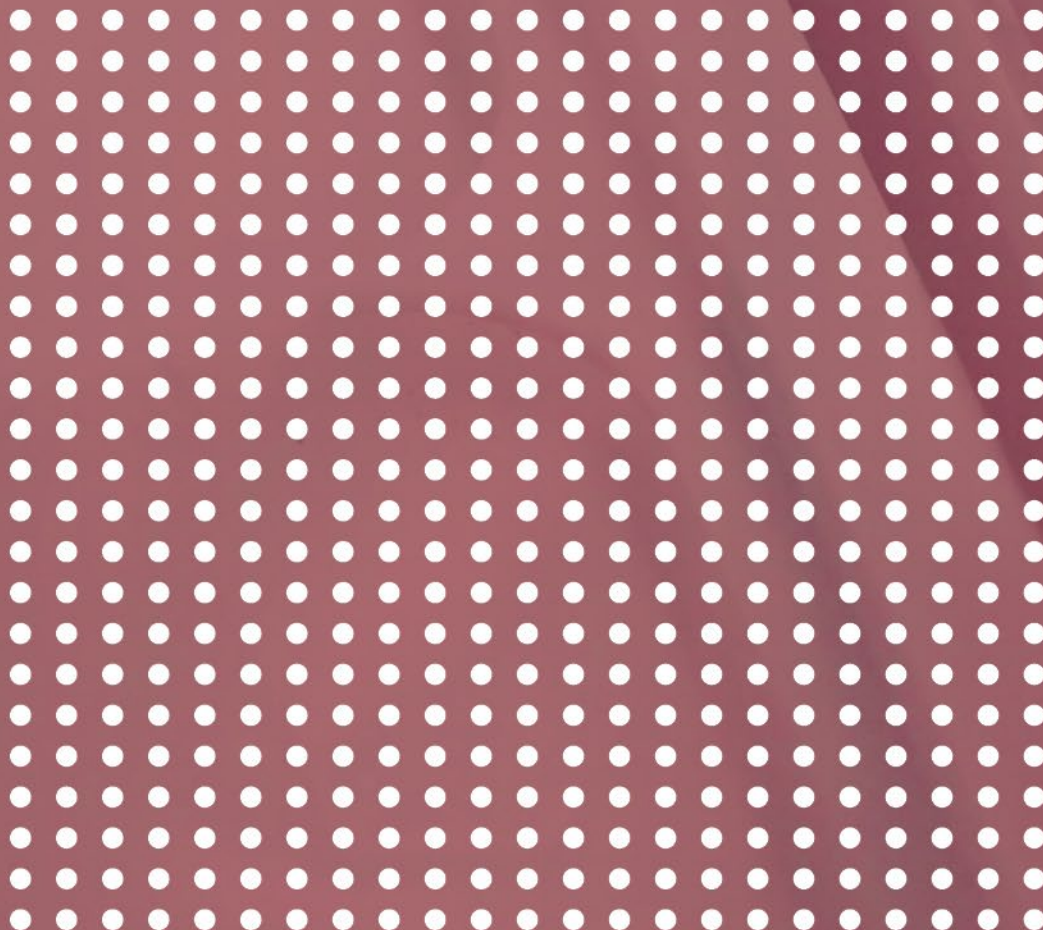


Subcontracted R&D: new rules

A guide to the new rules
Updated November 2025



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

The old rules, pre-April 2024

Previously, there was no definition of “subcontracted” in R&D tax relief legislation. However, in the majority of cases, a claim could not be made under the SME scheme where the expenditure was on activities which were “contracted out” to the company. In limited circumstances, it had been possible for SMEs to claim under the RDEC scheme where they had been subcontracted to undertake R&D – for example where they were contracted by either a large company or a company out with the scope of corporation tax.

So, where R&D is done by company B, a supplier, to fulfil a contract to its customer, company A, the different schemes meant different companies could claim:

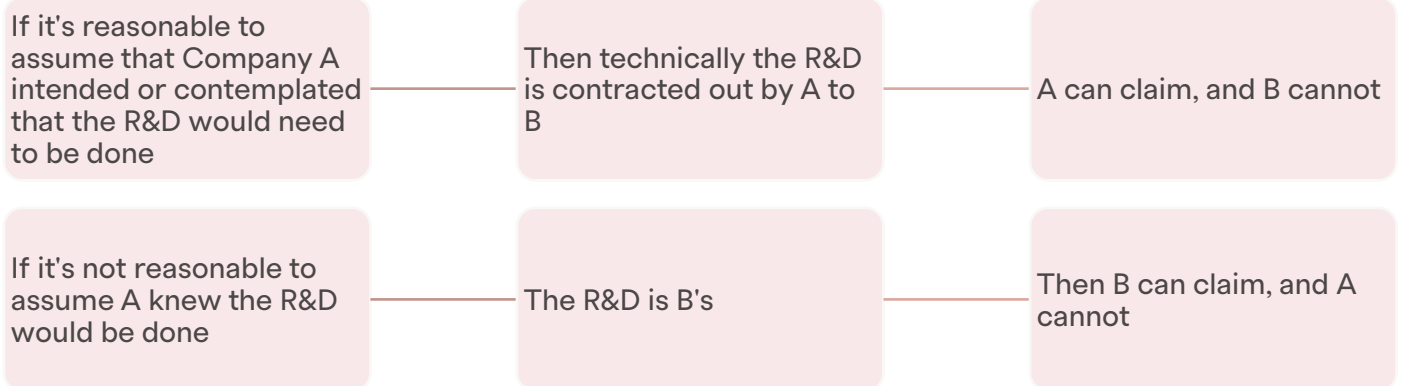
	Company A	Company B
SME scheme	Yes, can claim	No, can't claim
RDEC scheme	No, can't claim	Yes (if A isn't a UK SME)

HMRC's view was that any activities carried out by a company under a contract in order to fulfil the terms of a contract should be considered to be ‘contracted to the company’. Thus, HMRC considered only the outcome of a contract with regard to where the R&D activities fall, rather than the intention and knowledge of the parties as to what R&D will be undertaken. This created odd policy outcomes, such as giving relief to companies that had no input into the R&D. HMRC's interpretation of the rules have changed over time, with the supporting guidance changing a number of times.

The new rules, post-April 2024

With the new merged scheme, HMRC have looked to refresh and simplify the rules. To ensure consistency across the regime, for accounting periods beginning on or after 1 April 2024 these rules will also apply to R&D intensive SMEs.

So, where the R&D is done by Company B to fulfil its contract with Company A:



A person “contracts out” research and development if —

- a) the person enters into a contract under which activities are to be undertaken for it (whether by another party to the contract or by a sub-contractor),
- b) the activities undertaken in order to meet the obligations owed to the person under the contract include research and development, and
- c) it is reasonable to assume, having regard to the terms of the contract and any surrounding circumstances, that the person intended or contemplated when entering into the contract that research and development of that sort would be undertaken in order to meet those obligations.

HMRC's approach

In HMRC's consideration the meaning of **intended or contemplated** is more than the belief or knowledge that R&D will be required or realised. HMRC expect that a specific action regarding R&D was considered, planned, and acknowledged as needed. There is a need to understand and specify the action needed and not just speculate the probable actions or potential general applications.

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. 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 definition:

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

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, and
- 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).

There needs to be a deliberate push by either party in starting the R&D. Mere speculation or acceptance that R&D may be needed will not be sufficient.

Identifying the “decision-maker”

This term does not appear in the legislation but HMRC 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.

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Ultimately, HMRC is attempting to ensure that the company making the decision to undertake the R&D gets the relief for that expenditure.

Example - expertise

A manufacturer (Company A) contracts a third party (Company B) to provide specialist tooling and knows that R&D by Company B is likely to be required to develop this. The contract however is just for the provision of the prototype tooling.

Although Company A understands that R&D is required and provides a detailed specification of product requirements, it does not possess the specialist expertise in this specific area of engineering.

Although Company A understands that R&D will be required by Company B to fulfil the contract, Company B undertakes the associated economic risk. Furthermore, Company A does not specify for Company B, or set out internally, the R&D required (it is unable to as it lacks the expertise in this area) Company B would therefore (assuming it meets all other conditions) be in a position to claim the R&D relief.

Company A would not have contracted out R&D and would not be able to claim relief for any payment made to Company B. Even if the requirement for the tooling arises as part of an R&D project of Company A, it is still possible for the facts to support Company B, not Company A, making a claim. But this will depend on an analysis of those facts and the consideration of the surrounding factors of the undertaking of R&D.

Example - processes

Company A (in the chemical sector) has a product which requires an intermediate to be produced which is combined to form the final product. Company A has one source of supply for this intermediate but commercially this is a risk point, and so contracts Company B to produce the intermediate. The contract is for supply of X tonnes at a cost of £Y per tonne.

Company B has a completely different process train (equipment) from that which Company A developed its process for the intermediate, and which is different again from that of the current contract manufacturing organisation (CMO) supplier. Company A is aware of the difference in Company B's process train and understands at a high level that Company B will need to develop a process to deliver the intermediate in the quality, quantity and cost of goods required.

Company A may be aware of the requirement for R&D by Company B in order for it to fulfil the contract. Importantly however, Company A is unable to specify the R&D that would be required. Company B would be in a position to claim for the relevant expenditure.

Ultimately, as can be seen from the two examples provided above, each scenario and project undertaken will have a completely different set of facts and surrounding factors which must be considered as to whether the Company will have ownership over the R&D whether they were contracted to conduct the work or if this was contracted out. It is now a key step of the R&D claim process to establish where ownership of the R&D lies ahead of attributing any costs to a claim.

Contracts

HMRC's interpretation of whether something is subcontracted or not revolves a lot around the agreement in place. HMRC has stressed that it is important to look at the contract and circumstances surrounding the contract, this includes known facts and inferences. A few considerations are listed below;

- The nature of work undertaken, outlined in the contract,
- The trade of both parties,
- The terms of the contract,
- Communication with regards to the contracts. This could be either verbal or written communication or both,
- Contract pricing mechanism, (for example - consider what the price covers and how it was determined),
- The nature of the work generally done by the contracted party,
- Consideration of whether the contract is typical or atypical in the field or industry,
- General customer expectations of a contracted party in the field (whether a supplier of this kind is expected to generally be doing R&D).

Simply stating in the Contract that the R&D belongs to the customer won't be enough to satisfy HMRC requirements. The condition is that it must be reasonable to assume R&D was intended or contemplated, not simply that "the contract says x".

If a company is contracted to do work for another company, but the work does not form part of R&D for the customer and was instead initiated by the contractor, then the contractor may be able to claim relief for their work, if they meet the requirements of having valid R&D which is otherwise eligible for tax relief. This is considered an essential element.

If a company is contracted to provide a product or service which is not R&D, such as constructing a building or a software product, if they undertake R&D in delivering that product or service, they would be able to claim relief even though they are undertaking R&D on an activity contracted to them. The exact details of who should claim the relief will depend on the specific contract.

Contracted out by overseas company

The one exemption to all of the above - where a company has been contracted to carry out R&D by subcontractors who are not subject to UK Corporation Tax, such as an overseas company, then the UK company will continue to qualify for relief, provided R&D has been undertaken.



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](#)