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HMRC internal manual

Corporate Intangibles Research and Development Manual

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CIRD75550 - VRR: subcontracting to companies and others

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Where R&D is subcontracted other than as described in [CIRD75525 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird75525\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird75525), the conditions there in still apply, but there are certain further conditions:

Principal and sub-contractor connected

Use the normal definition of connected person in ICTA88/S839.

If the principal and the sub-contractor are connected, the principal can claim VRR on the lower of the payment made to the sub-contractor and the sub-contractor's relevant expenditure. The sub-contractor must have brought the whole of the payment it receives into account in determining its profit or loss for a relevant period, in accordance with generally accepted accounting practice.

A relevant period is a period:

- for which accounts are drawn up by the sub-contractor, and
- that ends not more than 12 months after the end of the accounting period of the principal in which the principal includes the payment to the sub-contractor as a deduction in accordance with generally accepted accounting practice.

The sub-contractor's relevant expenditure is revenue expenditure incurred by the sub-contractor on staffing costs and consumable stores in carrying out the work sub-contracted by the principal. The expenditure must not be subsidised [CIRD75300 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird75300\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird75300).

Example Drugs On Demand PLC draws up accounts to 30 June each year. In the year ended 30 June 2005 it makes a payment of £5 million for vaccine research to Vaccine for All Ltd which is its subsidiary company. Vaccine for All Ltd draws up its accounts to 31 December each year. The year ended 31 December 2004 and the year ended 31 December 2005 are relevant periods.

Vaccine for All Ltd. spends:

- £1 million on vaccine research in the year ended 31 December 2004,
- £3 million on vaccine research in the year ended 31 December 2005, and

- £2 million on vaccine research in the year ended 31 December 2006.

Vaccine for All Ltd.'s relevant expenditure in relevant accounting periods is £4 million (£1 million in the year ended 31 December 2004 + £3 million in the year ended 31 December 2005).

Drugs on Demand PLC may claim VRR of £4 million.

Principal and sub-contractor not connected

If the principal and sub-contractor are not connected 65% of the payment made to the sub-contractor is qualifying expenditure on sub-contracted R&D.

Where the principal and sub-contractor are not connected they may make a joint election in writing to have connected person treatment for the payments that the principal makes to the sub-contractor. The election must be made not later than 2 years after the end of the principal's accounting period in which the contract to have the research done is entered into. Once an election has been made it is irrevocable.

Example If, in the example above, Drugs on Demand PLC makes the payment of £5 million in its accounting period ended 30 June 2005 to an unconnected company, ExperimentsforU Ltd., to do the vaccine research it may claim VRR of $£3,250,000 = 65\% \times £5 \text{ million}$.

Drugs on Demand PLC and ExperimentsforU Ltd. may make a joint election to have the payment of £5 million treated as a connected person payment. The election must be made by 30 June 2007 because the payment was made in Drugs on Demand PLC's accounting period ended 30 June 2005.

There is guidance on the meaning of 'directly undertaken' at CA60400. A sub-contractor only directly undertakes work on behalf of a company if

the sub contractor does the work itself. It cannot subcontract it in turn to another party.

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