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Corporate Intangibles Research and Development Manual

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CIRD165000 - R&D Tax Reliefs: reformed reliefs: contracted out R&D: transitional provisions

FA24/SCH1/Para 18

The Finance Act 2024 makes transitional provisions to avoid overlap and gaps in entitlement where, in a situation where R&D is contracted out between companies, one has expenditure in a pre-1 April 2024 accounting period (i.e. beginning before 1 April 2024), and one has expenditure in post-1 April 2024 accounting period (i.e. beginning

on or after 1 April 2024).

In what follows “old R&D relief” means the SME scheme (Chapter 2 of Part 13 CTA09 before the FA24 amendments) and RDEC (Chapter 6A of Part 3 CTA09, now repealed), and “new relief” means ERIS (Chapter 2 of Part 13 CTA09 as amended by FA24) and new RDEC (Chapter 1A of Part 13 CTA09 as enacted by FA24).

Avoidance of double claims

Where, in respect of expenditure attributable to the same R&D activities, a company (A) would be entitled to old R&D relief, and another company (B) would be entitled to new R&D relief, the general rule is that A is entitled to relief and B is not. The exception is where B would also have been entitled to old relief on the expenditure, but for the amendments made by FA24.

Example 1

Company A, an SME, contracts out activities to its unconnected contractor company B, also an SME, which form part of A's R&D project. Company B undertakes independent R&D to fulfil its contract to A, but this R&D does not constitute R&D contracted out to it by A under new CTA09/S1133. Company A's accounting period runs from 1 March 2024 to 30 April 2025. Company B's accounting period runs from 1 April 2024 to 31 May 2025. The contract is entered into on 1 April 2024. Company A incurs expenditure and pays B £100k for its services on 31 January 2025. Company B incurs expenditure of £80k on R&D done to fulfil the contract between 1 April 2024 and 31 December 2024.

Without the transitional provision, both parties would be able to claim because:

- A has £65,000 of qualifying expenditure (subcontractor costs) under the old (SME) rules
- B has £100,000 of qualifying expenditure (staffing costs) under the new rules

Under the transitional provisions, A is entitled to claim, and not B, because B would not have been able to claim for the £100k under the old rules (R&D subcontracted to it by a person not within CTA09/S104C, now repealed).

Avoidance of gaps in entitlement

Customer under old rules deemed ineligible

Where a company has pre-commencement expenditure (i.e. expenditure incurred in an accounting period beginning before 1 April 2024), which

- is not eligible for old R&D relief
- would have been eligible to new R&D relief if it had been post-commencement expenditure (i.e. expenditure incurred in an accounting period beginning on or after 1 April 2024) as either:
 - expenditure on contracted out R&D (CTA09/S1042E or CTA09/S1053)
 - expenditure on activities contracted out to it by an irrelievable client (see [CIRD161000](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird161000) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird161000>)) (CTA09/S1042F or CTA09/S1053A)

That company is treated as if it were an ineligible company for the purposes of determining the eligibility of another company to new R&D on expenditure attributable to the same R&D.

Example 2

Large company A incurs expenditure on subcontractor payments to SME Company B in respect of R&D it subcontracts to B. This R&D constitutes R&D contracted out from A to B under new CTA09/S1133. Company A's accounting period runs from 1 March 2024 to 30 April 2025. Company B's accounting period runs from 1 April 2024 to 31 May 2025. Company A is not eligible to claim for its subcontractor costs under the old RDEC rules. But for the transitional provisions, Company B would not be able to claim – even

though it meets all other relevant conditions under the new rules -, but it can, because A is deemed to be an ineligible company within CTA09/S1042F(4) & CTA09/S1053A(4).

Customer under new rules deemed to have contracted out R&D

Where a customer (D) has post-commencement expenditure which would have qualified as subcontractor costs under the old SME scheme, but does not meet the definition of contracted out R&D (see [CIRD161000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird161000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird161000)) for new R&D relief, and its subcontractor (C) has pre-commencement expenditure attributable to the same R&D which would attract old R&D relief but for the fact that it has done the work to fulfil a contract to D, the expenditure is deemed to be contracted out R&D for the purposes of CTA09/S1133.

Example 3

Company A is an SME looking to claim new R&D relief. Company B is an SME looking to claim old R&D relief. It enters into a contract with B, under which B will supply A with a technologically advanced product, the development of which involves R&D. A lacks technical expertise in this area and detailed knowledge of the nature of the work done by B – albeit, A was aware that R&D would be required -, and so did not intend or contemplate that R&D of the sort done by B would be done when it entered into the contract, within CTA09/S1133.

B is unable to claim old R&D relief, because it has done its R&D to fulfil a contract for A. A would have been able to claim old R&D relief, because it has paid B to do R&D. The transitional provisions provide that A can claim new R&D relief, by deeming the R&D to have been contracted out by A to B.

Summary table

This table illustrates the effect of the transitional provisions (TPs) in three typical scenarios.

Typical scenario	Applicable scheme for A	Applicable scheme for B	Could A claim without TPs?
A pays B for R&D, but does not “contract out” within CTA09/S1133	SME	ERIS	Yes
A contracts out R&D to B within CTA09/S1133	RDEC	ERIS	No
A pays B for R&D, but does not “contract out” within CTA09/S1133	ERIS	SME	No

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