

ORDERWISE®

Super-deduction explained

How the super-deduction can be used on IT and software purchases

Last year the UK government announced that businesses will be able to use a **'super deduction'** to reduce their tax bill. **With less than a year left to claim, now is the time for businesses to start making those investments.** OrderWise is pleased to confirm that in most cases, spend on IT equipment, software and implementation services will be eligible, covering the vast majority of our products and services.

What is it?

Businesses will be rewarded for investing in new assets through a 'super deduction' off their tax bill. The government has done this to encourage businesses to invest now to help stimulate growth and recovery following the economic disruption caused by the pandemic.



When will it happen?

The tax break came into place on the **1st April 2021** and will be available on all qualifying expenditure made up until the **31st March 2023**.



What doesn't qualify?

There are some costs associated with an IT or software project that may not qualify, such as on-going support fees or software subscriptions.

We always recommend that customers and potential customers check with their accountant that the vast majority of spend on an IT or software project will qualify.

What counts as 'qualifying expenditure'?

HMRC set out detailed guidelines on what can be classed as qualifying expenditure.

The general rule is that qualifying expenditure is:

- Expenditure on the provision of plant or machinery for the purposes of an activity that the business performs, and
- The business incurring the expenditure owns the plant or machinery as a result of incurring the expenditure.

We then must ask what counts as 'plant or machinery'. Well, when it comes to IT and software, the good news is that most items do qualify. For example:

- Physical IT hardware such as computers and servers are recognised as plant and machinery by HMRC.
- Software such as ERP software and EPOS software also qualify under the guidance. This also includes items such as an Online Store or Trade Portal.
- In addition, the costs associated with bringing the IT or software investment into operation, such as the professional service costs of an engineer or consultant, can also be included.

The Three Test Rule for applying software as 'plant and machinery' is as follows:

- **Two-year test** – Providing the software will be used in the trade for a period lasting at least two years – this passes the test.
- **Function test** - Providing the software has a function and is used in the trade, rather than being part of the setting the trade is conducted from – this passes the test.
- **Premises test** – If an asset is part of the premises in which the business is carried on, it cannot be regarded as plant. As software is not part of the premises, this passes the test.

How does it work and how much is it worth?

Spend on plant and machinery, often referred to as 'capital' or 'fixed asset' spend in business, does not reduce profits in the year purchased as they are held on a company's balance sheet.

The cost of assets is slowly released as a charge through depreciation each year, reducing a company's profits. However, depreciation is not an allowable tax deduction, so it has to be added back when calculating taxable profits.

Fortunately, businesses have access to the Annual Investment Allowance that allows spend on qualifying expenditure of up to £1,000,000 to be deducted from that year's taxable profits. Therefore, this allowance reduces their tax bills by the applicable corporation tax rate (currently 19%).

The 'super deduction' will enhance this benefit further by increasing the amount to be deducted by an **additional 30%**.

See the illustration below to find out how this will benefit businesses in real terms.

	Original Annual Investment Scheme	Super-Deduction Scheme
Qualifying Expenditure	£100,000	£100,000
Super Deduction Applied (130%)		£130,000
Tax Deductible Saving (19%)	£19,000	£24,700
% Saved in Tax	19%	25%

Under the old rules, after spending £100,000 on qualifying assets, the business had been able to deduct this amount off their taxable profits, reducing their corporation tax bill by £19,000. However, using the 'super deduction', that £100,000 of spend is enhanced on the tax computation to reduce the taxable profits by £130,000 instead. The additional £30,000 deduction increases the tax saving by £5,700 to a total of £24,700.

With the 'super deduction' in place, the business is now saving tax at a rate of 25%. For every £1 spent on qualifying assets, 25p is returned in saved tax.

What about finance / leasing?

With regards to the leasing of equipment/software, it would depend on the type of contract as to whether it would be treated as capital expenditure or revenue expenditure.

If the lease were treated as revenue, it would be included in the profit and loss account.

However, if it were treated as a capital expenditure, then it would be included in the capital allowances computation and therefore, the super deduction would be available.

Assets acquired under Hire Purchase ('HP') contracts would be treated as capital expenditure and by concession, obtain capital allowances once you bring the asset into use in your trade, despite not legally owning it.

How does Software as a Service (SaaS) work?

The monthly payment for SaaS, where you never actually own the software, would be treated as revenue expenditure and written off in the profit and loss account.

With OrderWise, you own the software and we don't charge you to keep using our services on a monthly or recurring basis – therefore, you are able to assign this as capital expenditure which meets the requirements of the super-deduction scheme.