

## Written evidence submitted by the Association of Taxation Technicians (ATT) (FB01)

### Finance (No.3) Bill 2017-19: Clause 31 and Schedule 12: Temporary increase in Annual Investment Allowance

#### A. Executive Summary

1. The measure increases the cap on the Annual Investment Allowance (AIA), under which a business can receive 100% tax relief on qualifying capital expenditure, from £200,000 to £1 million for the two calendar years 2019 and 2020.
2. The transitional rules which apply when the AIA limit reverts to £200,000 on 1 January 2021 can result in a business having its effective AIA limit for a year restricted to very significantly less than £200,000.
3. The businesses most likely to incur such a significant restriction in their entitlement to the AIA are those businesses which are least likely to be able to benefit from the two-year increase in the AIA limit.
4. A brief amendment to the Finance Bill would prevent such lower-spending businesses from being penalised by the effective restriction.

#### B. Impact of the Temporary Increase in AIA

1. The Annual Investment Allowance (AIA) enables a business (whether subject to Income Tax or Corporation Tax) to obtain full tax relief on qualifying capital expenditure incurred in a chargeable period up to a capped level. Since 1 January 2016, that annual limit has been £200,000. In relation to that £200,000 limit, the business has total flexibility as to when to incur its expenditure within its relevant 12-month chargeable period.
2. For each of the two calendar years 2019 and 2020, Clause 31 increases the annual limit on a temporary basis to £1 million.
3. Paragraph 14 of the Explanatory Note published alongside the Bill explains:

“The temporary increase is designed to stimulate growth in the economy by providing an additional, time-limited incentive for businesses (particularly medium-sized businesses) to increase, or bring forward, their capital expenditure on plant or machinery.”
4. For a business whose accounting year ends on 31 December, their chargeable periods will align exactly with the two years when the £1 million limit applies. Such a business will qualify for the £1 million AIA limit in each of those two years.
5. For any business whose accounting year does not end on 31 December, Schedule 12 provides special rules for both the chargeable period which starts before 1 January 2019 (referred to in Schedule 12, paragraph 1 as the “first straddling period”) and the chargeable period which starts in 2020 but ends after 1 January 2021 (referred to in Schedule 12, paragraph 2 as the “second straddling period”).
6. The rules for the first straddling period operate in a straightforward way and should not cause any difficulty. By contrast, the rules for the second straddling period do not operate in an intuitive way. They are capable of producing unexpected outcomes as explained below.
7. For the second straddling period, Schedule 12, paragraph 2(2) requires the maximum AIA for the whole twelve-month period to be calculated by aggregating the time-apportioned amount of each of the £1 million and the £200,000. The business would be eligible for AIA on expenditure

up to that aggregate level if the expenditure was incurred on or before 31 December 2020. However, paragraph 2(3) restricts AIA on expenditure incurred on or after 1 January 2021 to simply the time-apportioned part of the £200,000 limit. HMRC's relevant [Policy Paper](#) (published on Budget Day) includes this example (copied exactly):

**“Example**

A company with a 12 month chargeable period from 1 April 2020 to 31 March 2021 would calculate its maximum AIA entitlement based on:

a) the proportion of the period from 1 April 2020 to 31 December 2020, that is,  $9/12 \times £1,000,000 = £750,000$ ; and b) the proportion of the period from 1 January 2021 to 31 March 2021, that is  $3/12 \times £200,000 = £50,000$

The company's maximum AIA for this transitional chargeable period would therefore be the total of (a) + (b) =  $£750,000 + £50,000 = £800,000$ .

However, in relation to (b) (the part period falling on or after 1 January 2021) no more than £50,000 of the business's actual expenditure in that part period would be covered by its transitional AIA entitlement.”

8. The example does not make it explicit but HMRC have confirmed to the ATT that in the above situation the business could claim AIA on expenditure of up to the full £800,000 (see the third paragraph of the example) provided it was all incurred in the nine-month period up to 31 December 2020. (This is consistent with the principle that a business can choose when within a chargeable period it incurs its qualifying expenditure – see B.1 above.)
9. It is in relation to expenditure incurred in the months starting with 1 January 2021 where the Schedule 12 rules produce an unexpected outcome. The AIA in relation to expenditure in those three months is capped at the time-apportioned fraction of the £200,000 limit alone. As the above HMRC example shows, in the case of a business with a year-end of 31 March 2021, its AIA cap for expenditure in the three months starting on 1 January 2021 is restricted (by paragraph 2(3)) to just £50,000 (being three-twelfths of the normal £200,000)<sup>1</sup>.
10. If the business in the HMRC scenario had taken significant advantage of the increased limit applying in the nine months up to 31 December 2020, the restriction in the part of the period starting on 1 January 2021 might be seen as more justifiable. However, the AIA restriction (imposed by Schedule 12, paragraph 2(3)) applies to the months of the chargeable period from 1 January 2021 onwards just as much if the business had incurred no qualifying expenditure at all in the nine months up to 31 December 2020. That has the effect of limiting the AIA entitlement of such a business for its whole 12-month second straddling period to the relevant fractional part of what would otherwise be the ordinary (unincreased) annual limit of £200,000.
11. In the scenario just described, the wording of paragraph 2(3) operates to convert a measure designed to stimulate growth in the economy by a five-fold increase in the AIA limit (see B.2 and 3 above) into the imposition of a 75% reduction in the AIA limit on any business which, for whatever reason, delays its qualifying expenditure until the final months of its trading year.
12. The restriction just described is given added resonance by the observation in a report by the

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<sup>1</sup> HMRC's use in the example of a 31 March year-end for a business is appropriate as that is a relatively common accounting date. For a business with a year-end of 31 January 2021 or 28 February 2021, the impact of the paragraph 2(3) restriction is even more significant with the AIA cap for expenditure in the period from 1 January 2021 being £16,667 or £33,333 respectively. For a business whose second straddling period ends *after* 31 March 2021, the cap increases from the £50,000 level by £16,667 for each additional month.

Office of Tax Simplification in June 2018<sup>2</sup> that only “about 30,000 businesses spend more on capital expenditure than the AIA Limit and about 1.2 million businesses spend less than the [£200,000] AIA limit”. Obviously, not all of the 97% of businesses who currently incur no more than the annual limit of £200,000 will be impacted by the restriction in the second straddling period. It does, however, highlight the fact that a measure which is likely to benefit only a small minority of business has the potential to disadvantage many more (even if only to the extent of obliging them to incur their capital expenditure earlier in their accounting year than they might otherwise choose to do).

### **C. Suggested remedy**

1. We have identified two possible ways of removing what for many businesses would be the unexpected adverse consequence of the temporary increase in the AIA. The first would be to include an opt-out provision enabling a business in effect to completely ignore the availability of the temporary increase. Conceptually, that has the great attraction of legislative simplicity. Such an opt-out provision would, however, require positive time-critical action by a business and also impose administrative burdens on HMRC.
2. The second alternative would involve the provision of a minimum level or “floor” for the available amount of AIA which would automatically ensure that no business would have any lesser entitlement to AIA in their second straddling period than if there had been no temporary increase. Whilst requiring a slightly more complicated drafting amendment, it would, we think, be much simpler in operation for businesses to follow and for HMRC to administer. In the attached Appendix, we set out an amended version of paragraph 2 of the Schedule and some examples of how the alternative of a “floor” provision would work.

### **D. Context note**

1. The businesses which will benefit from the temporary AIA increase are those businesses which have annual capital expenditure of over £200K. That will typically but not exclusively be larger businesses. Most such businesses will have relatively sophisticated budgeting systems which mean that they can (and must) plan their capital expenditure.
2. By contrast, businesses with lower annual capital expenditure (typically but not necessarily smaller businesses) are less likely to have sophisticated plans and are more likely to incur ‘needs must’ expenditure. Examples of high cost occasional expenditure by such businesses might include the replacement or addition of a lorry or some expensive farm or factory machinery. Such expenditure is dictated by the need of the moment. There may not have been any opportunity to advance the timing of the expenditure (no funds / demand for additional equipment had not yet arisen / old machine had not shown signs of breaking down, etc).
3. Importantly, such smaller businesses are less likely to have annual expenditure of more than £200K. So, they do not need the £1 million limit. The statutory £200K limit is sufficient on an annual basis – but the legislative mechanics of the temporary increase mean that just when they need to spend a significant amount, they find that it has (temporarily) shrunk to £50K or even less (see footnote 1 on page 2).

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<sup>2</sup> See: Accounting depreciation or capital allowances? Simplifying tax relief for tangible fixed assets at Paragraph 5.22 (OTS, 15 June 2018) at: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/716300/Accounting\\_depreciation\\_or\\_capital\\_allowances\\_print.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/716300/Accounting_depreciation_or_capital_allowances_print.pdf)

## Appendix: Suggested amendment and examples of its application

### Paragraph 2 of Schedule 12 (Amended text is emboldened, red and italicised)

*“Chargeable periods which straddle 1 January 2021*

- 2(1) This paragraph applies in relation to a chargeable period (“the second straddling period”) which begins before 1 January 2021 and ends on or after that date.
- (2) The maximum allowance under section 51A of CAA 2001 for the second straddling period is the sum of the maximum allowances that would be found if the following were treated as separate chargeable periods—
- (a) so much of the second straddling period as falls before 1 January 2021;
- (b) so much of the second straddling period as falls on or after that date.
- (3) But, so far as concerns expenditure incurred on or after 1 January 2021, the maximum allowance under section 51A of CAA 2001 for the second straddling period is ***the lesser of—***
- (a) ***such amount (if any) by which the maximum allowance for the second straddling period calculated under sub-paragraph (2) exceeds the amount of expenditure incurred on or before 31 December 2020 in respect of which the allowance was claimed, and***
- (b) ***the greater of:***
- (i) ***what would be the maximum allowance for the whole of the second straddling period if the modification made by section 31(1) were not made less the amount of expenditure incurred on or before 31 December 2020 in respect of which the allowance was claimed, and***
- (ii) the maximum allowance, calculated in accordance with sub-paragraph (2), for the period mentioned in paragraph (b) of that sub-paragraph.”

### Examples assuming a chargeable period of 12-months to 31 March 2021

	<i>Illustrative scenario:  Qualifying expenditure on or before 31 December 2020 of:</i>	<i>Maximum AIA on expenditure from 1 January 2021</i>	
		<i>Under Schedule 12 (as drafted)</i>	<i>Under suggested amendment to Schedule 12 (impact is only in Examples 5 and 6)</i>
1	£800,000	£Nil	£Nil (Para 2(3)(a))
2	£780,000	£20,000	£20,000 (Para 2(3)(a))
3	£550,000	£50,000	£50,000 (Para 2(3)(b)(ii))
4	£200,000	£50,000	£50,000 (Para 2(3)(b)(ii))
5	£120,000	£50,000	<b><i>£80,000 (Para 2(3)(b)(i))</i></b>
6	£Nil	£50,000	<b><i>£200,000 (Para 2(3)(b)(i))</i></b>

As shown in Examples 1 to 4, the suggested amendment would make no difference where the qualifying expenditure in the period up to 31 December 2020 was equal to or greater than the unincreased AIA level of £200,000.

As shown in Examples 5 and 6, the suggested amendment would ensure that the business would be entitled to the unincreased AIA limit of £200,000 on qualifying expenditure regardless of when the expenditure was incurred within its 12-month chargeable period. For any business with a 31 March 2021 year-end which had not incurred qualifying expenditure of as much as £150,000 by 31 December 2020, the shortfall is effectively added to the £50,000 in calculating the AIA cap for expenditure incurred after that date. The amendment does not, however, enable any such business to benefit from more than the normal annual AIA limit of £200,000 for the twelve-month chargeable period.

The suggested amendment makes no change to the maximum allowance for any business in the 12-month second straddling period. It simply restores for a business which cannot benefit from the temporary increase the flexibility to choose when within that chargeable period it incurs its capital expenditure.

## **Association of Taxation Technicians**

### **Note:**

#### **The Association of Taxation Technicians**

The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,500 members and Fellows together with over 6,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.

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