[2021] UKFTT 0437 (TC)

TC 08321

CORPORATION TAX – consideration of whether the Appellant is not entitled to "enhanced research and development allowances" under Chapter 2 of Part 12 of the Corporation Tax Act 2009 because the relevant expenditure for which this relief is claimed is "otherwise met directly or indirectly by a person other than the company" under s 1138(1)(c) of that Act - appeal allowed in principle

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2020/01846

BETWEEN

QUINN (LONDON) LIMITED **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JUDGE HARRIET MORGAN

The hearing took place on 10 and 11 June 2020. With the consent of the parties, the hearing was on the Tribunal video platform. A face to face hearing was not held because of the restrictions imposed as a result of the coronavirus pandemic. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Mr Laurent Sykes QC, counsel, instructed by Stewarts Law LLP, for the Appellant

Mr Francis Fitzpatrick QC, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents ("HMRC")

DECISION

Introduction

1. Quinn (London) Limited ("**Quinn**") has appealed against HMRC's refusal of its claims for what is commonly referred to as "enhanced research and development relief" made in respect of its accounting periods ending on 31 May 2017 and 2018 ("**the relevant periods**") under the provisions of Chapter 2 of Part 13 of the Corporation Tax Act 2009 ("**CTA 2009**"). I refer to these provisions as the "**SME scheme**" and to the relief provided for under the SME scheme as "**enhanced R&D relief**". HMRC refused Quinn's claims for enhanced R&D relief and amended its tax returns for the relevant periods on closing its enquiries into those returns on 21 April 2020 (under para 32(1A) of schedule 18 of the Finance Act 1998). All references in this decision to sections, parts and chapters are to those in CTA 2009 unless expressly stated to the contrary.

2. Under the SME scheme, where certain conditions are satisfied, in computing its profits for corporation tax purposes for an accounting period a company is entitled to a deduction of 130% of "qualifying Chapter 2 expenditure", which includes "qualifying expenditure on in-house direct research and development" ("**R&D**") which meets a number of conditions, including that it is incurred by the company and is not "subsidised". The conditions for this enhanced R&D relief to apply are that during the relevant accounting period, the company is a small or medium sized enterprise ("**SME**"), (b) it carries on a trade, and (b) the "qualifying Chapter 2 expenditure" is otherwise allowable as a deduction in calculating the profits of the company's trade for that period for corporation tax purposes.

3. Quinn carries on and, during the relevant periods carried on, a trade of providing construction and refurbishment works to a range of clients (the "**Clients**") in return for an agreed price. HMRC accept that, during the relevant periods, Quinn was an SME and that, in the course of its trade as carried on in those periods, Quinn has carried out R&D and has expended sums on the R&D which it was entitled to deduct in computing its taxable profits for the relevant periods for corporation tax purposes ("**the claimed expenditure**"). HMRC contend, however, that Quinn is not entitled to the enhanced R&D relief it has claimed in respect of the claimed expenditure on the basis that the claimed expenditure is "subsidised" within the meaning of s 1138(1)(c).

4. The question of whether the claimed expenditure falls within s 1138(1)(c), therefore, is the only issue in this appeal. Section 1138 reads as follows:

> "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, and
> (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." (Emphasis added.)

5. In brief, HMRC said that it suffices for s 1138(1)(c) to apply that the relevant R&D was carried out by Quinn in the course of it providing construction and refurbishment services to its Clients for which it was entitled to payment from the Clients of a sufficient amount to cover the claimed expenditure and which was in due course paid. In their view, it follows that the Clients indirectly "met" the claimed expenditure by paying Quinn for its services. Quinn argued that, on the contrary, it cannot be said that the claimed expenditure was "met" by Clients who, under an entirely commercial arrangement, simply paid a price for a product, the finished building works.

Facts

6. The facts set out below are based on the evidence of Mr Wells and the supporting documents produced in the bundles. Mr Wells held the position of "Heritage Commercial Manager "at Quinn since he joined the company in 2015. He has 40 years of experience in the construction industry. There was no factual dispute. The evidence of Mr Wells was accepted, and he was asked only a few clarificatory questions at the hearing. Witness statements were also produced by Mr Sean Coneeny, an officer of HMRC, and Ms Jennifer Tragner, a technical director of ForrestBrown Limited, a specialist R&D tax consultancy. Their evidence was not relevant and so is not recorded in this decision except as regards the evidence Ms Tragner gave referred to at [69] below.

7. Quinn is a construction company which operates across the UK through four separate divisions each of which has a specific target market: "heritage" deals with listed buildings and museums, "property services" focuses on refurbishment projects, "major works" specialises in new build and large-scale design and build contracts, and "central London" deals with projects of up to £10 million in the London area. Quinn undertakes contracts for a variety of customer types, including local authorities, property developers, hospital trusts and housing associations. Projects span the commercial fit out, social housing, education, heritage, public buildings, healthcare, retail, residential and leisure sectors.

8. Mr Wells set out details of three projects as samples of the projects undertaken in relation to which expenditure on research and development was incurred: works at Gunnersbury Park, Pitzhanger Manor and Radio House. All three projects were undertaken under traditional building contracts from a contractual perspective, based on the JCT Standard Building Contract Without Quantities (2011). This contract form is standardised and widely used in various construction projects in the UK whether by Quinn or third parties. In Mr Wells experience, there is nothing very unusual in the way the contractual arrangements operate for these three projects.

9. Each of these projects generated new technological knowledge or capability, which Quinn was then able to carry forward and exploit in future commercial work. This knowledge is of no value to Quinn's Clients, who often have no knowledge of the technical solutions that Quinn have come up with (or tried to come up with) during work on their site.

Three sample projects

10. Gunnersbury Park:

(1) On this project Quinn was tasked with restoring a Grade II Large Mansion by undertaking a refurbishment and conservation project of the mid-17th century Mansion and nearby parkland structures within a live, publicly open environment:

(a) This involved work to be carried out in the external aspects of the site, in line with the Client's specifications including (a) the restoration of the building façade which involved stripping the existing lead paint, structural repairs, Roman cement

render repairs to over 50% of the building fabric and applying KEIM mineral paint finish, (b) the restoration of 200 doors and windows, (c) structural roof repairs consisting of refitting existing or fitting new slate roof tiles, and installing new asphalt roofs and a substantial amount of new lead work, (d) the restoration of the existing chimneys, roof lights, and lanterns including new lead flashings, (d) the provision of all new heating and electrical services, (e) lime plastering and carpentry, (f) significant work on the lakes, (g) extensive protection works to existing roof lights, (h) the installation of box gutters and refurbishment of rain water pipes, and (i) the provision of a new café building.

(b) The Client also required a number of internal structural works, repairs and restorations and floor strengthening works and the installation of new mechanical, electrical and plumbing services throughout the building, a platform lift, a featured passenger lift, conservation works to existing fire places and decorative ceilings with fit-out works that would provide a museum to the community and apartments at one end of the Mansion overlooking the parkland.

(c) Quinn also restored the landscape, including by bringing a U-shaped pond, water features and follies back to their 19th century splendour.

(2) This project consisted of a number of deliverables in relation to a large, complex set of works, involving a number of different sub-contractors, where the works could impact on each other, for a total agreed contract sum set at the outset.

(3) During this project, Quinn developed a number of novel techniques for the refurbishment of heritage properties, including: (a) providing safety features on the pond using innovative designs to recreate Victorian appearances but which comply with modern health and safety requirements, (b) devising a process to replace load-bearing timber floor joists with steel supports, without compromising or damaging the listed structure, and (c) devising methods to measure the strength and integrity of a seventeenth century stone cantilevered landing and staircase, and (d) the adaptation of a micro-pile system to allow for installation of a lift shaft into the listed structure.

(4) In the pricing process for this contract, the requirements for the lake work were kept as a provisional sum; Quinn did not know the full extent of the works until it had done the design and carried out exploratory works. The requirement for the strengthening of the floor joists was known, and it was felt that this could be a technically complex deliverable to achieve. These works transpired to be more extensive than predicted. The strengthening work on the cantilevered landing and staircase was triggered by a revision to requirements during the project. Specifically, it was discovered that the anticipated use of the relevant area of the building would increase the structural requirements for the staircase, due to the chance of people queuing on the stairs and the landings to access that area. The micro-pile system was developed as the team identified an opportunity to improve existing technology to overcome unexpected poor ground conditions in an area which had restricted access and restricted head room.

11. Pitzhanger Manor:

(1) This is a major cultural venue in West London, comprising a Grade I listed manor house which was designed by Sir John Soane and now plays host to major art, architecture and design exhibitions following partial refurbishment in the 1980s. Quinn was engaged to undertake extensive renovation and conservation works to restore the manor house to its former glory and to enhance it as a destination for art and education. In the two centuries since Sir John Soane sold the manor, various owners had made significant alterations and additions to the house. The building project's objective was

to reveal the manor as it was in Sir John Soane's time, to conserve his work and to reinstate some of its key features which had been destroyed or concealed over the years.

(2) Key works undertaken at Pitzhanger Manor included: (a) the removal of a non-listed Victorian infill building between listed historic sections of the manor, (b) the creation of a basement underneath the building, (c) the reinstatement of the conservatory, roof light, and historic rooms, and (d) the installation of modern services to achieve a positive visitor experience, including small lifts to aid full accessibility.

(3) During this project, Quinn developed a method to reinstate authentic-looking pilasters which had been removed from a Grade I listed building and new techniques for strengthening damaged existing floor supports.

12. Radio House:

(1) This involved a fit out of an existing office building in Cambridge. The existing building had been stripped including the external envelope to the original reinforced concrete frame. Major structural works were completed to change the entrance location including creating a new steel mezzanine floor. The building was clad in a mixture of brickwork, curtain walling and glass reinforced concrete. The internal fit out captures the original details including the barrelled roof which involves intricate plaster work. This project was ranked excellent in terms of sustainability from a cost and environmental perspective.

(2) Key elements of works were (a) the demolition of existing façade, (b) the provision of a new roof and new brickwork to three facades, (c) the provision of curtain walling and glass reinforced concrete, and (d) the provision of new mechanical and electrical installation

(3) Due to the nature of the barrelled roof a new safety edge protection system had to be devised. A simple system would involve drilling into the structure. This would have been the first port of call but Quinn found unidentified asbestos within the concrete roof structure. Drilling under controlled asbestos regulations would have been costly and timely. Quinn searched the market and looked to edge protection specialists.

(4) Quinn required a clamping solution so the asbestos within the concrete roof structure was not disturbed. The only product that it could find on the market was a steel sheet solution which involved clamping the sheets in a vertical axis. Quinn required this solution but in a horizontal plane. A clamp was devised and tested on site and the method worked. Initially it was tested with posts. Quinn then placed the order for the full 90 meters. It engaged with the edge protection specialist to carry out training for its staff to enable them to install and most importantly modify it if required during this live project.

13. I have set out below Mr Wells' evidence on the detailed contractual terms and his explanation of how the contracts work in practice. It is useful to have in mind, when reading this, that the typical key basic terms of Quinns' contracts, as taken from one of the sample contracts, are as follows:

(1) Quinn's obligation is to provide "the Works" in a satisfactory state and to do so by the agreed deadline for an agreed fixed price. It is required to carry out and complete the Works and do so in a proper and workmanlike manner and in compliance with "the Contract Documents", "the Construction Phase Plan" and "the Statutory Requirements", and to give all notices required by "the Statutory Requirements".

(2) Contracts may distinguish between Works where Quinn is simply responsible for following someone else's design and those where it is responsible for the design of the Works, referred to as a "Design Portion".

(3) There are provisions setting out the standards applicable to the Works for which Quinn assumes responsibility: in particular they must confirm to "the Employer's Requirements" and Quinn is liable for any "Design Portion" to the same standard as would apply if Quinn were an architect.

(4) Provision is made for insurance.

(5) There is provision for poor workmanship or works to be corrected at Quinn's expense before the Completion Date and for it to remedy defects at its own expense after the Completion Date. The Works must be carried out by Quinn by the Completion Date and late completion attracts penalties such as liquidated damages and extensions of time are not given through fault of Quinn.

(6) The copyright in any design (the drawings and specifications to be followed in order to complete the Works) remains vested in Quinn.

(7) As noted the price is a fixed sum and, in the samples "fluctuation option A" was chosen which means that there is no adjustment to the fixed contract price for changes in the cost of labour or materials. The sum may not be varied (even for error) subject to the mechanisms set out. The JCT Guide at 94 states: "There is no contractual provision or mechanism for correcting erroneous rates or unit prices in the Contract Bills or other Priced Document and those rates and prices will continue to form the basis for any valuation of work of a similar character under the Valuation Rules." The price can be modified, however, if the scope of the work changes. The process for "Variations" (meaning subsequent agreed variations to the scope of the contract) is that the price is to be agreed on the same basis as the original contracts.

(8) Interim payments made by Clients are based on the value received by the Clients rather than the costs incurred by Quinn.

14. Mr Wells made the following main points on pricing:

(1) The Client is not interested in Quinn's expenditure. The Client is interested in the results Quinn has agreed to provide and not in Quinn's costs to fulfil that obligation. Because of the way the contract is typically structured, Quinn takes on many risks in order to fulfil those obligations with scope for profit as well. The costs which formed the basis for the enhanced R&D relief claims all fit into the contractual framework described. They are costs which Quinn incurs in delivering its product to the client.

(2) With items where Quinn has no design responsibility, Quinn is given all the detailed information it needs to do the works. Where it is responsible for design, it is given an outline brief of what the client requires the result to be and "it is up to us to work out how we get there". Quinn might get drawings but there may be only a single drawing. For instance, where the Client wants a lift, Quinn will be told, what its required speed is, its load bearing capacity, its dimensions, what it is to look like but Quinn will decide the rest. So, where there is a design element to the works, Quinn is not told how to design the works but is responsible for working this out itself. The design work is a means to an end, namely, to providing the final works Quinn has contracted to provide.

(3) Quinn uses external sources to identify potentially suitable tenders for commercial projects and applies weighted scores to various aspects of the job, including security of finance, whether Quinn has previously worked with the Client, and geography. These commercial considerations inform the pricing of a particular tender. For example, securing a project with a particular local authority, and then delivering it well, is likely to lead to further opportunities in the future. This relationship is therefore commercially advantageous to Quinn and this intangible value is likely to be factored into the pricing of the tender.

(4) A tender quote is always first based on a consideration of cost, and this includes materials, staff costs, costs of subcontractors and more general overheads. A profit margin is then factored in. As part of this process, Quinn seeks quotes from its own supply chain to produce as accurate an estimate of the likely expenditure as possible. Given the complexity of this type and scale of project, this detailed process of estimating the extent of likely costs is essential for the business to operate commercially. The team which puts together such estimates rely heavily on their experience and knowledge of similar projects to arrive at the appropriate figures. They are, however, still estimates of the likely costs to be incurred. Quinn seeks to build in some flexibility on costs where possible by putting in contingencies to ensure that the profit margin is not affected if costs end up being more than expected as can frequently happen (particularly where there is a large design element, as the Client's requirements do not provide enough detail for Quinn to know with precision what the work will cost). This could be a dedicated figure labelled as such or Quinn could build it into a higher profit margin.

(5) For all projects, a fixed price is then agreed for the work to be done although in practice this tends to be modified as works progress as further additional work is commissioned following a similar process to that undertaken at the outset.

(6) This tendering process is consistent across the business, and the three projects described above were all dealt with in this way.

(7) The anticipated profit does not match the actual profit as can be seen from the final "Cost Value Reconciliations" ("**CVRs**") for each of the projects. CVRs are maintained every month from inception of the project. The CVRs do not simply end when the project comes to an end as Quinn continues to be liable for defective works. For instance, in November 2019 there was work to be remedied at Gunnersbury in respect of the stucco paint in a couple of points and Quinn recently had discussions with the Client in respect of asbestos in the basement of the building. These additional works are reflected in an updated CVR even though the project formally ended a long while ago.

(8) The fixed contract sum agreed with the Client is broken down and itemised, but this represents Quinn's quote for each package of works rather than a breakdown of expenditure. In all cases, the fixed contract sum is payable in instalments throughout the overall commercial project. The Client places no restrictions on the manner in which Quinn uses the receipts; the receipts are not ringfenced, and there is no contractual obligation to only use receipts from a Client against the work done for that Client.

(9) To calculate these milestone payments, one of Quinn's quantity surveyors working on the project prepares a valuation. This valuation is passed to the principal quantity surveyor ("**PQS**"), who operates on behalf of the Client and reviews the calculation and either determines that it reflects accurately the value of the work delivered to that point or, if not, revises the figures. The PQS valuation is a calculation of Quinn's entitlement to value, taking into account any amounts which it has forfeited through non-compliance (for example, in the subcontract warranties, if the warranty is not delivered within 30 days, there is a penalty and payment is withheld or a percentage deducted).

(10) The disconnect between costs incurred and milestone payments can be seen when reviewing the monthly CVRs. It is possible, and not uncommon, for Quinn to be operating at a loss during a project, as costs incurred to date exceed the value of the work to the Client at any given point in time. Quinn may have to pay upfront for design for instance but there is no ability to charge the Client for that until the work is completed. Quinn cannot and does not expect its Clients to meet its expenditure, only to pay a value based on the work delivered to them.

(11) Quinn adopts a similar procedure for milestone payments to pay its subcontractors and, to the extent possible, aims to manage cashflow so that expenditure is aligned to income. However, if a payment from a Client is delayed for any reason, this has no impact on the payment terms for subcontractors (and other expenses), which must be met when they become due.

(12) In addition, payment terms with the subcontractors are determined through commercial negotiation with each subcontractor. There are some constraints imposed under the Housing, Grants and Regeneration Act (commonly referred to as the Construction Act). Any alignment achieved between outgoing payments to subcontractors and incoming milestone payments from Clients is achieved simply through effective negotiation.

15. Mr Wells explained that it is possible for the contract fixed price sum to be varied in a limited number of ways (a) through "fluctuations", (b) through the grant of an extension of time, with costs allowed, and (c) by agreed variations. Mr Wells said the following explanation is concerned with the ability of Quinn to increase the price charged rather than its liability to pay the client compensation or to incur additional costs.

(1) The contracts in question did not permit the contract price to be adjusted for fluctuations in changes in the prices of materials, labour or services based on factors such as inflation or supply issues. Raw material unit prices can be volatile, so in some construction contracts, the contractor may be allowed to increase its price if it suffers an increase in costs. In the three case study projects, the contracts specifically prevented any additional costs being charged to the Client for fluctuations other than Radio House which allowed for adjustments only if there is a change in statutory tax or duty rate.

(2) The risk of fluctuations being on Quinn has practical consequences. To take an extreme example, during the covid crisis the price of plaster increased dramatically given it was no longer being manufactured in the UK during the lockdown. This is a risk Quinn took on entering into the contract and it was a live one in that often the contract is entered into many months earlier – it could typically be a year and half before depending on the contract period. Similarly, if prices fall or are less than the amount shown in the initial tender documents Quinn benefits from that. Quinn also takes the risk for any cost arising from misunderstanding the scope of the work or if there is a co-ordination issue and of poor materials or bad workmanship. Quinn may or may not be able to recover these two from elsewhere in the project.

16. Mr Wells said the following as regards the situation when there are delays and extensions of time:

(1) If there is a delay, the starting point is that Quinn is liable to pay the client liquidated damages for each period of delay. For instance, in the Radio House contract liquidated damages are stated as £10,000 a week. So, if Quinn is late the Client serves a non-completion notice and ask for damages. If there is a delay due to a "relevant event" Quinn can get an extension of time which means it does not have to pay damages. In some cases, Quinn is entitled to costs for the change in circumstances. If it snows, for instance, Quinn can get an extension of time but weather is not something it can get costs for. If by contrast, Quinn is asked to do extra work, it is given extra time, and can then recover site costs such as rentals, additional costs for licences for scaffolding, any additional costs for telephone rental etc. Quinn needs to demonstrate its cost and this is always a bone of contention. It cannot claim loss of profit or the costs of preparing its schedule of costs. Loss of overhead recovery is contentious as Quinn needs to show the relevant staff could have been redeployed elsewhere which will require a bulging order book.

(2) Extensions of time can occur for a number of reasons. These are a necessary part of a large construction project, due to the complexity and interdependency of the different packages of works. For each project, there is an overall agreed program of works. If Quinn, or any supplier takes longer than planned to complete any part of the works for which it is responsible, and there are other aspects of the project which rely on completion of its work, this will have an impact on the overall program of works.

(3) Regardless of the reason for the delay, extra time on site results in additional costs, potentially across a number of project stakeholders. It is therefore necessary to have a process where the impact of the delay is considered. This consideration may result in an award of costs for the suppliers affected by the delay. Quinn may have to consider awarding costs to its suppliers. It cannot always pass this on to the Client. It depends on why the delay has occurred. Covid has caused delays – it can either be a "relevant matter" or not for the client. But if it has a lift supplier, the supplier will store the lift and will charge for the storage. That is the reality of today's market.

(4) Reasons for extensions could include an unforeseen aspect of the work necessitating R&D to resolve a complex technical issue. In this case, Quinn draws on additional technical personnel to work on the solution. Technical directors are typically not allocated to specific projects, but their costs are factored in as "overheads" in the contract sum. If they spend additional time working on the project, it is extremely rare for any additional allocation of overheads to be negotiated with a Client. They are a costed overhead regardless of how much time the technical director spends, Quinn still charges the same amount.

17. As regards agreed variations to the fixed contract price:

(1) The three projects referred to above all include a number of variations (with extensions of time), which has resulted in the final amount payable by the Client being greater than the initial agreed fixed contract sum. Variations are covered in detail in the terms of the contracts, which afford a degree of risk protection to each of Quinn and the Client by setting out a clear process for valuing variations. The most common trigger for a variation is a change to the Client's requirements; however, variations could be necessary due to unforeseen changes, such as unexpected site conditions, or could be instigated by a contractor. The price that Quinn submits for the change is linked to the price it has already submitted (for example, the price per square meter of plastering) and the Client can hold Quinn to the price. So, if Quinn has under-priced the plastering, it will have to live with this on the variation. If by contrast it has a good rate, the PQS cannot take that away from it. If the particular item is not already referred to, the contract requires a fair and reasonable price to be charged – so it up to Quinn to justify the price demanded.

(2) Whatever the trigger, the variation process follows a similar process to the pricing of the initial fixed contract sum and the points made above as to the risk it takes apply here too. Quinn estimates the costs for completion of the work and presents a pricing quote to the Client. There may be a process of negotiation, until ultimately a fixed price will be agreed for that scope of work. So, there is again an agreement based on estimated amounts. Quinn agrees the items individually both as to whether to include them and the price. That process can be long and drawn out. If Quinn does not correctly anticipate the work to be done, then the unanticipated cost is for Quinn's account. To take an example, the work on the Gunnersbury flooring involved installing a product in certain areas of the house where the owners (as opposed to the servants) used to live and where the under-floor design was different to reduce sound transmission. The Client wanted to use an innovative product called Corafill which gave 60-minute fire protection. Quinn had to price the installation work based on the anticipated strips to be used and it made a

significant difference, given the nature of the work, whether the strips were 3m by 3m or some other size. If Quinn got that wrong, this would have affected the ultimate cost and there is scope for it to get things like wrong before the work has actually started. There would be no ability to go back and renegotiate.

(3) For example, the work on the façade at Gunnersbury involved creating a new type of stucco based on a chemical analysis of the original stucco which Quinn had sent to labs for analysis. Quinn had to have it delivered in small batches since otherwise it would go bad. If Quinn did not work fast enough that would have been its loss subject to an agreed wastage factor. On Gunnersbury, in some cases, Quinn started the work that was the subject of the variation before it had agreed the price which also left it at risk because the subcontractors had been commissioned and some of the materials bought and the Client could have challenged the cost. Quinn did not really have a choice in this because delaying would also have a cost. Quinn cannot stop work because it has not agreed a price and is required to diligently proceed with the works – it needs to trust the contract mechanism to keep it out of pocket. This scenario happens a lot.

(4) Moreover, on variations, particularly when dealing with novel situations, Quinn takes the risk on things which are not down to materials or workmanship such as design, and pricing incorrectly.

(5) Non-recoverable costs for variations generally (such as where Quinn has made mistakes on the management of the scheme), are recorded separately in the CVR calculations and can be seen from the final CVRs. For instance, on another project Quinn had to do some work on a window. The site manager decided how the lead would go around the window. The architect disagreed and asked for it to be removed. Quinn had to call the lead contractor back and pay for him to re-do the work. This would go in the CVR as non-recoverable.

18. Mr Wells noted Quinn might also have non-recoverable items for things which are not variations. In relation to Gunnersbury there are examples of where costs are incorrectly estimated at the outset, whether in setting the price on a variation or setting the initial fixed price at the start of the project:

(1) One example relates to a variation relating to the café. Quinn assessed the cost of the blocks to be laid as part of this but the engineer recommended it to alter the way the blocks were laid to give additional stability. This meant that Quinn's estimate of the value of block and mortar used in the pricing was too low and this cost £7 per meter squared more than it was able to recover.

(2) An example relating to the original scope of work was the roofing of the main building. When Quinn measured this up it was done incorrectly, and it had to absorb the additional cost of £42,000.

19. Mr Wells produced a spreadsheet entitled "Numbers vs CVR" which shows the total difference with respect to sub-contractors, as opposed to other costs, as between the amount included in the amount charged to the client and the amount Quinn paid. He noted that it can be seen that the difference between the two varies. Sometimes an amount is recorded at the outset as a "provisional sum" where the precise scope of the work is not known but Quinn is deemed to have made allowance for the work in its pricing. The provisional sum is spent on instruction from the client and Quinn is deemed to have allowed the time for the particular work. In Gunnersbury for the ponds, it went through a number of different possibilities to meet the client's requirements and to stay within the cost reflected in the provisional sum.

20. The contracts with Clients are contingent on the successful delivery of the agreed works, and in entering into contracts for such large, complex projects, it is necessary for the contractual terms to clearly set out the parties' rights if the work is not satisfactorily delivered or if there

is a dispute. Quinn always takes out insurance policies to protect against normal risks. Under its contracts, it is liable for, and indemnifies its Client against, any injury or death caused to a person as a result of works as well as for any damage to real or personal property caused by the works. Quinn is contractually obliged to insure for these events, but in light of the risks this is also the only sensible commercial option.

21. Where Quinn is responsible for design, it is responsible for any flaws in the design. Quinn is often required to give a long-term warranty in respect of this. For instance, the lift shaft work on Gunnersbury involved a novel technique to spread the load without excavating too deep into the soil. It gave a 12-year warranty with respect to the design. As regards the pond at Gunnersbury it gave another long-term warranty. While in both cases it sought a similar warranty from the subcontractor (as part of the same document), this would not assist it if they went out of business. The contracts list the design portions of the contract.

22. The commercial contracts include a number of warranties covering the quality of the works delivered and ensures that any rectification of defects takes place at Quinn's cost. These provisions can be seen throughout the contracts for the three projects. In practice, if a Client expresses dissatisfaction with the works delivered, the first step is to dedicate additional resources to resolve these issues, at Quinn's own cost, to protect the client relationship. A number of warranties were given in respect of Gunnersbury. Where Quinn has a warranty, it needs to maintain insurance for the duration of the warranty. This is an additional cost, incurred for the duration of the warranty. A warranty is usually given where Quinn undertakes design work as is the case for all three projects. Quinn always undertakes design responsibility for temporary works such as scaffolding or boring a hole to access a particular element. In the case of Gunnersbury, the scaffolding was to be anchored to the ground so that it did not touch the building. Quinn designed the system and dismantled it. Because it is temporary, Quinn does not offer a warranty, but Quinn takes on the risk of the design. It is generally accepted that the contractor designs temporary works and takes responsibility for the design.

23. Quinn always takes responsibility for materials and workmanship (whether it does design work or not). On Gunnersbury, for instance a part of the ceiling came down recently. Quinn had to repair a small area of lime plaster which had not bonded to the timber. If the subcontractor is at fault through bad materials or bad workmanship, then Quinn can claim against them but not if they are out of business. There is generally snagging after 12 months, and a defects list is drawn up. Quinn may not be able to seek compensation from a sub-contractor, for example, if they are out of business.

24. This happened to quite a significant degree on the Radio House project during the life of the works. Both the electrical and mechanical contractor went under. The electrical contractor had almost finished so this represented an even greater future risk since no replacement would provide a warranty for the work already done. The additional costs incurred as a result of these administrations/insolvencies had been quantified using the CVR.

25. Mr Wells described a typical CVR by reference to the final CVR for Gunnersbury. He noted that (a) all the CVRs only include site costs, and (b) Quinn works on an overhead recovery of 7% of turnover work (on the basis of 4% for back-office costs and 3% for divisional costs). In other words, unless its margin in the CVRs is at least 7% it does not absorb its back office and divisional costs as these costs are not otherwise reflected in the CVRs. These costs include rent, rates and salaries of people employed as estimators, buyers and receptionists. He added that Quinn tries to get a margin of 12% as a minimum. It does not always achieve this and sometimes it does better.

26. In Mr Wells view:

> "Ultimately, we are engaged to restore a building with any necessary or desired changes to the existing building to be achieved e.g new fire systems or a lift where there was none.

> We seek to make a profit out of this or else there would be no point in doing what we do. The client is interested in the result and expects us to take responsibility for it. The costs in delivering that is for our account. We charge based partly on cost but the expenditure is very much ours."

Law

27. I have set out an overview of the tax rules relation to expenditure on R&D. On general principles, if a company incurs such expenditure of a revenue nature, it can deduct it in computing the profits of its trade for the relevant accounting period or periods for corporation tax purposes (which I refer to as obtaining "**ordinary relief**") (a) if it is wholly and exclusively incurred for the purposes of its trade (see s 54), or (b) it is related exclusively to the company's trade and is directly undertaken by or on behalf of the company (under s 87).

28. Where a company is entitled to ordinary relief in respect of expenditure it is also entitled to claim to bring an amount into account in its corporation tax computation, an "R&D Expenditure Credit" ('**RDEC'**), which it may be able to use to off-set certain tax liabilities or which may be payable to it in certain circumstances (under s 104A):

(1) The amount of RDEC is the relevant percentage of qualifying R&D expenditure for the period (11% for expenditure incurred from 1 April 2015; 12% for expenditure incurred on or after 1 January 2018; and 13% for expenditure incurred on or after 1 April 2020).

(2) In outline, RDEC is dealt with in seven steps in which it must or may (depending on the step) be used to cover tax liabilities of the company or another group company with any remaining credit being payable to the company in certain circumstances (see s104N).

(3) RDEC is available notwithstanding that the R&D expenditure is subsidised (see s 104A(3)(b), s 104F and s 104G).

(4) Whilst RDEC is available in addition to ordinary relief it is an alternative to a claim for enhanced relief (under s 104B). In other words, a company may not make a claim for RDEC and for enhanced R&D relief in respect of the same expenditure.

29. Enhanced R&D relief was introduced in 2000 it appears to provide a fiscal incentive to SMEs to incur expenditure on R&D. It is now contained in Part 13. The main provisions are as follows*:*

(1) Sections 1039(1) and (2) state:

> "(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) Section 1039(3) provides that relief under Chapter 2 is available to a SME and s 1039(7) provides that Chapter 2 also provides for the payment of tax credits **('R&D Tax Credits'**) where the company obtains relief under Chapter 2 and makes or is treated as making a trading loss.

(4) The term "SME" is defined by s 1119 as meaning a micro, small or medium sized enterprise as defined in Commission Recommendation (EC) N0 2003/361 subject to amendments made by s 1120.

(5) "Research and development" is defined by s 1138 of the Corporation Tax Act 2010 (pursuant to s 1041). This section defines R&D by reference to GAAP but also provides that if something is R&D for the purposes of s 1006 of the Income Tax Act 2007 then it is also such for the purposes of s 1138. Regulations (the Research and Development (Prescribed Activities) Regulations 2004/712) were made under s 1006 prescribing

certain activities as R&D. Regulation 2 of these regulations provides that activities which fall to be treated as R&D in accordance with the Guidelines on the Meaning of Research and Development for Tax Purposes issued by the Secretary of State for Trade and Industry are R&D for the purposes of these provisions.

(6) "Relevant research and development" is defined by s 1042, so far as is material, as research and development related to a trade carried on by the company.

(7) Section 1043(1) provides an overview of Chapter 2 and, in so far as is material, states that it provides for relief for SMEs for expenditure on "in-house direct research and development....where the cost of the research and development is incurred by the company".

(8) Sections 1044(1) to (5) provides that a company is entitled to corporation tax relief for an accounting period if it meets each of conditions A, C and D:

(a) Condition A is that the company is an SME during the accounting period.

(b) Condition C is that the company carries on a trade in the accounting period.

(c) 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. So far as is material, "qualifying Chapter 2 expenditure" means "qualifying expenditure on in-house direct research and development" as defined in s 1052 (see s 1051).

Where these conditions are satisfied the relief is an additional deduction in computing the profits of the period of 130% of the "qualifying Chapter 2 expenditure (see ss 1044(7) and (8)). The relief must be claimed (see s 1044(6)).

(9) Section 1052 stipulates that "qualifying expenditure on in-house direct research and development" means expenditure incurred by a company in relation to which each of Conditions A, B, D and E is met:

(a) Condition A is that the expenditure is incurred (amongst other things) on staffing costs, software or consumable items or comprises qualifying expenditure on externally provided workers.

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

(c) 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.

(d) Condition E is that "the expenditure is not subsidised (see s 1138).

(10) The full text of s 1138 is set out above. The issue is whether the expenditure falls within s 1138(1)(c) as expenditure "*met directly or indirectly by a person other than the company"*.

30. Where an SME has a "surrenderable loss" in an accounting period it may claim an "R&D Tax Credit" under s 1054:

(1) A company has a surrenderable loss in an accounting period if, so far as is relevant, it incurs a loss which includes enhanced relief for Chapter 2 qualifying expenditure incurred in that period (under s 1055).

(2) The amount of the surrenderable loss is the lower of the trading loss as is unrelieved or 230% of the related Chapter 2 qualifying expenditure (under s 1055(2)).

(3) The amount of the R&D Tax Credit was, during the material period, 14.5% of the surrenderable loss for the period (see s 1058).

31. Quinn pointed out that the language in s1138 or language very close to it, is used in a number of places in the tax legislation. For instance:

(1) Paragraph 8 of schedule 3 to the Oil Taxation Act 1975 provides that:

> "Expenditure shall not be regarded for any of the purposes of this Part of this Act as having been incurred by any person in so far as it has been or is to be met directly or indirectly by the Crown or by any government or public or local authority, whether in the United Kingdom or elsewhere, or by any person other than the first-mentioned person".

(2) Section 50 of the Taxation of Capital Gains Act 1992 provides that:

> "There shall be excluded from the computation of a gain any expenditure which has been or is to be met directly or indirectly by the Crown or by any Government, public or local authority whether in the United Kingdom or elsewhere."

(3) Section 532 of the Capital Allowances Act 2001 provides that:

> "For the purposes of this Act, the general rule is that a person ("R") is to be regarded as not having incurred expenditure to the extent that it has been, or is to be, met (directly or indirectly) by (a) a public body, or (b) a person other than R."

(4) Section 603(1) of the Income Tax (Trading and Other Income) Act 2005 provides that:

> "For the purposes of section 585, 588 and 600, the general rule is that a person ("A") is to be regarded as not having incurred expenditure so far as it has been, or is to be, met (directly or indirectly) by – (a) a public body, or (b) a person other than A."

(5) Section 172(1) of the Income Tax (Trading and Other Income) Act 2005 provides that:

> "Expenditure is excluded for the purposes of section 170 so far as it has been, or is to be, met (directly or indirectly) by – (a) the Crown, (b) a government or local or other public authority (whether in the United Kingdom or elsewhere), or (c) any person other than the person incurring the expenditure."

Submissions

Quinn's submissions

32. Quinn submitted that the wording in s 1138 is familiar and has been the subject of case law and guidance. HMRC's approach on the present facts is supported by neither. The question posed by s1138(1)(c) is who has *borne* the expenditure and that is plainly Quinn:

(1) Construction contracts are typically contracts which include an entire obligation on the part of the builder (see Chitty on contracts (33rd edition) at 21-032). The nature of such an obligation is exemplified by Sir George Jessel MR in *Re Hall & Baker* (1878) 9 Ch D 538 at 545: "If a shoemaker agrees to make a pair of shoes, he cannot offer you one shoe and ask you to pay one half of the price." This is a point that is explained by Griffith Williams J in *Executive Jet Support Ltd and another v Serious Organised Crime Agency* [2017] EWHC 2737 (QB) at [24]:

> "Mr Marshall submitted that an examination does not lead to the identification of any divisible element of the first appellant's obligation under the contract in respect of which they can say the consideration became executed – no separate price was specified for the permits or the inspection and those terms can hardly stand alone; they are useless to the buyer without delivery of the aircraft themselves and so they might simply be regarded as 'part and parcel of an entire obligation to deliver airworthy aircraft'. I agree."

(2) Quinn undertakes construction Works (as defined in each of the contracts) which involves property passing to the Client and the provision of extensive building work. Quinn is liable for the workmanship of the construction works and adequacy of the materials. That liability can be extensive and requires insurance. In order to ensure that it satisfies those obligations, it has to meet, in the sense of *bear*, its own expenditure and

in paying the price for the completed constructions works, Clients meet, in the sense of *bear*, their own expenditure.

33. Quinn considered this interpretation of s 1138(1)(c) is supported by (a) *Gaspet Ltd v Elliss (Inspector of Taxes)* [1985] STC 572 at 576 where in the context of s 95(6) of the Capital Allowances Act 1968 the Special Commissioners said that "we think the word 'met' must mean 'borne' and not simply 'paid'" and (b) *Stokes (Inspector of Taxes) v Costain Property Investments Ltd* [1983] STC 405 a decision relating to the meaning of s 84 of the Capital Allowances Act 1968. It was common ground that the comments which Quinn relies on in the High Court's decision in this case were "obiter"; they are not part of the decision of the High Court which is binding on this tribunal

34. In *Stokes v Costain*:

(1) The taxpayer claimed capital allowances in respect of certain plant and machinery (principally lifts and central heating equipment) installed in two building developments. At neither building site was the taxpayer the freeholder of the land developed. At both it became entitled, when the development was completed, to a lease or underlease out of which it granted further sub-terms. The question was whether the plant and machinery built into the buildings, which became "landlords' fixtures", could properly be said to "belong" to the taxpayer within the meaning of s 41(1) of the Finance Act 1971. This provided that "where -(a) a person carrying on a trade incurs capital expenditure on the provision of machinery or plant for the purposes of the trade, and (b) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period ... there shall be made to him ... an allowance." Harman J held that this requirement was not satisfied.

(2) As page 412 e to h Harman J recorded that, whilst he had already decided the case in favour of the Crown, there was another issue. It was alleged that, by reason of the financing arrangements made by the taxpayer, it did not "incur" the relevant expenditure on which it wished to claim allowances within the meaning of s 84(1) of the Capital Allowances Act 1968. This provided that:

> "Expenditure shall not be regarded for any of the purposes of this Part of the Act as having been incurred by any person in so far as it has been or is to be met directly or indirectly by the Crown or by any government or public or local authority, whether in the United Kingdom or elsewhere, or by any person other than the first-mentioned person."

(3) The contention of the Crown was that the taxpayer did not incur the expenditure on the relevant property development because a merchant bank, F, had agreed to finance the project. Although the precise nature and terms of the financing was not clear Harman J proceeded on the basis that there was a form of mortgage arrangement in place. The taxpayer argued as follows, as set out at 413 e and f:

> "...because the taxpayer agreed to provide a substantial asset as valuable consideration to [F] it could not be said as a matter of English language that [F] had 'met directly or indirectly' the expenditure on the development. He argued that the payments by [F] of the taxpayer's liabilities on the architect's certificates were no more than loans by [F]. The making of loans to 'A' cannot be said to be the meeting of 'A's liabilities; the loans merely provide the wherewithal for 'A' to meet his liabilities. The satisfaction of these loans by the transfer of an asset does not change the nature of the loans at the time they were made, and is merely a way of paying off debts. The transfer of the asset does not mean that the transferee has 'met' the expenditure which was the consideration for the agreed transfer."

(4) Harman J commented that the taxpayer undoubtedly bore risk as regards the expenditure and the financing such that there was a genuine incurring of the expenditure as follows at 413 g to 414 a:

> "It is clear on the facts that the taxpayer undoubtedly bore the risk of the cost of the development had there been an overrun in the cost-and, heaven knows, the courts have seen examples enough of overruns in English building contracts in the last 20 years. The excess of cost over the limit of the moneys which [F] was liable to provide was entirely to the taxpayer's account. Again, that money might well have been provided on a temporary basis by [F], but that money, according to the [F] agreement, would have had to be repaid by the taxpayer to [F] in addition to the procurement of the grant of the headlease by Maidenhead Corporation on the direction of the taxpayer to [F].
>
> Further, the taxpayer undoubtedly bore the risk that if the development were delayed in completion-another matter which was certainly a real risk in England at the time this development took place-it would have to bear the whole cost itself by repaying all the advances to [F] and would not be able to satisfy the advances by procuring the grant of the head lease to [F].
>
> It seems to me that the truth of this matter was that, although the financing arrangements were somewhat odd, there was a genuine incurring of the expenditure by the taxpayer, who was at risk of having to repay the loans, the advances, made from time to time by [F] by payment of the expenses, and that had any event occurred which prevented the taxpayer from procuring the grant to [F], eventually, of the headlease, plainly and beyond any question the taxpayer would have been liable to repay [F] all the moneys advanced."

(5) He concluded, at 414 a, that in those circumstances it was "impossible to say that the moneys advanced by [F] were in any genuine sense of the words being paid for the work done":

> "Those payments, at the time they were made, were undoubtedly, in my judgment, loans. The loan was discharged by the procuring of the grant of the headlease. In no proper sense did [F] 'meet' the taxpayer's expenditures. In my judgment the taxpayer's argument is right."

(6) He said that this accorded with the policy of s 84 in the following passages at 414 b to d, which Quinn particularly relies on:

> "The section's reference to meeting the expenditure of another is one which is plainly primarily directed to cases of government grants or local authority contributions and such matters. It includes the reference to expenditure being met 'by any person other than' the taxpayer, but that is a tail piece thrown in to catch any other such meeting of expenditure. The concept as it seems to me of that whole subsection is of the provision of money to meet expenditure by way of, in effect, bounty. 'Bounty' may be an inappropriate way to describe the grants made by a government department, remembering that the government have no money save what they take from taxpayers and then give back to other taxpayers. Nonetheless, it seems to me that a transaction whereby a financier lends money to meet a taxpayer's bills and as a result a valuable asset is transferred from the taxpayer to the financier is not appropriately described as the financier 'meeting' the expenditure of the taxpayer. He has bought an asset, paid for an asset, or whatever other phrase of the English language one may care to use, but he has not, in my judgment, met the expenditure of the taxpayer in any proper use of that term in the context in which it appears."

35. Quinn said that Harman J's reference to "bounty" is indicative of a situation in which the taxpayer receives funds from a third party in order to pay for the expenditure (or the expenditure is met by the third party paying the suppliers directly) but the taxpayer does not provide

anything in return (other than perhaps an agreement to incur the expenditure). Harman J's analysis puts the purpose of the payment by the third-party front and centre of the analysis. Applying that analysis here, s 1138(1)(c) is not applicable simply because expenditure is incurred using funds which can be traced back to a third party. What is required is an examination of the purpose behind that third party's payment.

36. On the specific wording of s 1138, Quinn made the following main submissions:

(1) The heading to s 1138, "Subsidised expenditure", can properly be used as an aid to construction (see *Inglis v Robertson and Baxter* [1898] AC 616 per Lord Herschell at 630). Moreover, the meaning of s 1138(1)(c) has to be assessed by viewing that provision in context by reference to the meaning of the preceding provisions in ss1138 (a) and (b).

(2) As regards the meaning of "subsidy" and "grant" in ss 1138(1)(a) and (b):

(a) In Case C353/00 *Keeping Newcatle Warm Limited v The Commissioners of Customs and Excise*, the Advocate General said that "a subsidy is ordinarily understood to mean a sum paid from public funds, usually in the general interest".

(b) In *Eurodi Limited v Teletch UK Limited* (unreported) it was held that: "The ordinary meaning of "grant" is "a gift or assignment of money by government or public authority out of public funds to a private or individual or commercial enterprise deemed to be beneficial to the public interest (*GTE Sylvania Canada Ltd. v R* [1974] 1 FCR 726 at p. 736 per Cattanach J. in the Federal Court of Canada)..."

(3) It is plain, therefore, that a "subsidy" or "grant" has to involve an element of bounty or something akin to that albeit that the relevant funds usually may be provided in the public or general interest. The same must be true of state aid. It is notable that:

(a) In each case, to fall within ss 1138(1)(a) or (b) the "subsidy", "grant" or "state aid" has to be "obtained in respect of "the relevant expenditure. In other words, it has to be earmarked for a purpose.

(b) Expenditure is treated as subsidised under s 1138(1)(a) if "state aid" is obtained in respect of the whole *or part* of the expenditure whereas expenditure is treated as subsidised under s 1138(1)(b) only *to the extent* that the "grant" or "subsidy" is obtained in respect of the expenditure.

Overall, the wording suggests that a payment for no consideration to meet a particular expense falls within ss 1138 (a) and (b) whereas a payment made to acquire goods or services, is plainly not caught.

(4) Read in context, therefore, the reference in s 1138(c) to expenditure which is "otherwise met" means expenditure which does not fall within ss 1138(a) or (b) but which, broadly, is funded for no consideration or is akin to a "grant" or "subsidy". Certainly, it would be odd for s1138(1)(c) to be given such a radically different meaning, as is the effect of HMRC's interpretation, that it would capture payments made by a third party for the acquisition of an asset under a profitable commercial contract.

(5) It is also notable that the purpose of the predecessor to s1138(1)(c), contained in para 19 of schedule 20 of the Finance Act 2000, is explained in a consultation document published prior to its enactment at note 19 as follows: "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."

37. In Quinn's view, therefore, s 1138(1)(c) may apply if a third party pays the taxpayer specifically to commission its staff to carry out R&D on the basis that the third party will obtain the benefit of whatever results from that R&D. It plainly does not apply where, as here, the third party is wholly indifferent to the R&D carried on by the taxpayer in buying a particular

product, the completed works, for a price which does not necessarily reflect the actual costs which the taxpayer incurs in providing that product.

HMRC's submissions

38. HMRC submitted that the applicable principles of statutory interpretation in the context of this appeal are as follows:

(1) When interpreting a statute, the court's function is to determine the meaning of the words used in the statute.

(2) The appropriate starting point is that the statutory language is to be taken to bear its ordinary meaning in the general context of the statute (see *R v Secretary of State for the Environment, Transport and the Regions, ex parte Spath Holme Ltd* [2001] 2 AC 249 at 396).

(3) In determining that ordinary meaning it is permissible to consult and take notice of an authoritative dictionary (see *R (on the application of Maybey) and Others v Cornerstone Telecommunications Infrastructure Ltd* [2019] EWCA Civ 1016 at [22]).

(4) The fact that context and mischief are factors which should be taken into account does not mean that when performing an interpretive role, the court can take a free-wheeling view of the intention of Parliament looking at all admissible material and treating the words of the statute as merely one item:

(a) context and mischief do not represent a licence to judges to ignore the plain meaning of the words that Parliament has used; and

(b) ultimately the Court is not looking for the intention of Parliament, it is seeking the meaning of the words which Parliament has used (see *Williams v Central Bank of Nigeria* [2014] AC 1189, Lord Neuberger at [72] and *R(AA(Sudan)) v Secretary of State for the Home Department* [2017] 1 WLR 2894 at [46]-[47]).

(5) Insofar as Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are admissible aids to construction (see *Westminster City Council v National Asylum Support Service* [2002] 1 WLR 2956 at [2] to [6]).

39. HMRC submitted that, in accordance with the principles of construction they had set out:

(1) Section 1138(1)(c) should be interpreted in the light of its ordinary meaning in the context of the statute. Part 13, of which s1138(1)(c) forms part, is a detailed, prescriptive and meticulously drafted code which leaves little room for a purposive interpretation. There is no substitute for going through the detailed conditions one by one, to see if, on a fair reading, they are satisfied and it needs to be remembered that the relief is a generous one giving relief for notional expenditure which has not actually been incurred in circumstances where the taxpayer can obtain ordinary relief in any event (see *Gripple Ltd v HMRC* [2010] STC 2283 ("*Gripple*") at [12]).

(2) The meaning of the term "subsidised" is not delineated by the ordinary meaning of that term; rather an elaborate rule is given for when expenditure is *treated* as subsidised for the purposes of Part 13 in the three situations set out in s 1138(1). The heading to this provision is no more than a guide to what follows; it does not control the meaning of the enacting words in the body of the provision (see *Director of Public Prosections v Schlidkamp* [1971] AC 739, in particular, the comments of Viscount Dilhorne and Lord Hodson that cross-headings are not meant "to control the operation of the enacting words" or are "not to be given controlling effect" (see page 20 f to g and page 13 a)).

(3) As regards s 1138(1)(b), there is no definition in the legislation of "grant" or "subsidy" so these terms prima facie bear their ordinary meaning. In the Oxford English Dictionary these terms are defined as follows:

(a) A "grant" means: "An authoritative bestowal or conferment of a privilege, right, or possession; a gift or assignment of money, etc. by the act of an administrative body or of a person in control of a fund or the like."

(b) A "subsidy "means: "A donation of money or other property, usually made to provide assistance."

On their ordinary meanings, therefore, these terms are not limited to encompassing a gift or bounty in the sense set out by *Quinn*. Moreover, it is evident that a "grant" or "subsidy" can have as its source a state or non-state entity. The cases *Quinn* refers to have not laid down a general definition of application in all statutory contexts. It remains of relevance to have regard to the ordinary meaning of the terms used as set out in the dictionary.

(4) In s 1138(1)(c):

(a) The word "otherwise" means in circumstances different from those present or considered. Hence s 1138(1)(c) is concerned with something *other than* a "notified State aid" or "grant" or "subsidy", namely, a third category which has its own specific test and ambit. Accordingly, the legislation treats as a subsidy something which is not a "notified State aid", a "grant", and/or a "subsidy" (as those terms are to be interpreted as set out above). This interpretation is supported by comments in *R v Uddin* [2017] EWCA Crim 1072 at [33].

(b) The ordinary meaning of "meet" in the Oxford English Dictionary encompasses being able to or sufficient to discharge or satisfy or fulfil a financial obligation. In the context of s1138(1)(c) "met" is equivalent to "discharged" or "satisfied" or "fulfilled".

(c) The words "directly or indirectly" cover at least two scenarios: (a) the term "directly" covers the scenario where the third party pays, discharges or satisfies the expenditure so the company does not have to pay anything, and (b) the term "indirectly" covers the scenario 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 but then reimbursed by a third party.

(5) In this case, Quinn incurred the material expenditure in the course of providing services to its Clients in respect of which it was entitled to payment and was in due course paid. It follows that the Clients indirectly "met" the expenditure by paying Quinn for its service.

(6) Quinn's analysis is based on a grant and subsidies involving an element of bounty yet it accepts there are circumstances which fall within s 1138(1)(c) that do not involve an element of bounty. The reliance on *Stokes v Costain* is misplaced. The remarks which Quinn relies on are not part of the binding decision and, in any event, Harman J was addressing the different question of whether expenditure was incurred not whether it was met by another party.

(7) HMRC's analysis is supported by the decision of the tribunal in *Hadee Engineering Co Limited v HMRC* [2020] UKFTT 0497 (TC) ("*Hadee*"):

(a) In that case, HMRC's argument, as recorded at [176], was that:

> "where the Appellant was paid to undertake an activity there is a clear and direct link between payments received and the qualifying expenditure. The

> Appellant's sales invoices show that the Appellant was directly remunerated for its design and production expenditure by its customers, with charges made for design time by the hour and there is very limited evidence of this being adjusted for within the claim. Even if the Appellant undertook R&D at its own risk, if the R&D is for the production of a bespoke product for a customer then payment for that product would amount to subsidy of the R&D".

(b) The tribunal upheld this at [226].

(8) There is nothing absurd nor surprising about this result. It is evident that s 1138(1)(c) was intended by the draftsman to capture situations where the expenditure is "met" otherwise than by way of a "grant" or "subsidy" and so can include a situation where a person meets the company's expenditure by paying for services pursuant to an arm's length contract. If it did not include this situation, it is difficult to see when s 1138(1)(c) would ever apply given that "grant" or "subsidy" is covered by s 1138(1)(b).

(9) This plain interpretation is also 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:

(a) This plain interpretation does not, on a fair reading and applying common sense, lead to a company's qualifying "stand alone" expenditure being treated as "met" by profits made from deploying the product of the qualifying R&D expenditure in subsequent dealings with clients. For example, if (i) in January a company incurs qualifying expenditure of £100 on developing a product on a "stand alone" basis, in that it does not receive any "grant" or "subsidy" and does not incur the expenditure in the course of fulfilling a contractual obligation to a client for which it is reimbursed, and (ii) in April it enters into a contract with a client and uses the product of its expenditure to fulfil its contractual obligations and is paid for its services, it is not an ordinary use of language to say that the expenditure incurred in January was "met" by the payments received for the services rendered in April; rather the expenditure incurred in January was "met" by the company and was then used to generate profits in April under the subsequent contract with a client.

(b) By way of analogy, if a law student incurs expenditure in obtaining a law degree and professional qualifications, it is not an ordinary use of language to say that the student's subsequent employer "met" either directly or indirectly that expenditure. Rather one would say that the expenditure incurred by the student was turned to account as it enabled him to acquire qualifications and obtain a paid job. By contrast, if a law student accepts employment with a law firm during his studies and uses his remuneration from the firm to pay his tuition and course fees, it is an ordinary use of language to describe those expenses as having been "met" directly or indirectly through or by the remuneration paid by the firm.

(c) Similarly, it would not be an ordinary use of language to say that a shareholder who has subscribed for shares in the company has "met" subsequent research and development "standalone" expenditure incurred by the company. Rather the shareholder has subscribed capital in return for an equity interest in the company and it is the company which meets the cost of the expenditure.

(10) In summary, HMRC submits that its interpretation of the legislation is in accord with the plain meaning and grammar of the legislation, is a fair reading of the legislation, does not result in any absurdity or perversity, is in accord with the overall purpose of the statutory scheme, gives purpose and function to s 1138(1)(c) which would otherwise be redundant, avoids a taxpayer who engages in "standalone" research and development being treated less favourably than one whose expenditure is incurred in the course of

fulfilling contractual obligations for a client where the expenditure is covered by payments made by the client, and is consistent with the material parts of the Explanatory Notes to Finance Act 2000.

40. Mr Fitzpatrick QC noted that (a) in the correspondence in the bundles HMRC had stated that: "If the expenditure fulfilling the contract exceeds what was paid, then the excess is not met by the payment and as such this excess would be allowable under the SME scheme. If this applies to any of the contracts undertaken for which R&D was claimed, then please let me know and the payment previously made can be adjusted", and (b) in the Radio House contract there was in fact a loss. He did not know whether Quinn had raised this with HMRC.

Quinn's further submissions

41. Quinn replied that:

(1) HMRC point to the fact that s1138 is there to prevent state aid but in reality, that only explains s 1138(1)(a) as the Explanatory Notes suggest. Indeed, on HMRC's view loss-making undertakings would be favoured over profitable ones and it is far from clear how this would comply with state aid rules:

(a) Sections 1138(1)(b) and (c) (unlike s1138(1)(a)) are nothing to do with state aid rules on accumulation and are there for the same reasons as the provisions cited above in other parts of the tax code, namely, to ensure that relief is not claimed for an expense which has not been *borne* by the person seeking relief.

(b) There is a general principle of statutory construction that where Parliament uses the same words as previously used, they should be assumed to have intended the words to mean the same thing unless there is a clear reason to the contrary. (See Arnold J in *Megnatic Services Ltd v HMRC* [2010] UKUT 464 (TCC) at [45] where he cites Bennion, Statutory Interpretation (5th ed, 2008) at pages 599-604.) The points made in *Stokes v Costain* are equally applicable in the present context.

(2) HMRC's analysis ignores that the purpose of a payment is not determined by how it has been calculated. Their argument confuses the measure of a payment with what the payment is for. However, this is a distinction for which there is high authority in a number of different statutory contexts:

(a) In *The Glenboig Union Fireclay Ltd v Commissioners for the Inland Revenue* 12 TC 427, Lord Dundas explained, at 456, that:

> "In the first place, what we must consider is not the measure by which the amount of compensation was arrived at, but what it was truly paid for…"

(b) A similar distinction was drawn by the Court of Justice of the European Unition ("**CJEU**") in the decision in *Lisboagas GDL – Sociedade Distribuidora de Gas Natural de Lisboa SA v Autoridade Tributtaria e Aduaneira* [2015] STC 1966. This is a VAT case concerned with whether Lisboagás had incurred land use tax where it subsequently recovered that cost under a broader commercial contract under which the tax formed a constituent expense of services provided by Lisboagás. The CJEU explained why Lisboagás rather than a third party had incurred the land use tax at [33]:

> "Moreover, in passing on the amount of the land use taxes to the company responsible for marketing the gas when it bills that company for the use of those infrastructures to supply gas to consumers, Lisboagás passes on not the land use taxes as such, but rather the price of using publicly-owned municipal property. That price is part of the set of costs borne by Lisboagás which in turn forms part of the price for its supply of services to be paid for by the company responsible for marketing the gas. The fact that, under the concession agreement, the amount of the land use taxes is listed as a separate

> item in the invoice issued by Lisboagás then in the invoices issued by the company responsible for marketing the gas to consumers is irrelevant in that regard."

(c) Accordingly, it is wholly irrelevant to the analysis that Quinn factors in its costs in agreeing the price for "Works" and whether the Clients see the basis on which Quinn has worked out the price (as they may do through the tender documentation):

(i) Any commercial entity aims to ensure it can recover its costs when pitching for work. That says nothing about what its clients pay for when paying the agreed price. The basis on which Quinn has charged the initial fixed price is relevant to the Client in that (A) if the scope of the "Works" changes because the Client changes its mind as to what it wants, as can happen on a big construction project, Quinn is entitled to further payment for the additional work, and (B) the JCT contract requires this further payment to be in line with the methodology used to derive the initial price. However, that does not alter the fact that what the Client pays for is the finished product.

(ii) Indeed, the evidence shows that the costs which Quinn factors in in agreeing a price do not necessarily correspond with the costs which are in fact incurred. As Harman J noted in *Costain v Stokes*, the risk of cost overruns is hardly new to the construction industry. Mr Wells' evidence demonstrates that Quinn's position is no different to any other builder in this respect. The fundamental point is that the manner in which a payment is calculated does not necessarily indicate what the payment is for.

(3) The use of the term "indirectly" in s 1138(1)(c) does not mean that the tribunal is to engage in an economic analysis of whether costs have been recovered:

(a) The plain meaning of "meeting" expenditure is not expanded by the word "indirectly" in the legislation. The two modes of meeting expenditure differ only in terms of the route through which payment is made. This is explained in *Cyril Lord Carpets Ltd v Schofield* 42 TC 637 per Lowry J at 643:

> "The Company admits that one can meet expenditure directly by paying the creditor, and indirectly by paying the taxpayer, the amount which the taxpayer has to lay out."

(b) Nothing in the "indirectly" language alters the meaning of "meeting" expenditure. That point is reflected in *Stokes v Costain* cited above where the indirectly language was also present. The words "directly or indirectly" are capable of modifying the meaning of the verb to which they attach only so far as is linguistically possible (see *Potts' Executors v Commissioners of Inland Revenue* [1951] AC 443); they cannot enlarge the meaning of the verb beyond this point. There is not an "indirect" meeting of expenditure where the purpose of the payment is anything other than the incurring of the expenditure. Indeed, it is understood that HMRC accept that the phrase "directly or indirectly" pertains to the mechanism by which the expenditure is met and does not qualify the concept.

(4) HMRC's analysis is wholly unworkable:

(a) Every company or business which incurs expenditure is invariably externally funded assuming some commercial success. On HMRC's interpretation, therefore, s 1138(1)(c) expenditure would never be anything but subsidised or "met", save for as regards loss-making companies, and the "meticulously drafted code…and large number of carefully delineated conditions" governing the availability of R&D relief (see *Gripple* at [12]) would largely be rendered unworkable.

(b) HMRC's view that R&D expenditure is not subsidised or "met" where the expenditure is only subsequently exploited for a commercial gain on a separate project is an unjustified gloss. It raises a number of questions, in particular, as regards how uncertain the scope for commercial gain needs to be when the expenditure is incurred and how this uncertainty is to be measured. As recognised in guidance issued by the Department for Business, Innovation and Skills the undertaking of research and development is inherently risky (see paras 4 and 12 of the guidance). There is no material distinction between the risk at an earlier stage in a research and development project of realising any revenue stream as a result of the expenditure and the risk at a later stage when, as here, the research and development is exploited by the taxpayer in the course of providing a product to its clients for a fixed price where the actual costs are uncertain.

(c) On HMRC's analysis the question arises as to whether A has "met" B's expenditure if B wants to develop and sell a product and pitches it to A before beginning its research and development and A likes the concept and enters into a contract to buy a certain number of the product at that point or whether it makes a difference if the contract is entered into after the relevant expenditure has been incurred. The legislature would surely have dealt with these practical difficulties if the intention is that the provision operates as HMRC argue for.

(d) Moreover, HMRC's approach is unprincipled in that it favours an entity that is not yet in a position to market the product of its research and development but will do so and at a later stage recover its costs and make a profit, over one that is already using the research and development in its trade to cover the costs and make a profit.

(e) It also follows from HMRC's approach that expenditure is only "met" by a third party where the contract is ultimately profitable. This is clearly a bizarre distinction to draw and one, which the legislature cannot possibly have intended.

(f) HMRC's approach of necessity requires tracing rules so as to link expenditure with revenue. This raises questions such as:

(i) How, in Quinn's case and as a general matter, consideration is to be allocated between qualifying research and development expenditure and other expenditure where those amounts together exceed the amount received from the third party as consideration. It is not known what apportionment methodology is to be used and whether an allocation is to be made pro rata or in priority to one category over the other.

(ii) What expenses are to be taken into account in allocating the consideration to both qualifying research and development expenditure and other expenditure and whether any allocation would comprise both variable and fixed costs and what methodology would be used to calculate appropriate fixed costs.

(iii) How the fact that whether a project is profitable may not be apparent for some time would be factored in. In the case of Quinn, it has an ongoing liability for the works it has created and claims may arise in the future.

(g) Overall if the legislation were intended to operate as HMRC argue, such tracing rules would have been set out in the legislation. It is also notable that there is no guidance on the issues raised above. If, as HMRC now say, a tracing exercise is necessary, such guidance would be available for taxpayers.

(h) Quinn has raised the inconsistencies arising from HMRC's approach in the correspondence with HMRC. For example, it has questioned why HMRC accept

that the provision of equity finance to a start-up business specifically to cover intended research and development expenditure does not count as subsidising or meeting that expenditure. HMRC's response was very unclear; they sought to explain this on the basis that there has to be a clear and direct link between the monies received and the research and development project and, in the seed funding scenario, they consider that there is not this clear and direct link between the benefit provided to the company by SEIS relief (where it is the investors obtaining that relief within the SEIS scheme) and the project. Moreover, to add to the confusion they have given an example above, with which Quinn agrees, that a subscription for share capital is not caught by s 1138. The subscriber pays for a product, the shares, just as the Clients pays for the works.

(i) By contrast Quinn's stance that the purpose of the payments made by the third party (in contractual terms of the consideration for the expenditure) is the relevant factor provides a principled and workable approach for determination of whether expenditure can be said to be "met" or not within the meaning of s1138(1)(c). It is also plainly consistent with other areas of tax legislation which contain similar provisions and for which there is case law – see above.

(5) HMRC's approach in this case is out of kilter with HMRC's own more orthodox published guidance in their manuals:

(a) In the context of s 532 of the Capital Allowances Act 2001 (at CA14100) HMRC provide guidance on whether a gift is a contribution towards expenditure:

> "Treat a non-returnable grant of money given by way of gift, that is, not in return for anything, as a contribution *if there is a clear connection between the receipt of the grant and the incurring of the expenditure*. The grant should be specifically related to the capital expenditure on the provision of capital assets." (Emphasis added.)

Therefore, not even a gift amounts to a subsidy unless it is made in connection with the incurring of the expenditure. Further, there is no reference to the type of commercial agreement which it is now argued gives rise to a subsidy.

(b) As regards land remediation relief:

(i) HMRC given an example (at CIRD63135) where they consider that compensation given by a third party causes the expenditure to be met directly or indirectly by that person:

> "Example 1: A Ltd acquires a plot of land for development. It discovers that the site has been contaminated by chemicals being carried onto the site from an adjoining factory owned by B Ltd, an unconnected party. A Ltd spends £150,000 on cleaning up the contamination and installing a barrier to prevent further contamination. A Ltd seeks compensation from B Ltd. After negotiations B Ltd agrees to settle the claim in full. A Ltd cannot claim Land Remediation Relief as all the expenditure has been met by B Ltd…."

(ii) Also, at CIRD63105 HMRC highlight that these provisions are dealing with cases in which expenditure is specifically given by a third party for the purposes of covering the expenditure in question (such as support for staffing costs given under COVID-1).

(c) As regards s 50 of the Taxation of Capital Gains Act 1992, HMRC give an example, at CG15288, relating to that section and Extra-Statutory Concession D53 which, unsurprisingly, also rests on a set of facts in which the third party's purpose in making the payment was to cover a particular expenditure:

> "The effect of the concession may be illustrated by an example. An asset cost £60,000 but this was partly met by a grant of £40,000. Section 50 applies to treat the cost of the asset as £20,000. Later the asset is sold for £90,000 and the grant is repaid out of the proceeds. By concession the sale proceeds are reduced to £50,000 (£90,000 - £40,000) and the gain before indexation allowance becomes £30,000 (£50,000 - £20,000)."

(d) There is no suggestion in any of the guidance that a commercial contract which permits the taxpayer to make a profit is akin to a subsidy. In this case, HMRC appear to be engaged on a frolic of their own, entirely out of step with HMRC's practice in other contexts where the same or similar language applies.

(6) The decision in *Hadee* is of limited persuasive value given none of the above authorities referred to in this case were cited to the tribunal. The contractual obligations were not clear in that case since the contracts were not adduced by the taxpayer and were not available to the tribunal. Quinn agrees that if a payment is made by a third party to the taxpayer in order to incur R&D expenditure on behalf of the third party (which means it is sub-contracted expenditure within the definition, as was found to be the case in *Hadee)* and the payment is equal to the costs incurred, the R&D expenditure is subsidised as well as sub-contracted. It is not clear from *Hadee* what the contractual arrangements were (see [226]) but the burden of proof was on the taxpayer (see at [128] and [211]) and it failed to discharge that burden. Overall, the decision in *Hadee* says nothing about Quinn's position.

HMRC's further submissions

42. HMRC said that most of Quinn's objections to HMRC's interpretation are highly theoretical and hypothetical. It is not for the tribunal to decide on the correct interpretation of s 1138 in the context of the facts of this case by reference to these hypothetical scenarios uninformed by the actual facts of the case. Moreover, leaving aside the Radio House contract, the difficulties Quinn has raised do not arise on the facts of this case. It appears that in fact Quinn received sufficient sums from its Clients under the relevant contracts to cover the R&D expenditure. Moreover, any taxpaying making claims for tax relief in respect of such expenditure must keep records of the expenditure and how it formed part of the relevant project.

Decision

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.

51. Finally, I note that I did not find the decision in *Hadee* helpful in deciding this issue given the different facts and the lack of information available on the terms of the applicable contracts in that case.

Allocation of case as Complex

52. Quinn made an application for this case to be allocated to the Complex category which HMRC opposed.

53. Under rule 23 of the rules governing the tribunal (the First-tier Tribunal (Tax Chamber) Procedure Rules), when the tribunal receives a notice of appeal, the tribunal must give a direction allocating the case to one of the specified categories, namely, Default Paper, Basic, Standard or Complex (see rule 23(1) and (2)). The tribunal may give a further direction re-allocating a case to a different category at any time, either on the application of a party or on its own initiative (see rule 23(3)). Under rule 23(4), the tribunal "may" allocate a case as a Complex case:

> "only if the Tribunal considers that the case –
>
> (a) will require lengthy or complex evidence or a lengthy hearing;
>
> (b) involves a complex or important principle or issue; or
>
> (c) involves a large financial sum."

54. Quinn's view is that this case involves both a complex or important principle or issue and a large financial sum for the purposes of rules 23(4)(b) and (c).

55. Quinn first made a request for the appeal to be allocated to the Complex category in its notice of appeal which it submitted to the tribunal on 19 May 2020 with brief reasons only for the request. However, following the tribunal notifying the parties that the case was allocated to the Standard category, Quinn then submitted an application for re-categorisation as Complex with full reasons. Quinn chased the tribunal for a response to the application on a number of occasions. On 4 May 2021, the tribunal informed the parties that a Judge had authorised the allocation of the case to the Standard category in May 2020 but said that Quinn could renew its application as Quinn then did. In my view, given that the Judge did not have Quinn's full reasons for the application and did not provide any reasons for the allocation to the Standard category, it is appropriate for the renewed application to be considered at a tribunal hearing with full argument from both parties.

56. The parties referred to a Practice Statement on the categorisation of cases in the tribunal issued by the President of the tribunal on 23 March 2020, the decision of the Upper Tribunal in *Capital Air Services Ltd v HMRC* [2010] UKUT 373 (TCC) ("*CAS*") and decisions of the tribunal in *Dreams plc v Revenue & Customs* [2012] UKFTT 614 (TC) ("*Dreams*") and *Badzyan v Revenue and Customs* [2017] UKFTT 439 (TC) ("*Badzyan*").

57. In the Practice Statement, it is stated that:

> "The Tribunal will assess whether, having regard to the nature of a particular case, any one or more of these criteria [in rule 23(4)] are satisfied. In making this assessment the Tribunal will take into account all the circumstances, including the implications of the costs-shifting regime (subject to the right of the taxpayer to opt out) and the fact that cases allocated to the Complex category are eligible, subject to various consents, to be transferred to the Upper Tribunal.
>
> If on such an assessment the Tribunal considers that a case meets the stated criteria, it will, in the absence of special factors, allocate the case to the Complex category."

58. In *CAS* the Upper Tribunal gave the following guidance on the factors of relevance in this appeal:

> "14.....what is complex or important must be assessed in the context in which the question arises, namely taxation and tax appeals. It may not be straightforward to establish precisely what principles or issues are actually involved in a particular case or whether, once identified, they can be described as important, (giving rise to the question Important to whom?).
>
> 15. As to the third of those issues, what is, or is not, a large financial sum must be assessed by reference to the sort of cases undertaken in the Tax Chamber. What may be large in the context of a social security claim may be small in the context of tax disputes generally.
>
> 16. Although we consider it to be clear that the third issue must be approached in that way, it is less clear whether it is appropriate to refine that approach by considering different types of work undertaken by the Tax Tribunal.....and it might be said that what can be seen as a large financial sum in a personal income tax case might nonetheless properly be regarded as small in the context of dispute concerning petroleum revenue tax. We do not consider that it is appropriate to adopt this refinement. It will lead to complexity and opaqueness in the allocation of cases resulting in an inappropriate use of the resources of the Tribunal (both judicial and financial) with a risk of unnecessary and disproportionate satellite litigation.
>
> 17. A further question is whether it is appropriate to take account of the circumstance of the parties in assessing whether a large financial sum is involved. For instance, a given amount of VAT may be very large indeed when viewed through the eyes of a small trader with a turnover of a few hundred thousand pounds, but may be seen as almost trivial when viewed through the eyes of an international corporation with a turnover of hundreds of millions of pounds. We do not consider that, as a general rule, the circumstances of the parties should be taken into account in this way. We say that this should be the general rule

because there may be special factors which take a particular case out of the ambit of this general rule....."

59. At [22], the Upper Tribunal said that in deciding whether or not to allocate the case as Complex:

"the judge would be entitled to take account of the costs implications of allocating as Complex and to ask himself whether it is really the sort of case where a costs-shifting regime should be available".

60. At [25], the Upper Tribunal added that it is clear that the assessment of what is complex evidence or a complex issue is a matter of judgment and that the "task of making that judgment is assigned to the tribunal". At [28], they noted that it was is suggested that rule 23(4) gives the tribunal a discretion whether or not to allocate to the Complex category even if the tribunal does consider that one or more of the criteria are satisfied (given, in particular, the use of the word "may"). They had earlier referred to this issue at [9] and [10] where having considered what the term "complex" means on its ordinary meaning in this context (namely, "complicated" or "comprehending various parts connected together; composite, compound") they said the following:

"9. We cannot, however, dismiss the possibility of a case which is not complex within the ordinary meaning of that word and yet is one which satisfies one or more of the criteria in rule 23(4). Thus a case might involve no lengthy or complex evidence and may be capable of being dealt with in a short hearing; it might involve no complex or important principle or issue. It might, however, involve what is, on any view a large financial sum. But the case would not by reason of its high value alone be seen as 'complex' within the ordinary meaning of that word.

10. The question then is whether the case can, or should, be allocated as a Complex case. The argument here is that a case which satisfies any of the criteria is at least capable of being allocated as a Complex case; on this approach, the criteria are not simply gateways through which a case must pass before it can be allocated as Complex, but are part of the defining architecture by which the class of Complex cases can be identified. We consider this aspect further at paragraph 29 below."

61. At [29], they commented further on this issue but concluded that they did not consider that it was necessary to resolve it or to provide general comment:

"The existence and scope of [the] discretion is linked with what satisfies the criteria for allocation as Complex in the first place. Take the following example. A case may be very straightforward, involving no complexity and no lengthy hearing. It may, nonetheless, involve a large amount of tax. It may well not be appropriate to allocate such a case as Complex. But whether this is because the case does not fall within the criteria for allocation (on the basis that a case must be complex in the ordinary sense of the word before it can be categorised as Complex), or whether it is because the Tribunal has a discretion not to allocate it as Complex, is not clear. If fulfilment of *any* of the criteria set out in rule 23(4) is sufficient to qualify the case as Complex, then it can only be by exercise of a discretion that the case could be allocated other than as Complex. In contrast, if a case has to be 'complex' as that word is ordinarily understood before it can be allocated as Complex, then the case in this example is not capable of allocation as Complex and no question of the exercise of a discretion arises. We do not consider that it is necessary to resolve this issue in order to determine the present appeal; and we do not consider it appropriate to form a view in order to give more general guidance."

62. However, at [30], they commented that if the tribunal does have a discretion to allocate other than as Complex a case which is capable of being allocated as such (on the basis it satisfies one or more of the tests in rule 23(4)):

"*it must be a discretion of limited scope. The general rule should, we consider, be that a case capable of being allocated as Complex ought to be so allocated. Any discretion to*

allocate other than in accordance with that general rule should be exercisable only in the light of special factors." (Emphasis added.)

63. In *Dreams*, however, the tribunal (Judge Bishopp) took a different view as regards the tribunal's discretion to allocate a case to the Complex category where one or more of the tests in rule 23(4) is satisfied. At [6], Judge Bishopp set out his interpretation of rule 23 as follows:

> "Plainly the first task is to identify the correct approach. It is apparent from perusal of rule 23 that, while allocation to one or other category is mandatory, the tribunal has a discretion in relation to the choice of category. The discretion whether to allocate an appeal to the Complex category arises, as the rule makes clear, only when one or more of the conditions specified by sub-rule (4) is satisfied; but it is apparent from the manner in which the rule is drafted that, even if that hurdle is overcome, the tribunal is still required to exercise a discretion. The rule states that the tribunal may allocate an appeal to the Complex category only if one or more of the conditions is satisfied; it does not state that it must do so. *Thus it is possible for the tribunal to refuse allocation to the Complex category even if that threshold requirement is satisfied; and the question correspondingly arises, in what circumstances should it so refuse*? (Emphasis added.)

64. At [12], he commented on the passages in *CAS* on this point. Having noted that the Upper Tribunal did not feel it necessary to resolve the issue of whether merely passing through one or other of the "gateways" is enough for a case to be classified as Complex or if or a litigant who wishes to have his case classified as such must establish something else and if so what, he said:

> "but it [the Upper Tribunal] nevertheless appears, in [30], to have decided that if a case can be allocated as Complex - by which I take it to have meant that it passes through one or other of the gateways - it should be so allocated unless there are "special factors" dictating otherwise. In other words, if this proposition can be taken at its apparent face value, there is no additional criterion, and the burden must be on a party resisting allocation as Complex of a case which has passed through a gateway to demonstrate the "special factors"."

65. At [31], however, Judge Bishopp said that he did not think that the Upper Tribunal in CAS intended that, absent special factors, an appeal which satisfies a gateway should be allocated as Complex:

> "....as I have explained, passage of an appeal through one of the gateways is what gives rise to the discretion to allocate an appeal to the Complex category: rule 23 provides that the tribunal *may* do so only if one of the gateways is passed through, not that it *must* do so. I mentioned, at para 12 above, the apparent indication by the Upper Tribunal that, absent "special factors", an appeal which passed through a gateway should be so allocated. I do not, however, think that is what the Upper Tribunal intended, at least if "special factors" is taken to imply some exceptional circumstance. It is not consistent with the manner in which rule 23(4) is drafted, as I explained it at para 6 above, and it is inconsistent with what the Upper Tribunal said in *Capital Air Services*, at [10]."

66. Having concluded that the test in rule 23(4)(a) was not met, Judge Bishopp considered the tests in rules 23(4)(b) and (c):

> (1) At [25], Judge Bishopp acknowledged that the outcome of the appeal may be of great importance to the taxpayer and indeed to its competitors, but he did not see how the determination of the issue in that case, the correct VAT treatment of adjustable beds, amounts to "a complex or important principle or issue". In his view, "it is the type of issue which the tribunal resolves routinely, in appeals which have been allocated to the Standard category". He said that if he was right in his view that something "out of the ordinary" must be shown, he had "no doubt that this appeal does not come close to passing through this gateway". He also thought, at [26] that this test was not satisfied

because there were issues about whether the relevant assessment was made in time and there was a "legitimate expectation" argument.

(2) At [27] he said that rule 23(4)(c) poses rather greater difficulty. Having referred to the comments of the Upper Tribunal in *CAS* on this test, he noted at [28], that the amount involved (over £5 million) was "undoubtedly, a large sum for most people, and for most small traders" and said this at [29] and [30]:

> "29. The inference to be drawn from what the Upper Tribunal said is that laying down a guideline, even one adjusted in line with inflation, is undesirable. I agree; and I also take the view that examination of a taxpayer's accounts to see whether the sum in issue is large, by reference to its turnover, profit, net assets or some other yardstick, is neither desirable nor practical. How, then, is a judge considering the proper allocation of an appeal, left as I am in this case with only the amount in issue as the possible gateway to the Complex category, to decide whether that amount is sufficiently large and whether, if it is, that fact alone is enough to warrant allocation to the Complex category?
>
> 30. Here, I am unable to draw any further assistance from *Capital Air Services* since the amount in issue there was not the determining factor. The Upper Tribunal did make it clear that it is necessary to leave out of account the fact that (to use its own examples) a large amount in the context of income tax may be modest in the context of petroleum revenue tax. It follows from what I derive from its decision that an absolute standard, that is to say one which does not vary depending on the taxpayer or the tax, is to be adopted. That approach does not, however, indicate where the dividing line should fall. *The conclusion to which I have come is that the sum should be large by comparison with the median value of the cases which come before the Chamber and are allocated to the Standard and Complex categories. The adoption of that approach, it seems to me, represents a simple and straightforward means of applying the condition*. In my judgment £5 million does meet that test, and in consequence rule 23(4)(c) is satisfied." (Emphasis added.)

67. Judge Bishopp concluded, at [34], that the appeal raised questions which were "fairly routine for this Chamber" and that its "only distinguishing feature" was that there was a sufficiently large sum in issue for it to pass through the rule 23(4)(c) "gateway" and, although he was mindful that the Upper Tribunal in *CAS* did not equate "complex" with "Complex", he decided that "the amount of tax in issue does not "trump" the fact that, by reason of its failure to pass through the other gateways, the appeal is more suitable for allocation to the Standard category". He plainly considered, therefore, that he had discretion to decide not to allocate the case to the Complex category even though one of the tests in rule 23(4) was met and although no "special factors" were raised as to why it should not be so allocated, it seems on the basis that overall there was nothing "out of the ordinary" about the case.

68. Quinn said that the tribunal should apply the approach set out in *CAS* at [30] and allocate the case to the Complex category on the basis that two of the tests in rule 23(4) are met and that there are no "special factors" indicating that it should not be so allocated. In its view, the tests in rule 23(4)(b) and (c) are met, broadly, for the same reasons as those tests were held to be met in *Badzyan* at [42] to [45]. Quinn relied, in particular, on the passages in these paragraphs that I have highlighted below:

> "42. It is clear from [14] of *Capital Air Services* that what is complex or important should be assessed in the context of taxation and tax appeals. HMRC submitted that the issues of whether the Partnership was a conduit and whether individual partners were taxable when income was allocated to the corporate member were both complex and important. Mr Gotch submitted that the latter point was merely "a short point of construction of the partnership deed", while the former point was not relevant to Mr Badzyan because he had forfeited his right to profits.

> 43. In the context of tax appeals relating to partnership taxation I am not persuaded that the issues in Mr Badzyan's appeal are unusually complex. *I am, however, of the view that they are "important", in part because they would be likely to be determinative of (or materially relevant to) certain issues in relation to the Partnership assessment, and also because of the precedential weight of those issues beyond Mr Badzyan's appeal.* HMRC stated during the proceedings that the total tax at stake in relation to the Partnership was approximately £30 million and in relation to variations of the arrangements was several hundreds of millions of pounds. While Mr Gotch submits that this unfairly conflates Mr Badzyan's appeal with other assessments, in my judgment the overlap between the principles or issues in Mr Badzyan's appeal and those other situations does render the points at issue in his appeal important.
>
> 44. Does the case involve a large financial sum?.....
>
> 45. I take the correct approach to this question to be that adopted by Judge Sinfield in *JSM Construction*, at [26] to [29]. In this case, the amount assessed in the discovery assessment is approximately £300,000. *However, in light of information which HMRC have discovered since they issued the assessment, they consider that the amount of undeclared tax for 2011-12 is closer to £800,000. Even without taking account of the "indirect" arguments discussed in Babergh District Council v HMRC [2011] UKFTT 341 (TC) in relation to "the taxpaying community as a whole", which I would not regard as a proposition of general application in relation to Rule 24(4)(c), I regard £800,000 as a relatively large sum in context*."

69. Quinn noted that the sum at stake in this case is at least £800,000 and may be as much as £1.2 million. In its view, the decision in this case will have precedential weight beyond this appeal given that there is currently no authority on the point in issue. Quinn noted also that the evidence is that there are a number of other similar cases where HMRC have raised this point in similar terms; Ms Tragner said that she was aware of 8 to 10 separate cases being dealt with by her firm.

70. HMRC emphasised that the correct allocation of this case to a specified category had already been considered by a Judge when Quinn's original application was made. However, that does not prevent the tribunal from reconsidering the allocation and, for the reasons already given, I consider it is appropriate for the tribunal to do so on hearing full argument from the parties.

71. HMRC said that, in any event, neither of the tests in rule 23(4)(b) and (c) are met on the basis that (a) the case does not fall on the right side of the median value test set out by Judge Bishopp in *Dreams*, and (b) the case involves simply a short point of statutory construction. They added that on the basis of the approach set out in *Dreams*, even if one of these tests is met, the circumstances are not such that the tribunal should exercise its discretion to allocate the case as Complex on the basis that it does not involve anything "out of the ordinary".

72. In my view, the correct approach to follow in determining whether this case should be allocated as Complex is that set out in *CAS* by the Upper Tribunal. The comments made in the *Dreams* case are not binding on the tribunal and, in my view, it is not appropriate to have regard to them to the extent that they do not accord with the comments made by the Upper Tribunal in *CAS*. I respectfully disagree with the tribunal's view in *Dreams* that the Upper Tribunal did not mean that, absent "special factors", an appeal which passed through a "gateway" should be so allocated. That is precisely what the Upper Tribunal said at [30] of their decision in *CAS*, on the assumption that the tribunal does have discretion whether or not to allocate an appeal to the Complex category if one or more of the tests in rule 23(4) is satisfied, albeit they did not decide whether the tribunal in fact has such discretion. I can see nothing in the Upper Tribunal's comments at [10] of their decision which detracts from the plain meaning of the relevant passages.

73. Views may differ on whether the appeal involves a "large financial sum" for the purposes of rule 23(1)(c) (and it seems to me that the reference in *Dreams* to the median value of cases is a gloss on the rule). However, I consider it clear that this appeal involves a "complex or important principle or issue" for the purposes of rule 23(4)(b) given that, as Quinn emphasised, it involves an issue on which there is currently no binding authority and the determination of this issue affects the scope of the SME scheme as it may be expected to affect many taxpayers. There are no "special factors" which indicate that the appeal should not be allocated as Complex notwithstanding that this test is met.

Conclusion

74. For all the reasons set out above, it is directed that this appeal is allocated to the Complex category and this appeal is allowed in principle.

75. 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.

HARRIET MORGAN
TRIBUNAL JUDGE

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