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HMRC internal manual

Corporate Intangibles Research and Development Manual

From: [HM Revenue & Customs](#)
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CIRD161000 - R&D Tax Reliefs: reformed reliefs: contracted out R&D: overview

This guidance deals with the definition of “contracted out” R&D at CTA09/S1133. This definition is relevant for both the new merged scheme RDEC (new RDEC) and enhanced R&D intensive support (ERIS), and is used for:

- Determining the eligibility of payments for R&D contracted out by a claimant company to a third party (see [CIRD138000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird138000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird138000))

- Determining the eligibility of work done by the company that has been contracted out to it by a third party (this is generally not qualifying – see below and [CIRD163000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird163000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird163000))

The general rule is that only the party who takes the decision to undertake or initiate R&D will be able to claim. Transitional provisions apply. Some relevant provisions are signposted briefly in this overview page. Fuller details are available at [CIRD165000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird165000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird165000).

Please note that contractor payments (see [CIRD138000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird138000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird138000)) are subject to overseas restrictions, which are explained at [CIRD150000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird150000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird150000) and following.

In a departure from the language used in predecessor legislation, the term “contractor” is used - as distinct from “subcontractor” - for the party immediately engaged by a customer to perform R&D. “Subcontractor” is used exclusively to refer to a party to whom R&D is subcontracted by a contractor or subcontractor.

Concise examples are available at [CIRD162000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird162000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird162000), with more extensive examples at [CIRD162100 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird162100\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird162100).

When R&D is contracted out

CTA09/S1133(2)

R&D is contracted out by a person (A) where:

- A enters into a contract (which may be written, verbal, or implied) for activities to be done for it
- The activities done to meet the contractual obligations include R&D
- Having regard to the terms of the contract (which may be written, verbal, or implied) and any surrounding circumstances, it is reasonable to assume that A intended R&D of that sort would be done when it entered into the contract.

“Contracted out” R&D is R&D within the second bullet point, to the extent that the third bullet point applies to it.

To whom R&D is contracted out CTA09/S1133(4)

R&D is contracted out to:

- The party to the contract who undertakes the obligations to the person who contracts out the R&D
- Any sub-contractor who undertakes contractual responsibility for the activities needed to meet those obligations.

Contractual chains

R&D is “contracted out by” the end customer (A) and any contractor or subcontractor who subcontracts that R&D to a subcontractor.

The R&D is “contracted out to” any person with a contractual obligation to perform R&D activities to fulfil the contract to A. This includes any contractor or subcontractor.

Eligibility to claim **Contracted out R&D**

A company (A) can claim for the costs of contracting out its own relevant R&D to another person (B), but will need to be able to demonstrate that it intended or contemplated that R&D of that sort would be done.

Under the transitional provisions ([CIRD165000](#))

(<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird165000>)), if B is still able to claim for the work it does for A under the old RDEC scheme, A will not be able to claim.

R&D undertaken to fulfil a contract

A company (B) can also claim for R&D relevant to its trade which it has done to fulfil a contract for a third party (A) if B took the initiative to do R&D - but normally only if this work does not constitute R&D “contracted out” to it by A. The exception is where A is an irrelievable client (see below).

Under the transitional provisions ([CIRD165000](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird165000) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird165000>)), if A is still able to claim for the work it is paying B to do for it under the old SME scheme, B will not be able to claim.

Activity as contractor for an irrelievable client (CTA09/s1053A & s1042F)

Even where a company (B) does R&D contracted out to it by another company (A) and B is not the decision-maker (see below), B can still claim if A is an irrelievable client. Irrelievable clients are:

- ineligible companies (see [CIRD163000](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird163000) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird163000>))
- any person not acting in the course of a trade, profession or vocation within the charge to tax in relation to the contracting out of the R&D by that person

Identifying the “decision-maker”

This term does not appear in the legislation. CTA09/S1133 operates in effect to identify the person who has made the decision to undertake or initiate R&D by having regard to whether or not it is reasonable to assume from the terms of the contract and any surrounding circumstances that

the ultimate customer (A) intended or contemplated that R&D of the sort carried out by any contractor or subcontractor (B) to fulfil that contract would be carried out when A entered into that contract.

In cases where this is less obvious, the party claiming should ensure that it can, if necessary, justify its claim. It may be helpful for it to discuss with the other party (or parties) to the contract if this would help to resolve any doubt, although HMRC recognises that this may not always be possible. Where such discussions take place and an agreement is reached between the parties as to which party can claim – whether or not this is made explicit in any written contract -, HMRC will, where this agreement can be evidenced, regard such agreement as persuasive unless it appears that the parties have not applied legislation reasonably, or have failed to take into account an important circumstance.

Meaning of "intended or contemplated"

These terms are not defined in the legislation, and so take their ordinary meaning. “Intended or contemplated” goes beyond mere awareness that R&D will take place and requires a specific appreciation of what R&D will be done and therefore the ability to understand and specify that.

Even where A happens to have detailed knowledge of exactly the kind of work to be carried out by B, it will not intend that R&D be done if, as a matter of fact, it is indifferent to how B delivers the contract deliverables.

‘Contemplated’ does not indicate a minor or fleeting consideration but a more substantial intention. From the Collins English dictionary, 1 ed, definition:

Contemplate. 1. to think about intently and at length; consider calmly... 3. to look at thoughtfully; observe pensively...

Meaning of "R&D of that sort"

R&D can only be contracted out by A to the extent that A intends or contemplates that a particular sort of activity be carried out. This does not entail that A must be able to know, describe or specify the work to be carried out in every detail ("the how"), but work which falls substantially outside of or beyond A's intention ("the what") cannot be R&D contracted out by A.

Importance of "surrounding circumstances"

It will frequently be obvious from the nature of the work being done and the nature of the respective trades of A and B who has initiated R&D. Where the situation is less obvious, a more detailed examination is required.

The legislation requires us to "have regard to the terms of the contract and any surrounding circumstances". The language of the contract is therefore important, as a source of evidence in assessing what Company A intended or contemplated, but so are the surrounding circumstances. HMRC would expect that where R&D is intended and contemplated, a number of commercial factors will align with that and form part of the "surrounding circumstances" referred to in the legislation. It is necessary to look at these overall circumstances in the round, to determine whether Company A's primary objective is to have a project completed (whether construction of a building or infrastructure, or development of software) or whether Company A's primary objective is to have some R&D performed.

These circumstances might include (but are not necessarily limited to):

- intellectual property (IP) ownership,
- financial risk in undertaking the work
- autonomy in how the activity is executed
- means by which the R&D is ultimately to be exploited

- the decision-making process (for example whether the motivation to undertake the R&D flows from the customer's wider strategy or an immediate tactical challenge recognised by the contractor)
- the experience and seniority of decision-takers
- nature of the parties (for example whether it is evident that B specialises in providing R&D services and the contract is typical of those R&D activities).

These circumstances will not necessarily all be equally relevant or helpful in every case – for example, the question “who bears the risk” can be complex with bespoke, complex risk-sharing arrangements in some sectors such that unpicking who bears the R&D risk will not give a simple unambiguous answer (and the answer may well vary for different aspects of R&D on a single project).

Application

It should be noted at the outset that a company can only claim for qualifying expenditure on R&D which is its own relevant R&D, that is:

- R&D for tax purposes under 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))
- Relevant to the company's trade ([CIRD81400 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird81400\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird81400))

In what follows, A is the ultimate customer, and B is any contractor or subcontractor (see above).

The examples referred to below are in [CIRD162000 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird162000\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird162000).

Activities not relevant R&D of B (example 3)

When considering whether or not R&D is contracted out by A, what matters is whether or not the activity is relevant R&D of A. Activities that are relevant R&D of A, but are not relevant R&D of B, will be R&D contracted out by A to B if the conditions at CTA09/S1133(2) are met. It makes no difference whether or not B is aware of A's R&D project.

A has no relevant R&D (example 2)

Conversely, where the activities contracted for do not form part of relevant R&D for A, it is highly unlikely that A will have intended or contemplated that R&D be carried out at all or that the contract and surrounding circumstances would lead one reasonably to assume that this was the case.

Barring exceptional circumstances, in such a case, any R&D done by B to fulfil the contract is not R&D contracted out by A to B.

A and B have different R&D projects (example 6)

It may happen that there is R&D contracted out by A to B, which is distinct from other relevant R&D of B carried out in order to fulfil that contract.

In such a case, B's relevant R&D is not R&D contracted out to B by A.

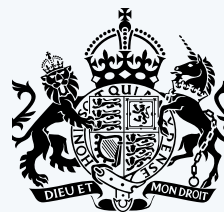
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