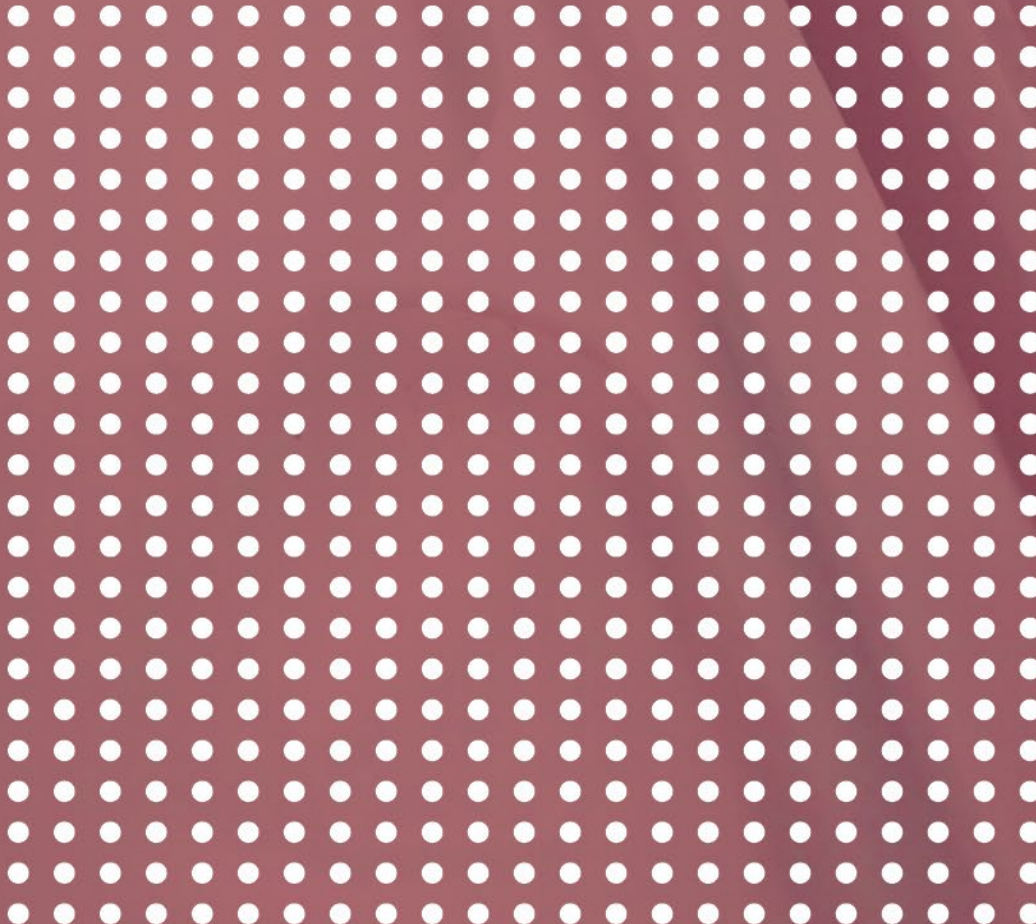


Overseas R&D: new rules

A guide to the new rules
July 2025





New rules relating to overseas subcontracted or externally provided workers for R&D come into effect for accounting periods that begin on or after 1 April 2024.

The rules

For accounting periods beginning on or after 1 April 2024 there are additional rules for R&D work that has been subcontracted out to a contractor or an externally provided worker (EPW). There are now restrictions on “overseas” spend which apply to EPW payments and contractor payments.

Meaning of “overseas” / “abroad”

The terms “abroad” and “overseas” are used interchangeably in this guidance, and they both mean “not in the UK”. The UK is the United Kingdom of Great Britain and Northern Ireland, comprising England, Scotland, Wales, and Northern Ireland.

General rule

Spend on EPWs whose earnings are not subject wholly or in part to UK PAYE and contractor payments for R&D undertaken overseas only is **excluded** from qualifying expenditure under both ERIS and new RDEC, unless an exemption applies.

The exemption

This section applies in circumstances where there are conditions necessary for the purposes of the R&D being undertaken: This could be either:

- That the conditions are not present in the UK or
- That the conditions are present in the location where the R&D is undertaken and that it would be wholly unreasonable for the company to replicate the work in the UK.

“Conditions” includes in particular:

- geographical, environmental or social conditions
- legal or regulatory requirements as a result of which the research and development may not be undertaken in the UK. This list is not exhaustive.

However, conditions are disregarded to the extent that they relate to:

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

The list of conditions to be disregarded is exhaustive.

Meaning of “necessary”

Necessary is not defined in statute and takes its ordinary meaning. If the R&D cannot proceed unless a condition is met, that condition is necessary for the purposes of the R&D.

Just because it is necessary to carry out one or more activities of the R&D project outside the UK does not mean that other activities of the project meet this test. Each must be judged on its own merits.

Meaning of “Not present in the United Kingdom/present in another location”

What is relevant is the conditions that exist at the time the R&D activity is undertaken. HMRC would expect that, in project planning, a company would consider alternatives and identify the best way forward and that this planning could be used to identify and justify choices made.

Meaning of “Wholly unreasonable”

Whether it is wholly unreasonable for the company to replicate the conditions in the UK will depend upon the R&D, the circumstances of the company and the reason for undertaking the work abroad.

In particular, time pressure may affect this. Time pressure may arise either from the demands of the R&D itself (e.g., samples may have a limited life, a particular result may be needed before the next iteration of a test run) from commercial, legal or contractual factors, or from a mixture of both. There may be evidence to demonstrate this in project planning documentation, commercial documentation or less formally (communications between staff or between companies as the project evolves). Time pressure will affect different companies in different ways, depending on their size, resources and capacity.

There will be circumstances where it is obvious that time pressure is relevant, such as where unanticipated events occur which disrupt or change plans. In other cases, time pressure will be apparent at an earlier stage when it becomes clear even then that some necessary condition will not be present in

the UK. Each company's circumstances need to be taken into account – what is wholly unreasonable for one may be reasonable for another.

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 9 below).

Ultimately, HMRC is attempting to ensure that R&D is undertaken within the UK.

Geographical, environmental and social conditions

These are features of the world (whether natural in origin, such as a disease, or the result of human activity, such as a test facility). HMRC's view is that this includes (but is not limited to):

- Medical circumstances such as incidence of a disease or availability of participants to trial a drug or other medical treatment (participants here covers both participants with particular relevant characteristics and willing participants in general, in particular note that there is a particular class of eligible costs for both reliefs that covers clinical trial participants).
- Animal or plant distribution.
- Physical or geophysical circumstances (deep oceans or high altitudes; volcanic or seismic conditions; minerals and geology; fortuitous features such as deep mines suitable for locating particle detectors).
- Centres of human expertise such as university or other research groups.
- The presence of machinery or facilities to which a company may require access.
- Cost (other than that associated with the R&D itself).
- Environmental sustainability (for example the carbon impact of shipping materials or equipment long distances or by the choice to use green energy or be able to recycle waste).
- Legal factors such as IP ownership.

Other geographical, environmental and social conditions may also exist.

Legal or regulatory conditions

HMRC's view is that this includes:

- Explicit legislative requirements (such as that activities must take place in a particular country or according to recognised regulatory principles which do not obtain in the UK) whether set out in national legislation, international agreements or treaties or elsewhere.
- The requirements and decisions, formal and informal, of regulatory bodies (so for example, if testing of a drug must be done according to a method agreed by a regulatory body and that body decides that activity must take place in a particular country, or imposes requirements that make that necessary, then this is a regulatory requirement, even if it is not stated somewhere in legislation).
- Guidance from regulators, local and state government and professional or accreditation bodies (e.g. specific accreditation from an industry body for a newly developed product).

- Agreement by the regulator to a process that the company has proposed to ensure the trial complies with good clinical practice standards and that any proposed manufacturing facilities comply with Good Manufacturing practice standards.

Examples

Geographical and Legal examples:

Example 1

Motorcycle and Motor Car Grand Prix regulators restrict their testing sessions to specific tracks, normally overseas. If a manufacturer uses such a facility for expenditure attributable to R&D that is affected by the overseas restriction (e.g. EPW costs) then would qualify.

Example 2

An SME life sciences business undertakes a range of clinical trials which include overseas EPW / subcontracted activities. Some clinical trials relate to treatments for diseases more commonly present in the UK. The company uses a global CRO to identify clinical trial participants, and UK and overseas clinical trial sites are used.

The work could theoretically all happen in the UK - there are no regulatory requirements to carry out the studies overseas. However, the company is keen to utilise an ethnically diverse population sample (which is becoming increasingly important to regulators) - to achieve this diversity it requires them to undertake the trials in multiple overseas locations.

This also has the benefit of speeding up patient recruitment. Therefore, a variety of circumstances are behind the decision for undertaking the work overseas. As there is no regulatory requirement for overseas activity, this exemption does not apply. However, the significance of other circumstances such as the increased speed of patient recruitment or other benefits that result from accessing an ethnically diverse population would need to be assessed and could lead to eligibility.

Example 3

A drug company is required to run a trial in Germany to provide evidence in that territory such that the authorities will agree an appropriate price reimbursement for a drug after it is approved for use by the regulatory authorities. In the absence of that evidence, it is unlikely that it would be economically viable to supply the product in Germany.

The payment for the cost of the trial would therefore meet the rule that there are relevant conditions necessary for the purposes of the research and development. In this instance the relevant conditions are both economic and regulatory. However, had the primary reason been a lower cost of carrying out the trial, this would not satisfy this condition.

The company might evidence this, if necessary, using a vendor selection form with a detailed description as to why a certain UK subcontractor or overseas subcontractor is chosen to conduct its R&D work.

Alternatively, if there is specific correspondence from the regulatory body underlying the choice of supplier, this would also be useful evidence as might notes of meetings or calls.

Wholly Unreasonable examples:

Example 4

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 that it would be wholly unreasonable for the company to replicate in the United Kingdom 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 the exemption 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 that it would be wholly unreasonable for the company to replicate in the United Kingdom would not be met.
- If there is time pressure, and the replication of a facility in the UK would take too long, the condition that it would be wholly unreasonable for the company to replicate in the United Kingdom would apply if the work was undertaken outside the UK.

Example 5

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 that the circumstances are that there are conditions necessary for the purposes of the research and development.

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 6

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 7

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 that the circumstances are that there are conditions necessary for the purposes of the research and development, if undertaken in a location where the necessary conditions arise.

Example 8

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 that the circumstances are that there are conditions necessary for the purposes of the research and development 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 9

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).

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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 it satisfies the overseas exemption.



Help and contact

If you have any questions or need to talk about the impact of these changes:

Email us via rdtax@ct.me

Call us on 0131 558 5800

Book a 1-2-1 with Dave Philp, our R&D Tax Director: [Calendly - David Philp](#)