



TIGATM

**GUIDE TO R&D
TAX INCENTIVE
SCHEMES**

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CONTENTS

ABOUT TIGA / ABOUT MMP	Page 03
INTRODUCTION	Page 04
WHICH TAX INCENTIVES ARE AVAILABLE AND HOW MUCH COULD I SAVE?	Page 05
WHO CAN CLAIM? / WHICH COSTS QUALIFY?	Page 06
HOW DO I MAKE A CLAIM?	Page 08
VGTR OR R&D?	Page 09
FAQs	Page 11
CONTACT	Page 13

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TIGA represents developers, digital publishers, service companies and education providers and is the trade association for the video games industry.

Our core purpose is to strengthen the games development and digital publishing sector. We achieve this by campaigning for the industry in the corridors of power, championing the industry in the media and helping our members commercially.

TIGA is intent on building an enduring organisation which continually improves; a business that will make a significant impact on the games industry and so benefit our membership and the wider economy.

Since 2010, TIGA has won 28 business awards and commendations and been awarded Investors in People status on four occasions. These achievements reflect our drive for improvement and to meet best practice.

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MMP is an award-winning consultancy which helps companies maximise the potential of their innovations. MMP has won TIGA's best tax team twice, and been a finalist for a number of awards including the SME National Business awards for "Service Excellence".

MMP combines specialist knowledge of IP planning, grants and technology tax incentives, such as the R&D Tax Credit, Video Game Tax Relief and Patent Box, with professional qualifications and practical experience in engineering and scientific disciplines. We apply these skills in a client-friendly way to make our clients lives easier and ensure they meet their goals. MMP works with companies of all sizes, with in-depth knowledge of the video game sector.

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**INTRODUCTION**

The tax incentive landscape is in constant flux, with some updates in recent years making R&D tax incentives (R&DTIs) more generous than before. However, with the introduction of Video Game Tax Relief (VGTR), it has become more difficult for video game companies to make sure they are maximising the benefit that they receive from tax incentives.

We are frequently asked by companies which scheme they should be claiming under, but there is no easy answer to this — it largely depends on the company's individual circumstances. Although the R&DTIs are more generous (unless you're claiming as a large company), there are more restrictions on the types of activities and costs that are eligible. VGTR is less generous (again this doesn't apply if you're claiming as a large company), but a greater variety of costs will qualify. For instance, you can claim UX or design work under the VGTR, but you'll be hard-pressed to include this under the R&DTIs.

We often hear companies say: "But I claimed this cost or this activity before and my claim was approved by HMRC". Unfortunately, your claim was not actually "approved". If you included an ineligible cost or activity, and subsequently received a tax credit/relief this means HMRC did not review the claim in detail and the problem was not identified at the time. HMRC has the ability to go back four years if they discover something is incorrect, and up to 20 years if there is dishonesty. They are also able to issue penalties of up to 100% of the amount claimed.

As you can see, it is imperative that your business is claiming for the correct activities and costs. This guide has been produced to present the latest guidance in a clear and simple manner, to ensure you are adequately informed when considering applying for R&D Tax Incentives. It cannot however be treated as advice. Individual circumstances will always require specific consideration and you should speak to a professional.



**WHICH TAX
INCENTIVES ARE
AVAILABLE AND
HOW MUCH COULD
I SAVE?**

Which tax incentives are available and how much could I save?

There are three primary R&D Tax Incentive schemes available for SMEs and large businesses.

For SMEs:

- R&D Tax Relief – reduces the company's taxes – tax savings of up to 25% of the eligible amount spent on R&D
- R&D Tax Credit – gives you cashback of approximately 33.3% of the eligible amount spent on R&D (you don't need to be paying tax to qualify)

For large companies:

- Research and development expenditure credit (RDEC) – cashback of approximately 11% of the eligible amount spent on R&D

The definition of what qualifies as eligible R&D is consistent across all three schemes. The types of expenditure that are eligible are broadly similar, with certain restrictions regarding subcontracting under the RDEC scheme. Further details are available in HMRC's published guidance¹.

What is a small company?

The definitions of large and small companies are driven by the EU classification with specific modifications made for the UK. It is important to remember that if the company is part of a group then the figures for the entire group need to be considered.

There are three main criteria that distinguish an SME from a large company:

1. Does the company have more than 500 employees?
2. Is the turnover greater than €100 million?
3. Is the balance sheet total greater than €83 million?

The company is likely to qualify as an SME if the answer to the first point is "no", along with a "no" for question 2 or 3².

An SME may be required to claim under the RDEC scheme in certain circumstances. For instance, it is not possible to claim under the SME scheme for expenditure that is subsidised (for example, received a grant or certain types of loans). In cases where a qualifying project has received a subsidy it is possible to claim for relief under the RDEC scheme. Covid support from government for example needs careful consideration.

1: <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird80000>

2: Please note there are additional criteria the company needs to meet to be considered an SME. Please consult the relevant EU SME legislation for a complete evaluation of your company's status, alternatively MMP can conduct this review as part of an engagement.

**WHO CAN
CLAIM?
WHICH COSTS
QUALIFY?****Who can claim?**

To be eligible for R&D Tax Incentives you must be:

- A company
- Subject to corporation tax
- Carrying out eligible R&D related to the company's trade
- A going concern

Which costs qualify?

For an expense to be eligible for R&DTIs, it needs to meet the criteria for one of the scheme's 'cost buckets'. It also needs to be revenue expenditure (i.e. classed as day-to-day operating costs). If it doesn't fit into one of these categories, then it isn't eligible.

There are also different rules for what can be included under the R&D Tax Credit/Relief and RDEC schemes.

The cost buckets include:

- Salary
- Consumables
- Software
- Externally Provided Workers (EPWs)
- Subcontracted R&D

We're often asked about hosting costs. Strictly speaking, hosting costs such as AWS do not meet the requirements of any of the cost buckets. However, hosting costs are typically composed of a wide range of products, and depending on how the company utilises these products, some of them may be eligible under the "Software" category. This is dependent on the company, the services and how they are being utilised. Detailed advice should be sought. In order to provide more clarity, HMRC has confirmed that they will be launching a consultation and releasing further guidance on this.

Determining if your costs are eligible for R&DTIs can be a minefield. Further guidance regarding each of the cost buckets is available from HMRC³.

If you have any questions or would like extra support, don't hesitate to get in touch with the team at MMP.

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3: <https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird82000>

**WHICH
ACTIVITIES
QUALIFY?**

This depends: are you trying to achieve something new or different with your next project? Are you improving an existing product or process? If the answer to either of those questions is yes, and you're having technological difficulties along the way, then it's likely that at least some of your project is eligible for R&DTIs.

For a project to be eligible for the R&DTI, it must meet the following three criteria:

Technological Advance (TA)

The project must seek to achieve a TA — 'something new or different'. To assess this, it's useful to consider what the technology baseline was at the onset of the project. What have your competitors achieved? What's already in use within the industry? Is your advancement different from and better than any existing technology?

It is crucial to consider this from a technological perspective. For instance, if you were able to achieve more realistic physics in your gameplay but you did this by simply using a different physics engine, with no technological uncertainty – TU – (see below) involved, then it's unlikely to count as a TA. However, if you needed to fundamentally modify and develop how the physics engine worked to achieve this, which introduced a genuine TU, then it is likely to qualify.

Technological Uncertainty (TU)

There needs to be a TU to overcome when trying to achieve a TA. Again, the emphasis here is on the word 'technological', commercial uncertainties (i.e. will gamers like this?) don't qualify.

When assessing if your TA is eligible, consider these questions: what didn't work? What alternative technologies did you try? What modifications did you have to make to your code?

If the development process was straightforward, then the likelihood that you faced any genuine technological uncertainty is low.

Systematic approach (SA)

When carrying out R&D, you should be following a process: a series of steps you're planning to execute.

All types of systematic approaches, for example new product development process, Scrum, waterfall or Kanban, are acceptable. Not all companies have their processes documented, but it is not necessary for this to be a formal, documented process.



HOW DO I MAKE A CLAIM?

Once you've determined which activities are eligible then you'll need to write a summary of each of the eligible R&D projects.

This should include the following:

- A description of the advance in science or technology that was being sought.
- An explanation of the particular scientific or technological uncertainties that needed to be resolved to achieve the advance.
- An account detailing how and when the particular uncertainties were overcome.
- An explanation of how the project went beyond what was the current state of knowledge.
- Why the knowledge or capability sought was not readily deducible by a competent professional.

You'll also need to map these activities to eligible costs, and subsequently calculate the R&D tax claim. Once this is done, you'll need to have your accountant add the R&D tax figure into your tax computation and CT600.

HMRC has an online system⁴ where you can enter the technical description of the projects, amount of tax relief you're claiming, a breakdown of your qualifying costs, and more. This will save you from formatting the information into a report and then emailing it to HMRC.

If you're particularly uncertain about your ability to claim, you could opt for Advanced Assurance, which will provide you with certainty about your claim for the next three years. However, it can be quite an onerous experience because it is similar to a typical HMRC enquiry process.

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4: <https://www.gov.uk/guidance/corporation-tax-research-and-development-tax-relief-for-small-and-medium-sized-enterprises#support-claim>

**VGTR
OR R&D?**

Video Game Tax Relief is available for expenditure incurred on eligible video game projects. Similar to R&DTI, the relief is intended to encourage investment in the UK but is aimed at specifically supporting the video game industry.

The VGTR differs from the R&DTI in the following ways:

- The video games must be intended for commercial release.
- No eligible R&D needs to be carried out to claim this incentive.
- Games with the primary purpose of advertising or gambling are excluded.
- Core expenditure on the game production is eligible.
- The video game must pass the BFI⁵ cultural test.

The particulars of your company, as well as the costs and the activities being carried out, need to be analysed to determine whether it is best to claim under one of the R&DTIs or the VGTR. As a rule of thumb, it is usually better to claim under the R&DTI, instead of the VGTR, if the company is an SME and is undertaking work that is of a more innovative nature. Below are two examples: one showing where the R&DTI scheme would be more beneficial, and the other showing where the VGTR scheme would be preferable.

Example where the R&DTI scheme is more beneficial

In the financial year-ended 31 December 2016, a small loss-making Video Game Development Company, with losses of £2.5m, produces a new video game with a total expenditure of £1m.

The majority of the work carried out has been on creating a novel game physics engine and is completely innovative work. It is estimated by the team that 75% of the total expenditure is eligible for R&DTI. All of the total expenditure is incurred within the EEA⁶; therefore under the VGTR, 80% of the core expenditure is used (as this is lower than the EEA expenditure).

VGTR calculation**Core expenditure = £1,000,000****Core EEA expenditure = £1,000,000****80% of the core expenditure = £800,000**

To calculate the VGTR, the lesser of the EEA spend and the 80% of the core expenditure is used:

total VGTR = £800,000 × 25% = £200,000**VGTR benefit = £200,000**

**VGTR
OR R&D?****SME R&D Tax Credit calculation**

Eligible R&D = £1m * 75% = £750,000

Surrenderable loss is equal to the lower of enhanced loss (£750,000 * 130% + £2.5m = 3,475,000), or 230% of the eligible R&D expenditure (£1.725m)

payable R&D tax credit = surrenderable loss × applicable rate

payable R&D tax credit = 1,725,000 × 14.5% = £250,125

R&DTI benefit = £250,125

The calculations below demonstrate that, in this instance, there is a £50,125 benefit in claiming R&DTI over VGTR.

Example where the VGTR scheme would be more beneficial

For this example, the previous scenario still stands, with the Video Game Development Company spending the same total of £1m. However, in this instance, the game is developed on an industry standard gaming engine and the majority of the work done was for routine game creation. Therefore, because of the nature of the work being performed, the team estimated that only 20% was eligible for R&DTI.

As demonstrated by the following calculations, in this scenario it is preferable for the company to claim under VGTR:

VGTR calculation

Core expenditure = £1,000,000

EEA Core = £1,000,000

80% of the core expenditure = £800,000

total VGTR = £800,000 × 25% = £200,000

VGTR benefit = £200,000

SME R&D Tax Credit calculation

Eligible R&D = £1m * 20% = £200,000

Surrenderable loss is equal to the lower of enhanced loss (£200,000 * 130% + £2.5m = 2,760,000) or 230% of the eligible R&D expenditure (£460,000)

payable R&D tax credit = surrenderable loss × applicable rate

payable R&D tax credit = 460,000 × 14.5% = £66,700

R&DTR benefit = £66,700

In this instance, there is a clear £133k benefit in claiming VGTR over R&DTI.

FAQs

What if my competitors have already developed something similar?

If you don't know how their advance was achieved (e.g. if it's a trade secret) then the work you're carrying out on the project could be eligible.

Does the R&D need to be successful?

No, it doesn't. In fact, failure can help demonstrate just how innovative the company is, and that there was genuine uncertainty involved in the project.

What doesn't qualify?

If you're doing something routine that has no technological uncertainty involved, then it's unlikely to be eligible for R&D. In addition, work in the arts, humanities and social sciences is not eligible.

Can we claim for an ongoing project?

Yes. An R&D claim needs to be made for each accounting period, but we know your projects don't conveniently start and end when your accounting periods do. As long as eligible expenditure was incurred during the accounting period, then you can claim on the eligible work carried out during the relevant timeframe.

Is there a minimum R&D expenditure needed to claim the R&DTI?

No, there used to be a £10,000 minimum limit, but this was removed from 1 April 2012.

Is there a maximum amount or a limit per project that I can claim under the R&D scheme?

Yes, there is a €7.5m maximum limit on the total amount of aid for any one R&D project.

Is there any guidance on how HMRC will apply the rules?

Yes, guidance can be taken from HMRC's Corporate Intangibles R&D Manual⁷ (CIRD).

Do I need to own the intellectual property?

No. The condition requiring ownership of the intellectual property arising out of the R&D was abolished as of 9 December 2009 for SMEs. From this date there was no requirement to own the intellectual property for SMEs or large companies.

How long does HMRC take to approve the claim?

HMRC aims to respond as quickly as possible, with the goal of responding to R&D tax credit claims within 28 days. However, this process can take longer than this, i.e. if an enquiry is opened. In instances such as these, there is no set time length for the approval of a claim and it could potentially take months or years.

Does the R&D have to be in the UK to be eligible?

There is no requirement for the R&D, or the subcontractors carrying out the R&D, to be in the UK.

FAQs

Can I claim both R&D tax relief and video game tax relief on the same project?

No, it is not possible to claim both R&DTI and VGTR on the same game or the same expenditure.

I've received a grant/loan; does that have an impact on my R&D tax incentive claim?

Receiving a grant or loan, including the Business Bounce Back loans or Coronavirus Business Interruption Loan Scheme, can have a significant impact on your R&D claim. Detailed advice should be sought.

I've just improved an existing technology, is that eligible?

Yes, an appreciable improvement to an existing process, material, device, product or service through scientific or technological changes is considered eligible. This includes using science or technology to duplicate the effect of an existing process, material, device, product or service in a new or appreciably improved way.

We've been contracted by a publisher to develop a game and we need to do R&D to achieve this - can I still claim the R&D tax incentive?

Subcontracting legislation varies depending on company size and relationship between parties, detailed advice should be sought in this circumstance.

I've subcontracted some of the work, does this still count as eligible R&D expenditure?

For an SME, the company's relevant R&D related work which has been subcontracted to another company is still eligible. For a large company, only R&D work contracted to a qualifying body, individual, or a partnership (each member of which must be an individual) is eligible. Additional information can be found in the CIRDS manual.

I've received my R&D tax credit, does that mean my claim is approved?

No, this means that the claim has been processed but not necessarily approved. HMRC has the ability to go back four years if they discover something is incorrect, and up to 20 years if there is dishonesty. They are also able to issue penalties up to 100% of the amount claimed.

Can I claim for work I did last year?

Yes, the time limit for making claims is the two previous years from the end of the company's next accounting period.

Do I really need to write a report?

HMRC requires a summary of the eligible R&D and related eligible costs (as well as relevant R&D documents, CT600s and tax computations); this is usually presented in report format and will aid HMRC in processing the claim. As mentioned above, it is possible to submit this using HMRC's online template.

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Keep up-to-date with the latest news on the R&D tax incentives at www.mmp-tax.co.uk

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Whilst every care has been taken to ensure the accuracy of the information in this guide at the time of publication, the information is intended as guidance only. It should not be considered as legal advice.