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HMRC internal manual

Corporate Intangibles Research and Development Manual

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CIRD151100 - R&D Tax Reliefs: reformed reliefs: overseas restrictions: conditions: exclusions

Excluded conditions CTA09/S1138A(3)(b)(i) and (ii)

The legislation excludes two things from being conditions, as defined in (3)(a), that would meet the test in CTA09/S1138A(2). These are

- cost of the R&D activity
- availability of workers to carry out the R&D activity.

These are the only conditions that are excluded. Unlike CTA09/S1138A(3)(a), the list in (3)(b) is exhaustive.

Meaning of “cost of the R&D activity”

R&D activity means R&D for tax purposes within the DSIT guidelines (see [CIRD81910](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird81910) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird81910>)). Costs of R&D are costs incurred by the company on activity within the DSIT guidelines, whether or not the expenditure is qualifying Chapter 1A or Chapter 2 expenditure (see [CIRD130000](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird130000) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird130000>) and following). For example, the costs of renting a laboratory are costs of the R&D activity, even though rental costs are not qualifying expenditure.

Discussion

Cost of the R&D will often be a factor in deciding where work is to take place. Where it is the only determinative factor in activity taking place abroad, it will not justify the activity meeting the criteria, because of CTA09/S1138A(b)(i). However, cost will often not be the only factor. For example, if time pressures mean that R&D cannot wait until a new facility is developed in the UK, the fact that the staff to operate the facility are in short supply, and therefore expensive to employ, does not mean that CTA09/S1138(3)(b)(i) and (ii) prevent the conditions in CTA09/S1138A(2) being met. The conditions are met because another factor – the facility to carry out the R&D – would not be available.

Cost of the R&D and availability of workers will often go together, given that worker costs are a significant factor. But for the avoidance of doubt the same reasoning applies to both. If the only conditions that cannot be met for the R&D to take place in the UK relate to cost or staff availability, then overseas expenditure will not qualify. But where other factors are significant, the mere

existence of cost and/ or staff availability will not in itself disbar the overseas expenditure.

For clarity, the cost factor here is the cost of the R&D. Other costs are not excluded by CTA09/S1138A(3)(b)(i). For example, the cost of constructing or adapting the facility referred to above may or may not be a cost of the R&D, depending on whether it is a cost of the R&D. This will depend on the accountancy treatment of the expenditure. However, transport costs generally will be a cost of the R&D, albeit not one that would qualify for R&D relief.

Example 1

Raw materials required to undertake the R&D are only available overseas, and the alternative to carrying out the work abroad would be to incur significant cost and carbon footprint of shipping the materials to the UK just to do the R&D testing. However, if transporting the materials to the UK is part of the cost of the R&D, it cannot be taken into account. If environmental concerns and the need for a steady supply of material were overriding factors, they might be relevant. Whether the condition in CTA09/S1138A(2) is satisfied therefore depends on the wider facts.

Similarly, the second excluded condition is the availability of workers to carry out the R&D.

Example 2

A company needs AI computer scientists for an R&D project. There are many AI computer scientists in the UK, however the company has advertised open positions for a prolonged period but not enough people have applied. The company however finds several AI scientists from a well known university outside the UK and engages them on an EPW basis (under the supervision, direction and control of the core UK development team).

As availability of workers is not a condition that can be taken into account for the purposes of

CTA09/S1138A(2), the related EPW costs will not qualify.

Example 3

A software business designing software for use by financial services customers has teams of EPWs overseas to build software that links with the local stock exchanges. This is necessary due to the engineers needing detailed knowledge of the financial regulations in that territory in order to link with the stock exchange in a compliant manner.

There is a need for specific knowledge and it is plausible that this knowledge is more likely to be accessible by engaging individuals in the location of the stock exchange. However, this scenario relates to the availability of workers and it could be that this knowledge is readily transferable. As such, based on the facts presented, it is unlikely that overseas expenditure would qualify.

The exclusion in CTA09/S1138A(3)(b)(ii) does not extend to other “people related” factors such as location close to key investors or to a leading university research group which might provide advice or guidance, unless these individuals are workers carrying out R&D. Such factors might justify activity taking place abroad, but each case will depend on its merits (for example, is there a comparable UK university research group that could provide the same quality of input?)

Example 4

A company is looking to undertake pre-clinical research on a new biologic drug candidate in a rare disease. Although there is some knowledge of this disease type in the UK the pre-eminent specialists are based in Switzerland and are able to conduct the pre-clinical research. The Company is able to provide evidence that the team in Switzerland have a level of technical capability that is not available in the UK.

However, availability of workers to carry out the R&D, as in the example, is not a condition that can satisfy CTA09/S1138A(2)

As set out above, in determining whether or not it is wholly unreasonable to replicate conditions, existing abroad, in the United Kingdom, time pressure may be a consideration. Given the R&D project's need for results within a certain timeframe it may not be reasonable for the company to replicate the conditions. Given more time, the answer might be different.

Since the availability of workers to carry out the R&D is excluded as a condition that can affect this judgement, it follows that if timeliness is an issue solely because of staff availability, it cannot be grounds for meeting the conditions in CTA09/S1138A(2). If, however, there are wider timing issues, besides staff availability, the condition may still be met.

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