

TAX TALK

Welcome to our monthly Tax Talk email!

This month's edition was written by our Research & Development Tax Manager, Mehul Kyprianou-Chavda, who explores R&D in the IT and Software industry.

Software claims account for 24 % of all submissions to HMRC under the Research & Development tax credit scheme. This is not surprising given the rapid growth of software and software-based companies in the UK, which leads the pack in Europe ahead of the EU27 according to the latest published figures.

No doubt that part of this may be attributed to the government's generous R&D (research and development) tax incentives, however with the number of claimants growing significantly year-on-year there are still many businesses yet to make their first claim.

R&D tax relief is the government's way of rewarding businesses that are investing in innovation by developing new, or improving existing products, processes, services, devices and materials or advancing the state of knowledge in their sector.

Guidance for what qualifies as R&D for tax purposes is broad and is designed to cover and be applied to all fields of Science & Technology (with the exception of Social Sciences, of course!).

Knowledge and capability in different fields of science and technology develop at different rates. Software Development and Information Technology, as a whole, is a rapidly changing field. To address this HMRC published new guidance in December 2018, following a two-year project executed by a purpose-assembled subcommittee consisting of HMRC officers, members of HMRC's Chief Digital and Information Office (CDIO, HMRC's own internal IT function) and members of the RDCC (an HMRC-sponsored steering committee with members such as ourselves!).

HMRC's own guidelines for the scheme, the BEIS guidelines (formerly the BIS Guidelines), haven't changed. Two critical criteria must be satisfied for a software project to qualify as R&D:

1. The project sought an advance in the field of Software Development or Information Technology, either by looking to increase the knowledge or capability in these fields.
2. In trying to achieve this advance, there was a technological (or scientific) challenge that couldn't readily be overcome by professionals from this field.

Building robust arguments around these criteria, the legislation and the most recent guidance from HMRC, is the role of the Specialist Tax Consultant, who is able to construct these from discussions in the consultation with the key technical members of staff working on solving the technical challenges.

The new guidance advises on the application of existing BEIS guidelines to software and gives a number of contemporary qualifying software examples.

Here are some key clarifications that HMRC has made :

- They require an **advance in the field of software development**, focusing on the underlying challenges in writing the code and not on the functionality or commercial application of the piece of software.
- **Boundaries of R&D**: not all of a software project may qualify for R&D tax relief. It's really important to engage a specialist who can ensure you don't under or over claim by including too little or too much.
- **Enquiries**: HMRC will engage the assistance of their IT professionals from the CDIO and the technical professionals (from the field of software development) working on the project will be required to support in addressing HMRC's queries.

The new guidance that has been published provides clarity on what can qualify and the level of detail and justification required.

18 months on and it can be seen that HMRC are leveraging this increase in the requirement of technical detail when conducting enquiries. In the recent 1st Tier Tribunal case of AHK Recruitment Limited (2019), the claimant's initial submission to HMRC failed on all three points.

Access to non-repayable funding, such as R&D tax relief will be critical in the coming months as the financial difficulties of the coronavirus aftermath become apparent. Hence it is more important than ever to engage a specialist to identify any potentially qualifying software development projects and to have the reassurance that strong justifications are made that stand up to HMRC scrutiny.

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