Super-deduction and intangibles

A range of generous tax incentives was introduced in the Chancellor's Budget in March 2021 to drive innovation and stimulate investment in the UK to aid post-pandemic recovery.

A key announcement was the new super-deduction for capital expenditure which is available through the capital allowances regime. Capital allowances enable businesses to write off the cost of certain tangible capital assets when computing their taxable profits.

There may be an opportunity for capital investment on intangible fixed assets relating to software to also qualify for the super-deduction, subject to meeting certain criteria.

The ability to claim the super-deduction on software is likely to provide significant additional benefit to businesses on investments which otherwise may not have attracted the enhanced tax relief.

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What is the super-deduction?

- A **130% first year allowance** for investment incurred on certain plant and machinery (which would have normally attracted tax relief at 18%) which is new and unused.
- A cash tax benefit (for a tax paying business) of 25% of the cost of the qualifying expenditure.
- Temporary and applies to new expenditure incurred from 1 April 2021 to 31 March 2023.
- Only available to companies within the charge to corporation tax.
- Only available for contracts entered into on or after 3 March 2021. There may be instances where an earlier contract (e.g. Master Service Agreements) does not commit a business to incur expenditure at the outset but a later sub-contract does. Such connected contracts will need to be reviewed on a case-by-case basis to determine whether they fall in the scope of the relief.
- Consideration will need to be given on how a business intends to use and dispose of assets as it may trigger a balancing charge which effectively claws back the benefit.

How does the super-deduction apply to intangible investments?

Companies typically take a tax deduction for intangible fixed asset spend as it is amortised or impaired. Where a company incurs capital expenditure on an intangible fixed asset relating to software, the company can elect so that no tax relief for such expenditure is obtained through the intangibles regime and instead allows relief to be obtained through the capital allowances regime.

Software would normally qualify for capital allowances at 18%. As a result of the super-deduction, where such an election is made, the rate of relief on such expenditure will increase from 18% to 130%

How does the super-deduction interact with R&D claims?

- R&D claims only relate to expenditure which is deemed revenue for tax purposes whereas the super-deduction only applies to expenditure which is capital for tax purposes.
- Where intangible additions relating to software projects include capitalised revenue costs as well as costs that are capital for tax purposes, it should be possible to elect, to claim the super-deduction on expenditure which is capital for tax purposes and to claim a revenue deduction on the elements that are revenue in nature which may qualify for R&D expenditure credit (RDEC).
- It should not be possible to make an R&D claim on the same expenditure a super-deduction has been claimed on. This is on the basis a distinction will need to be made first on whether expenditure is capital or revenue and the tax treatment to adopt should follow accordingly.
- In practice careful upfront consideration will need to be given on what expenditure is considered capital or revenue.

What expenditure could qualify?

- Capital expenditure on software purchased from a third party software vendor or developed internally.
- Capitalised staff costs relating to projects which are capital for tax purposes.
- Third party systems professional integration fees.
- Capital expenditure on the purchase of software assets from a third party software developer who has developed the software and holds costs off-balance sheet, where it hasn't been used in the business.
- If expenditure is capable of qualifying for the super-deduction and R&D allowances (i.e. capital R&D costs) a company can choose which allowance to claim.

What expenditure does not qualify?

- Capital expenditure on software acquired from a connected party.
- Capital expenditure on software acquired in a purchase of trade and assets from a third party.
- Capital expenditure incurred on software which is considered a 'lease' to a third party, potentially an uncommon situation but still subject to clarification.
- Capitalised revenue expenditure relating to software.

What next?

- Companies that are currently incurring capital spend on software, or are planning to in the next few years, should evaluate the application of the super-deduction rules, the phasing of the spend and the interaction of these with the company's wider tax profile to optimise their position.
- Software providers, systems integrators and related service providers should engage with their customers to evaluate how the contracting and phasing of work can be updated (where required) to allow customers to benefit from the enhanced relief.
- Software developers should evaluate the nature (on balance sheet vs off balance sheet), contracting and phasing of their own development spend to establish opportunities to claim and manage the timing of when expenditure is incurred in the run up to March 2023.

How can PwC help?

- We have a dedicated team of capital allowances, R&D (including software engineers) and tax and accounting specialists focusing specifically on the super-deduction relief to assist businesses to obtain clarity on the optimum tax treatment prior to committing to investment decisions.
- To assist businesses understanding the different incentives available to them, and the complexities that can result from monetising the super-deduction, we have developed a modelling tool that allows businesses to undertake scenario planning and assess how the various incentives and allowances (e.g. R&D credit, patent box, tax loss use) interact and the net impact on their tax position.
- We can assist from undertaking upfront feasibility exercises to help appraise investment decisions, right through to entitlement and claim preparation, submission and agreement with HMRC.

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