HMRC internal manual

Corporate Intangibles Research and Development Manual

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CIRD152000 - R&D Tax Reliefs: reformed reliefs: overseas restrictions: 'wholly unreasonable' examples

Example 1

The company wishes to carry on destructive testing of its product, using a commercial testing lab (to which the work would be contracted).

If suitable test facilities exist both in the UK and abroad, the following apply:

If a UK test facility is available on the required timescale, the activity would not qualify if contracted outside the UK because the necessary conditions exist in the UK

If there is time pressure and UK facilities are available but are fully booked on the required timescale, the condition at CTA09/S1138A(2)(c) would apply if the activity were undertaken outside the UK.

If suitable test facilities do not exist in the UK, the question is whether the company (not somebody else) can reasonably replicate them in the UK.

If the company does not have the expertise or capability to effectively own and run a testing facility, or the facility might see little use, making its creation uncommercial it would be wholly unreasonable for the company to do this. In this case and the condition at (2)(c) would apply if the activity were undertaken outside the UK.

If the company already operates similar facilities in the UK which could be easily adapted (assuming other factors do not prevent this, for example that doing so would prevent the facility being used for other necessary work) and provide the capacity required, it could be reasonable to expect it to do so. In this case, the condition at (2)(c) would not be met if the activity were undertaken outside the UK.

If there is time pressure, and the replication of a facility in the UK would take too long, the condition at (2)(c) would apply if the undertaken outside the UK.

Example 2

A disease with no prevalence in the UK requires a clinical trial to be undertaken outside the UK and the company decides to run the trial in Japan where the disease is prevalent. A contract research organisation (CRO) needs to be appointed with local knowledge and so a Japanese company is appointed.

Some of the activities it performs such as project management and data analysis do not need to be undertaken at the trial site. The Japanese CRO does not have operations in the UK and it would not be reasonable to expect the claimant to engage another party to do this because adding another would make the structure of the project more complicated, slower and prone to error. The entire cost paid to the CRO would therefore meet the conditions of CTA09/S1138A(2).

In contrast, had the appointed CRO been a multi-national enterprise with personnel in the UK who could undertake the project management and data analysis, the expenditure attributable to those activities would be ineligible if the activities were not undertaken in the UK.

Example 3

A pharmaceutical business engages a contractor to collect samples of newly identified plant species not native to the UK to determine their value as medicines. This requires a condition (the presence of the plants) that is not present in the UK, and one which is present in the foreign country. It would be wholly unreasonable, indeed impossible, to replicate this condition in the UK. And it is a condition that exists in places outside the UK. So this activity could qualify if undertaken in a location where the necessary conditions arise.

The question arises as to whether plant samples, gathered in a tropical country, should be analysed locally or brought back to the UK for this work. The answer to this will depend on a number of factors. It may be that the samples are unstable and need to be analysed quickly and this makes it necessary to do the work locally. Or possibly, the volume of samples from different countries means that some sort of initial screening is necessary, with only the most promising candidates brought back to the UK for follow up. Either of these could justify a claim for overseas expenditure.

Example 4

A company is conducting R&D to develop a prefabricated wall panel for an overseas market which has different regulatory standards/ building practices to the UK. Development requires the company to work closely with construction companies local to this market to evaluate the constructability of prototypes. This clearly requires conditions (the presence of alternative construction practices) that are not present in the UK. It would be wholly unreasonable to replicate these conditions in the UK and these conditions exist in places outside of the UK. Therefore, this activity would satisfy CTA09/S1138A(2) if undertaken in a location where the necessary conditions arise.

Example 5

A company is conducting R&D in the development of a software service for the commercial banking market in the US. Development requires the company to have a collocated team in the US due to access regulations within the US banking sector. This requires conditions (the presence of US banking systems and regulatory requirements) which are not present in the UK, and which would be wholly unreasonable to replicate. This condition exists in the US. Therefore, this activity would satisfy CTA09/S1138A(2) if undertaken in the US, where the necessary conditions arise

Whether or not conditions can be replicated in the UK is not necessarily an either/ or question. It may be possible to replicate them in part, either numerically or qualitatively.

Example 6

Company A, the claimant, commissions Company B to undertake a clinical trial in the US. As this is contracted-out R&D for A, the overseas rules apply. (If A carried out the work itself directly, there would be no restrictions on its staff costs or any payments it makes to clinical trial participants as these categories are not restricted).

In this case there is no regulatory requirement for the work to be done in the US.

B is able to recruit 100% of the trial participants in the US in a reasonably efficient timeframe. Prior to submitting the claim, relevant databases indicate that it would not have been unreasonable to recruit 20% of the participants in the UK on the same timescale. A therefore limits its qualifying expenditure to 80% of the relevant cost (had it been clear that the UK recruitment could not be managed on a reasonable timescale, the full cost could qualify).

Under a different contract, Company B undertakes a clinical trial recruiting 50% of the participants in Europe and 50% in India. Although relevant databases show that 10% of the trial participants could have been sourced from the UK, this would have significantly disrupted the business plan resulting in delays and increased execution risk. In this instance the entire cost of the trial can be included as this factor means that is satisfies CTA09/S1138A.