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# RESEARCH AND DEVELOPMENT TAX RELIEFS: NEW CONTRACTING OUT RULES AND OVERSEAS RESTRICTIONS – DRAFT GUIDANCE

## Response by Association of Taxation Technicians

### 1 Introduction

- 1.1 The Association of Taxation Technicians (ATT) is pleased to provide comments on the *Research and development tax reliefs: new contracting out rules and overseas restrictions – draft guidance* (the ‘draft guidance’) published on 9 February 2024.<sup>1</sup>
- 1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.
- 1.3 Overall, we found the draft guidance to be very helpful in addressing what are relatively complex areas of the proposed new Research and Development (R&D) tax relief regime. In particular, we welcome the practical focus and extensive use of examples. However, it is a shame that this guidance is only being published now, less than two months before the new regime is due to take effect.
- 1.4 We provide our more detailed comments on specific sections of the draft guidance in sections 2 to 6 below.

### 2 Section 3 – Overseas expenditure: contractor payments

- 2.1 Section 3.1 discusses the requirement for contractor activities to be undertaken in the UK. At the end of this section, a list of bullet points is given of factors to consider where contractor payments have to be apportioned between UK and non-UK elements. We would recommend that the second bullet point, which refers to ‘salary costs’ be extended to also refer to other qualifying costs. Whilst salary costs are likely to be the predominant cost in R&D, other expenditure such as consumables may be significant.

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<sup>1</sup> <https://www.gov.uk/government/consultations/draft-guidance-research-and-development-rd-tax-reliefs-new-contracting-out-rules-and-overseas-restrictions>

- 2.2 Section 3.2 discusses evidence to support claims which include consideration of overseas expenditure on contractor payments. Whilst this clarifies a number of key points, the addition of some brief examples of what HMRC would and wouldn't accept as evidence would make it more helpful. We also note that the second to last paragraph sets out evidence it would be prudent for a company to identify and retain, including 'PAYE or NIC reference numbers' – this is sensitive information, which contractors may be unwilling to share with their customer.

### 3 Section 4 – Overseas expenditure: externally provided workers

- 3.1 The conclusion of Example 1 in Section 4.1 would benefit from being expanded. In particular, the wording at the end "...and therefore 65% of the payment is qualifying expenditure." is not entirely clear as to whether the 'payment' referred to is the entire staff provision payment, or just the 60% which represents qualifying earnings.
- 3.2 Example 2 in Section 4.1 discusses the application of s1138A, and would therefore seem to fit more naturally into Section 6 of the draft guidance. Those reading the guidance will not yet have had any explanation as to the tests in s1138A, so discussing their application in Section 4 appears premature.

### 4 Section 5 – Overseas expenditure: other qualifying cost categories

- 4.1 Section 5 helpfully clarifies that the overseas expenditure restriction applies only to contractor payments and externally provided workers – not other qualifying expenditure. However, we believe the first paragraph of this section would read better if it said [italics indicate our proposed changes] "No similar restrictions *regarding overseas expenditure apply* to other categories of expenditure beyond contractor payments and payments for externally provided workers. *Therefore there is no territorial restriction on staffing costs, consumables software, data and cloud computing, or payments to clinical trial participants.*"
- 4.2 In Example 3, the final paragraph (starting "As the EPWs...") is more relevant to Section 6 than Section 5 of the draft guidance. As noted above for Example 2, readers will not have been introduced to s1138A yet, so may be confused to see this discussed at this stage.

### 5 Section 6 – CTA09/1138A: Externally provided workers and contractors: R&D undertaken abroad

- 5.1 Overall, we found this section to be very helpful in clarifying HMRC's intended application of what are otherwise very subjective terms (e.g. 'wholly unreasonable') in the relevant legislation. The addition of numerous examples is also welcome.
- 5.2 It would however be helpful to expand on the discussion in these examples to explain that expenditure can be apportioned where part of it meets the conditions of s1138A and part of it does not. For instance, in Example 6, this could be discussed in the context of some samples being unstable and needing to be analysed quickly in the country of origin, but others are not and could have been processed in the UK.
- 5.3 In Example 9, which discusses contracting out of clinical trials, there is discussion of the contractor ('B') determining prior to submitting the claim that 20% of the participants could have been recruited in the

UK in the same timescale. As a result, the customer ('A') limits its claim to 80% of the relevant cost. We would query whether this is practical – is B likely to carry out this detailed analysis? If they do not (or will not share the outcome with A), and A cannot carry out the analysis themselves, what position does that leave the claim in?

5.4 Section 6.1 discusses at length the conditions in s1138(3) which might necessitate R&D being undertaken overseas. We have the following comments about the conditions listed under the heading 'Geographical, environmental and social conditions':

- 'the presence of machinery or facilities to which a company may require access' – it might be helpful here to refer back to the earlier guidance about the requirement for it to be 'wholly unreasonable' for this condition to be replicated in the UK.
- 'cost (other than associated with the R&D itself, see section 6.2 below)' – as cost is specifically excluded from being a necessary condition by s1138A(2)(b), including this item here could lead to confusion. We would recommend either deleting this bullet point entirely, or expanding on what costs could be considered.
- 'legal factors such as IP ownership' – this condition would seem to fit more naturally under 'legal or regulatory requirements' than 'geographical, environmental and social conditions'.

5.5 In Example 10, the final sentence appears to be missing some words where it says "... then would qualify". We would recommend changing this to say "... then the conditions of s1138A(2) would be met."

5.6 In Example 11, the final paragraph has a typo (in that it refers to s1138, not s1138A). It would also be helpful, in this example, to expand on why the requirement in s1138A(2)(a) is met since the work could theoretically take place in the UK.

## 6 Section 7 – Contracting out R&D: new rules

6.1 Overall, this section of the guidance contains some helpful clarification, and the addition of numerous examples is welcome.

6.2 Section 7.1 contains some typos:

- The first sentence of the first paragraph should read "..... counteracting a market failure *which* would otherwise reduce...."
- The second sentence of the third paragraph should read "...which is important for the reasons set out in *this* section."
- The paragraph starting "Regardless of which party is able to claim...." is duplicated – appearing after Example 18 and then again at the very end of the section. We would recommend deleting the first instance.

6.3 With regards to section 7.2:

- When discussing s1133(2), it would improve the flow of the guidance to move the sentence starting "If all three parts of the definition..." from the end of paragraph one to after paragraph two.
- It is helpful to have a large number of examples illustrating the interpretation of s1133. However, the vast majority conclude that company B (the contractor) can claim. It would be

helpful to have more examples showing where the conditions of s1133 are met, such that only company A (the customer) can claim.

- In Example 21 a closing bracket is missing from “(as referred to in section 1133(2)(c))”
- In Example 22 there is a typo in the first paragraph of the second sentence (‘professionals’ has two ‘s’ at the end).
- In Examples 25 and 26, it would be helpful to explain what the acronym ‘OEM’ stands for.

- 6.4 In section 7.3, Example 27 sets out how s1133 will apply in a subcontractor situation, where s1133 does not apply to the initial contracting, but does apply to the subcontract. This provides a clear answer that Company B (i.e. the contractor) is the only party eligible to claim. It would be helpful to also cover the perhaps less common, but more complicated, scenario in which the conditions of s1133 are met by both the original contracting, and the subcontracting, as who is entitled to claim in that scenario is less obvious.
- 6.5 In section 7.6, It would be helpful to clarify, in the final sentence before Example 29, how groups without a CRM should submit an election.
- 6.6 The title of section 7.7 (‘Interaction with CTA09/1042F and CTA09/1053 (claims by contractor where customer cannot receive relief’) does not tie in well with the content, which addresses subcontracting scenarios for irrelievable clients. We would recommend changing this title to specifically reference subcontracting.
- 6.7 In Example 30, the second paragraph states that Company B might not be able to claim if an intermediate contractor does not meet the conditions of s1042F “..because the R&D is in respect of a trade not chargeable to corporation tax”. However, if the intermediate contractor was not within the charge to corporation tax, then all parties who contract out the R&D would meet one of the conditions in s1042F(4), and B should be able to claim. Is the ‘not’ in this example a typo?
- 6.8 In Example 31:
- The first sentence should read “UK Automotive company A contracts...” (not ‘subcontracts’).
  - The second paragraph should read “It contracted R&D to another person” (not ‘subcontracted’).

## 7 Contact details

- 7.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson on [erawson@att.org.uk](mailto:erawson@att.org.uk).

## The Association of Taxation Technicians

[XX] February 2024

## 8 Note

8.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 9,800 members and Fellows together with over 7,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.