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HMRC internal manual

Corporate Intangibles Research and Development Manual

From: [HM Revenue & Customs](#)
([/government/organisations/hm-revenue-customs](#))

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CIRD90600 - R&D tax relief: SME scheme: payable tax credit - restriction of the credit inc PAYE cap

CTA09/S1060

If a company claims a payable R&D tax credit the Revenue pays it an amount in respect of the credit unless any of the following apply:

- The company has other outstanding debts to HMRC. S130 FA2008 gives HMRC the power to set off amounts that are due to be repaid to a

company against debts owed by that company, including contract settlements. See in this connection [DMBM700010](http://www.hmrc.gov.uk/manuals/dmbmanual/DMBM700010.htm) (<http://www.hmrc.gov.uk/manuals/dmbmanual/DMBM700010.htm>). This includes CT, PAYE and VAT debt.

- There is an enquiry into the company's return for the accounting period for which the R&D tax relief is claimed. In this case, payment may be withheld until the enquiry is completed. HMRC may make provisional payments before the enquiry is completed.

Note in particular that you do not need to seek authority from companies before set off takes place but you do need to tell the company of the set off in writing.

Any surplus R&D tax credit after clearing any other HMRC debt can be paid.

CTA09/S1058A-S1058D

1058 Amount of tax credit

For accounting periods beginning on or after 1 April 2021:

The amount of payable tax credit that a company is entitled to for an accounting period is the lesser of:

- 14.5% of the surrenderable loss for that period
- The sum of £20,000 plus 300% of the company's relevant expenditure on workers for payment periods that end in the accounting period

A company would calculate their own PAYE cap regardless of whether it is in a group.

If the accounting period is less than 12 months, the figure of £20,000 will need to be proportionately reduced. For example, for an accounting period of 6 months, the relevant figure will be £10,000 plus 300% of the company's

relevant PAYE and NIC expenditure for that six-month period.

If the period of account is more than 12 months and overlaps 1 April 2021, schedule 3 of the Finance Act 2021 states that the PAYE cap applies to accounting periods which commence on or after 1 April 2021. For Example, for a period of account of 18 months starting on 1 January 2021, the cap would be applicable from the accounting period starting 1 January 2022.

1058A Relevant expenditure on workers

The company's relevant expenditure on workers is an amount of PAYE and NIC. It includes the company's own total PAYE and NIC liabilities (not just those relating to R&D activity). NIC liabilities includes employers and employees NIC. This is the sum of

- the amount of income tax due under PAYE regulations, plus
- the amount of Class 1 national insurance contributions due

Amounts due are those that are to be paid to HMRC for the accounting period.

In calculating these amounts, disregard any deductions made in respect of; statutory maternity pay, statutory adoption pay, statutory paternity pay, statutory shared parental pay, statutory parental, bereavement pay, child tax credit, working tax credit.

The relevant expenditure on workers also includes some PAYE and NIC relating to connected companies which are subcontractors, or which provide it with externally provided workers, as follows:

Subcontracting provided by connected companies

In addition to a company's own PAYE and NIC liabilities, if a company contracts out R&D activities

to a connected company, it may include any PAYE and NIC staffing costs incurred by the connected company in performing the R&D activities.

Externally Provided Workers provided by connected companies

Additionally, where a company pays a connected company for providing it with externally provided workers to carry out R&D, it may include the relevant portion of the PAYE and NIC staffing costs incurred by the connected company.

The externally provided workers figure is identified by calculating the appropriate percentage of expenditure on staff costs incurred by the connected company in providing the workers to the claimant company and which forms part of the connected company's PAYE and NIC liabilities for the accounting period.

A formula of $R \text{ over } T \times 100$ is used to calculate the "appropriate percentage" where:

- R is the amount of the company's qualifying expenditure on the externally provided worker that has been taken into account in calculating the amount of the company's qualifying R&D expenditure for the period, and
- T is the total amount of the company's qualifying expenditure on the externally provided worker.

Staffing costs include those relating to any qualifying indirect activities included in the R&D claim

Example 1

An individual employee's PAYE and NIC amounts to £10,000 but they spend only 50% of their time on qualifying R&D activity. £10,000 is included in calculating the cap with no restriction for non-qualifying activity

Example 2

An externally provided worker (EPW) PAYE and NIC amounts to £10,000. They spend 50% of their time on qualifying activity so the 'appropriate percentage' is 50%. The amount to be included in the cap is £5,000.

Double Counting

If the company has provided any externally provided workers to connected companies or undertaken contracted R&D on behalf of a connected company, there is a potential for double counting PAYE and NIC liabilities.

To prevent this, the following must be deducted from a company's relevant expenditure on workers (CTA09/S1058C)

- the relevant portion of staffing costs for the payment period incurred by the company in providing externally provided workers to a connected company
- any staffing costs for the payment period incurred in undertaking contracted out R&D on behalf of a connected company

1058D Exceptions to the tax credit cap

The tax credit cap does not apply in accounting periods where a company meets both conditions A and B.

Condition A

A company meets this condition if it is creating or preparing to create relevant intellectual property or if it is performing significant management activities in relation to relevant intellectual property that it holds.

These activities must be undertaken wholly or mainly by employees of the company. This does not include directors of the company (unless they are employees).

Meaning of creating, or preparing to create relevant IP (CTA09/S1058D(2)(a) and (b))

A company that is carrying on R&D will satisfy this part of the test (even if the R&D is, ultimately, abortive) as will a company that is carrying out preparatory work before undertaking R&D (for example, scoping a project or seeking to understand potential markets). But the activity (whether creating, or preparing to create, IP) must be undertaken wholly or mainly by the company's own employees – it cannot for example be met by subcontracting R&D.

Performing management activities (CTA09/S1058D(2)(c))

Examples of “management activity” in relation to intellectual property are formulating plans and making decisions in relation to the development or exploitation of the intellectual property.

This could include activity such as registering a patent or undertaking litigation. Such activities can involve engaging external professionals such as lawyers or patent agents who will not be employees.

Again, the management activity must be undertaken wholly or mainly by employees of the company. This does not include directors of a company (unless they are employees). The condition does not require professionals such as those mentioned above to be employed by the company themselves, but the company must – via its employees – be managing that work and managing its relationship with the professionals.

The intellectual property being managed here must be owned by the company. Holding an exclusive licence for the IP will not meet this test. [The test does not require that all the IP arising from the company's past R&D be owned.]

Companies must be performing a significant amount of management activities in relation to relevant IP.

Meaning of relevant intellectual property

Intellectual Property means any patent, trademark, registered design, copyright, design right or plant breeder's right, or any rights under the law of a country or territory outside the United Kingdom which correspond or are similar to these. This can include know-how and trade secrets.

To allow know-how or trade secrets to qualify as IP they must derive from R&D or from carrying on R&D and the greater part by value of the intellectual property must be created by the company.

Condition B

Condition B is that the sum of qualifying expenditure incurred in the accounting period on

- subcontractors provided by connected companies
- EPWs provided by connected companies

does not exceed 15% of the company's qualifying R&D expenditure for the period. This includes qualifying expenditure, where parties have jointly elected to be treated as connected.

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