heavily circumscribed and it is evident that not all such expenditure will qualify for the relief. It is not appropriate to assume that there must always be a claim by someone for enhanced R&D relief and then contort the legislation to meet that aim;

(4) whilst Collins cannot claim enhanced R&D relief where it fails the Contracted Out Condition, it may be entitled to claim a payable tax credit, known as a research and development expenditure credit ('RDEC') provided its customer is a 'large company' for the purposes of the statute (a large company cannot claim enhanced R&D relief and cannot claim RDEC on expenditure on work contracted out to an SME);

(5) this is hardly a surprising result as a large company cannot claim enhanced R&D relief (the scheme is not intended to be available for a large company which does not require the correction of any market failure given their economic power but may be entitled to the lower rate of RDEC where it conducts its own R&D) and so it would be surprising and would subvert the scheme if, where a large company contracted out work to an SME, the SME was entitled to claim enhanced R&D relief on what is, in substance, R&D expenditure of the principal large company funded by the large company whose expenditure was never intended to benefit from enhanced R&D relief. Hence it makes perfect sense that the SME should be entitled to claim RDEC where a large company contracts out work to it, but not enhanced R&D relief;

(6) similarly, if an SME contracts out work to another SME, then it is only the principal which can claim and not the contractor as the expenditure is in essence, expenditure of the principal funded by the principal and it is key to the architecture of the scheme that only a principal can claim;

(7) the enhanced R&D relief scheme is complex as is its relationship with RDEC, itself a complex scheme. It is quite wrong to start with an assumption that either the principal or the contractor must be able to claim enhanced relief in every case and then to seek to force the legislation into a form which gives that result.

70. However, we agree with the submission made by Collins that the purpose and function of the conditions preventing claims for expenditure on activities that have been "contracted out" is to operate in concert with those provisions that provide for SMEs to be able to claim for expenditure on "contracted out R&D" (CTA 2009 section 1053). Together, these rules operate to prevent double relief for the same R&D by passing the ability to claim up the chain to the company that has commissioned, and paid for, the R&D activity. That is a limited and direct purpose.

71. In identifying the meaning borne by the words which Parliament used in the context of the legislation, we also agree with Collins that this interpretation is supported by the Explanatory Notes regarding the predecessor provisions. We consider these Explanatory Notes to be helpful as an aid to interpretation which casts light on the objective setting or contextual scene of the statute and the mischief at which it is aimed (see *R (Westminster City Council) v National Asylum Support Service* [2002] UKHL 38 at [5]). Paragraph 18 of the Explanatory Notes states that the provision "requires that expenditure is not incurred by a company in carrying out activities contracted to it by another person. This complements the rules relating to sub-contracted R&D in paragraphs 9 to 12, which allow the principal to

claim R&D Tax Relief where R&D is contracted out, and prevents double relief for the same R&D”.

72. We also consider this interpretation to be consistent with the decision in *Quinn*, and with paragraph 17 of the Explanatory Notes concerning intellectual property. Although the intellectual property condition is now abolished, we consider the Explanatory Notes in relation to that condition remain helpful as an aid to understanding the contextual scene and identifying the mischief which the statute was seeking to remedy. It states that the “purpose of this test is to identify the person who has the ownership rights to any fruits of the R&D. A person must have such ownership rights to claim R&D Tax Relief. It prevents people who are carrying on R&D activities on behalf of another person (‘sub-contractors’) from claiming R&D tax relief for that work”.

73. Objectively assessing the meaning which a reasonable legislature would be seeking to convey in using the words “contracted out” and “contracted out R&D”, we do not consider the broad interpretation suggested by HMRC to be appropriate. We consider the natural meaning of the words used in the provisions excludes the relief in circumstances where the qualifying expenditure is on research and development activities, when those activities are carried out on behalf of another person.

Conclusion on Contracted Out Condition

74. Having found that the contracts between Collins and their clients do not “contract out” R&D activities to be carried out on behalf of the Client, we have concluded that the expenditure was not incurred by Collins in carrying on activities which are contracted out to Collins by any person, for the purposes of the relevant statutory provisions.

CONCLUSION

75. For the reasons set out above, we allow this appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

76. 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.

**KIM SUKUL
TRIBUNAL JUDGE**

Release date: 21st OCTOBER 2024