

R & D Tax Relief - Qualifying Costs

Which costs qualify for R&D Relief?

To qualify for the enhanced research & development tax relief, a project must meet the definitions set out by the Department for Science, Innovation and Technology (DSIT). These state that the activity must seek to make an advance in science or technology.

Only specific categories of revenue expenditure qualify for the enhanced tax relief. Where qualifying costs are only partly incurred in connection with the R&D activities an apportionment of the qualifying costs is required.

For accounting periods commencing from 1 April 2024 only expenditure incurred in the UK qualifies, meaning that the cost of employing workers overseas or using overseas sub-contractors or offshore externally provided workers will not count as qualifying expenditure for R&D purposes. Where the work cannot be carried out in the UK, such as when the work relates to environmental conditions only found outside the UK then this restriction does not apply.

Enhanced tax relief is available for certain specific categories of expenditure, as follows:

Employee costs

Costs of directly employed staff who are engaged in carrying out R&D projects are the main cost that can be included in a claim. These costs also include Employer's National Insurance Contributions, in addition to the gross wages paid.

Pension costs paid by the company can also be claimed, as can certain incidental reimbursed expenses directly incurred by the employee, including reimbursed travel expenses incurred undertaking the R&D. Reimbursed expenditure relating to purchases on behalf of the company (e.g. equipment) cannot be included in qualifying staff costs.

The staff must be company employees under a contract of employment, not self-employed contractors or staff operating through their own personal service company.

Directors wages can be included but may be restricted if their time is charged through another group company. Any wages costs must be accrued within the accounting period and actually paid during the period or within the following nine months, and must also have been paid before any claim is submitted.

Employees are unlikely to spend the whole of their time on R&D and so the amount claimed should be based on records of the proportion of time spent undertaking qualifying R&D projects. Ideally timesheets or similar records should be maintained in support of this. HMRC will usually restrict claims where 100% of a particular employee's wages are included within the claim, as they believe some non-R&D activities will normally be undertaken by all staff.

Indirect/support staff

Where staff are engaged wholly or partly in supporting the R&D staff their employment costs can also be claimed as "qualifying indirect activities".

The definition of qualifying indirect activities is widely drawn and includes clerical support staff (e.g. typing up reports), maintenance engineers, security staff, administration and training staff.

However, HMRC seek to limit these costs to those specifically identifiable as a particular part of an R&D project, rather than more general costs. For example, central HR and finance staff costs are usually excluded; while staff time spent ordering materials for the R&D can be claimed.

Agency staff (“externally provided workers” - EPW)

Costs for staff provided by an agency or staff provider who are directly and actively engaged in carrying out R&D can be included. The agency must contract directly with the individual whose services they supply and not through another intermediary, such as a personal service company.

This may require an apportionment of the costs to reflect the element relating to actual R&D activities. The qualifying expenditure is also restricted to 65% of the relevant EPW costs, unless the entity providing the staff is a connected party, when the actual staff costs can be claimed, but limited to the amount of the payment made to the agency or staff provider.

Materials

Physical materials used directly in carrying out the R&D, such as might be used in a prototype or for testing, can be claimed. Any materials that are “consumed” or transformed in the R&D project can be claimed, but not those that are included in finished, saleable products.

It is not possible to include indirect costs such as rent (even of lab or test facilities) or telecoms charges, even though these may be essential to the R&D effort, as they do not fall within the materials heading.

Utilities

The costs of electricity, gas, water and other fuel used directly in carrying out R&D can be claimed.

This can include the costs of lighting and heating an office where the R&D is undertaken, as well as the costs of running machinery used for research, but does not include the rent of laboratory or test facilities.

Costs relating to telecoms, networking, etc. cannot be claimed as utilities.

Software

Computer software used directly in the R&D project can be included under this separate heading. This can be something as simple as Microsoft Word or Excel, or could be a dedicated piece of specialist software that has been custom made for use in the R&D project.

Cloud Computing and Datasets

For accounting periods beginning after 1 April 2023 the cost of undertaking research through modelling on cloud computer platforms will qualify for relief, as will the acquisition of data licences (datasets) needed to support this research. This should allow expenditure on

platforms such as Amazon Web Services, Microsoft Azure and Google Cloud Platform to qualify for relief where it is used directly in the research work.

Subcontracted R & D expenditure

Under the current R&D scheme there is no restriction on claiming costs related to R&D work contracted out to a subcontractor.

There needs to be a clear contract between the parties for the R&D activities and for the subcontractor to actually carry out this work, rather than relying on any existing product or knowledge. The contract needs to explicitly envisage the need for R&D, rather than simply be a contract for the purchase of defined goods or services.

Where the subcontractor is an unconnected business the qualifying expenditure is limited to 65% of the cost, while research undertaken by a connected party, such as a fellow group company, is limited to the wages cost within the subcontractor business or the amount of payment made, if lower.

The work needs to be carried out in the UK.

Clinical trial volunteers in the pharmaceutical industry

Payments to volunteers involved in the testing of drugs for the pharmaceutical industry or more specifically for "investigation in human subjects undertaken in connection with the development of a health care treatment or procedure" qualify for as an allowable R&D cost.

Capitalised revenue expenditure

Although the relief is primarily limited to revenue expenditure, any expenditure under the above headings that has been capitalised may still be claimed in some instances.

Where an expense is not included in the company's profit and loss account and it relates to an intangible asset (e.g. creation of intellectual property), then R&D relief will still be available on the full cost provided that it would have qualified as a tax deductible expense had it not been capitalised.

Capitalised revenue costs that relate to tangible assets (e.g. prototypes) can only be included in an R&D claim to the extent that a tax-deductible expense is claimed in the profit and loss account (e.g. depreciation/amortisation).

Capital expenditure

Although R&D tax relief is only available for revenue expenditure, the costs of acquiring capital equipment benefit from a separate special category of Capital Allowances.

This gives relief for 100% of this capital expenditure up front, which may otherwise have only qualified for limited Capital Allowances over a longer period.

Accrued expenditure

It is important that qualifying expenditure can be reconciled to the accounts. In addition to the accounting entry, it is important that any expenditure has actually been paid, as accrued but unpaid expenditure cannot usually be claimed.

Advance Assurance

HMRC offer a service for small or medium enterprises to obtain confirmation whether the project will qualify for R&D tax relief.

This assurance service is restricted to those companies that have not claimed tax relief before and may provide a useful guarantee that tax relief is available.

Further Advice

For further advice contact us on 023 8046 1200 or visit www.hwb-accountants.com.

HMRC guidance: <https://www.gov.uk/guidance/check-what-research-and-development-rd-costs-you-can-claim>

The above summary is based on legislation and guidance published as at 1 October 2026.

The summary is intended to provide a general guide and individual advice should be sought about your specific circumstances.