Further written evidence submitted by the Chartered Institute of Taxation (FB02c)

Capital allowances

Clauses 29 to 34

Executive Summary

These clauses introduce many changes to the capital allowances regime.

The seemingly constant chopping and changing of reliefs relating to capital allowances brings complexities and uncertainty to the UK tax system. It undermines investor confidence in the UK as most businesses cite certainty as more important than the precise amount of relief available.

The changes are also likely to have unintended consequences, particularly as a result of the temporary changes to the Annual Investment Allowance, the level of which has changed five times in the ten years since it was introduced.

1 Background

1.1 Clauses 29 to 34 of the Finance Bill make changes to the capital allowances regime in the UK tax code. Capital allowances are the mechanism by which businesses are able to get tax relief for capital expenditure. This is done by allowing a proportion of the capital expenditure to be expensed against annual pre-tax income. Capital allowances are given for specified items of capital expenditure, and the expensing is usually spread over a period of years. Capital allowances are a tax approximation of the accounting depreciation which is taken in a set of accounts in respect of capital expenditure to arrive at accounting profits, but which is ignored for tax purposes.

1.2 The changes being made to the capital allowances regime by clauses 29 to 34 are many and varied. They introduce a new relief (Structure and Buildings Allowance (SBA)), reduce a different relief (Special rate expenditure on plant and machinery), temporarily increase another relief (Annual investment allowance (AIA)) and make changes to what is available under others (Enhanced Capital Allowances).

1.3 All of these changes have been made without any prior consultation.

2 Overview

2.1 The CIOT appreciates that some of the changes outlined above are rate changes which we accept are a political decision and most are made in pursuance of policy intents which we would support – to improve international competiveness (SBA), to more closely follow average accounts depreciation (Special rate expenditure) or to stimulate business investment (AIA). Nevertheless the overall impression resulting from so many changes is of a lack of cohesion and stability in the UK tax system.

2.2 A number of measures also have immediate effect. Whilst this is normally understandable when a measure is for the prevention of avoidance, the SBA in particular is not such a measure, and the fact that it also has not been consulted upon may lead to confusion as to its scope and application.

2.3 In addition, the seemingly constant chopping and changing of reliefs relating to capital allowances brings its own complexities and unintended consequences, as explained in relation to AIA below. It could also act so as to undermine investor confidence if they feel unable to rely on the allowances being given for any long term investment – as explained below, the reduction to the Special Rate has a retroactive effect. Our understanding is that most businesses cite certainty as more important than the precise amount of relief available and in this regard the continual changes to capital allowance reliefs are unhelpful.

3 Clause 29: Construction expenditure on buildings and structures (SBA)

3.1 The government announced at Budget 2018 that it will introduce a new SBA, available for expenditure on new non-residential structures and buildings from Budget Day (29 October 2018).

3.2 This measure is intended to improve the UK's international competitiveness and to stimulate business investment. We do not disagree with these objectives as policy intentions, nor that a relief for the expenditure that the SBA is aimed at may be welcome. However, we do question why it was necessary to introduce this relief as a 'done deal' and with immediate implementation, with no prior consultation. We agree that competitiveness is better served by having fewer categories of unrelieved expenditure. But it would be feasible to do this by reducing the extent of categorising expenditure solely for tax purposes. This relief does the opposite and introduces another type of asset classification required only for tax purposes - something cautioned against by the Office of Tax Simplification (OTS) in its review of capital allowances. The approach seems at odds with the direction pointed to by the evidence gathered by OTS in its own more consultative approach. OTS took the view, based on solid evidence, that such categorisation was onerous. It is disappointing, therefore, that, having commissioned the OTS review, the government has decided to do the opposite of what was recommended, with immediate effect, without prior consultation and with details yet to come.

3.3 Further, the UK's international competiveness will be judged as a result of the overall package of measures, and the stability of the tax system as a whole. As mentioned above, unless coherent and effectively targeted, change is not generally welcomed by business and, as mentioned below, the benefit of this relief may not compensate many large businesses for the reduction in the special rate for certain expenditure. The result may be that this measure has a more positive impact on domestic investment rather than international competitiveness.

3.4 Whilst introducing a measure with immediate effect is normally understandable when it is for the prevention of avoidance, the SBA is not such a measure, and the fact that it also has not been consulted upon may lead to confusion as to its scope and application, until such time as the detail is finalised and clarified in regulations which will only happen in the coming months.

3.5 Instead of a fully developed relief being introduced after a consultation which would have provided an opportunity for stakeholders – such as ourselves and other representative bodies, and business – to explore with government its scope and application, the Finance Bill sets out only a framework of the new relief – with immediate effect, but with the consultation still to be had.

3.6 A Technical Note[1] was published alongside the Budget which poses many questions as to the scope and detail of the relief in it. The government is seeking views on these aspects of the relief and decisions as to the issues raised will only be addressed in secondary legislation in the Spring after responses have been received.

3.7 This means that businesses will not be able to have confidence in the new relief during the consultation period as the detail of it is not yet known and the fact that it will have immediate effect means that there is a cliff edge and businesses will not have the opportunity to factor the availability of the allowance in to their investment decisions that are currently underway, nor obtain any relief for previous expenditure.

3.8 In our view events should have occurred the other way around – the legislation should have followed a proper consultation process. It is neither sensible nor responsible for the government to introduce reliefs into the tax system at a time before they have consulted upon the scope and application of the relief or fully considered, and are therefore able to legislate for, the details of the relief.

3.9 The lack of finality around the relief may also have an effect on the costings for the relief given in the Budget Red Book as, inevitably, the costings must depend on the precise scope of the allowance.

4 Clause 30: Special rate expenditure on plant and machinery

4.1 Budget 2018 announced that, from April 2019, the capital allowances special rate for qualifying plant and machinery assets will be reduced from 8% to 6%. It is stated that this is to more closely match average accounts depreciation, although the Chancellor in his speech also stated that this reduction would part-fund the SBA referred to above.

4.2 The reduced rate still gives tax relief for investment in these assets, but over a longer period of time. The reduction has an element of retroaction, as investment decisions may have been taken on the basis of an 8% rate of allowance. Tinkering with rates and allowances in this way undermines the principles of stability and certainty and as a result reduces the international competitiveness of the UK's tax system.

4.3 The impact of this change in rate will be different for different businesses. Many large businesses will not be compensated for this reduction in the special rate by the new allowances available under the SBA. Thus, the aspiration of improving the UK's international competitiveness by the introduction of the SBA may be misplaced.

5 Clause 31: Temporary increase in annual investment allowance (AIA)

5.1 The AIA allows businesses to claim tax relief on the whole of their qualifying capital expenditure up to the amount of the allowance in the year of expenditure (rather than spreading it over many years as is usually the case for capital allowances). In principle, this is welcome.

5.2 The AIA was introduced in 2008 at £50,000. In just over ten years, the level of the allowance has changed five times, to amounts ranging from £25,000 to £500,000. It is currently £200,000; being set at this 'permanent' level in the Summer Budget 2015 (effective from 1 January 2016). Budget 2018 announced a time-limited increase in the allowance to £1m,

[1] https://www.gov.uk/government/publications/capital-allowances-for-structures-and-buildings-technical-note

from 1 January 2019 to 31 December 2020, after which it will revert to its current level of £200,000.

5.3 The increase in the allowance will help businesses who are intending and able to make investments in that period, and in that respect should fulfil its aim of encouraging investment. A high level of AIA also simplifies the tax / capital allowances computations of businesses within its limits. Many small companies pay no corporation or business income tax as a result of the AIA, for the good reason that they are reinvesting their profits

5.4 However, the smallest businesses earn profits below the existing level of the Allowance, and increasing it benefits larger businesses, including the largest companies for whom the impact is relatively immaterial. There are thus diminishing returns from increasing it to higher levels. We accept that the right level for it is a matter of political judgment. However complexities can arise if it is repeatedly altered, particularly where a business's accounting period spans changes in the AIA. This can result in a lower amount of AIA being available than expected (as illustrated in the examples in the Tax Information and Impacts Note published on Budget Day[2]). The unrepresented / ill-advised may fall foul of these complexities. It would be preferable if the Chancellor were able to give greater longer term stability to its level.

6 Clause 32: First-year allowances and first-year tax credits

6.1 Enhanced capital allowances (ECAs) are available in respect of expenditure on energy saving technology identified as such on government lists – the Energy Technology List and Water Technology List. The government will end ECAs and the related First Year Tax Credits for such technologies from April 2020. In the meantime this clause also provides regulatory power to update the lists to reflect the most efficient technology in 2019.

6.2 It is intended that the revenue saved from ending these capital allowances will be used to fund the Industrial Energy Transformation Fund which the government believes is a more effective way to support energy efficiency.

6.3 In contrast to the reliefs discussed above – and not offering a view ourselves on whether ending ECAs is a good or bad thing - we welcome the fact that the ECAs are not going to end until April 2020, which gives businesses time to prepare for the changes.

7 Clause 33: First-year allowance expenditure on electric vehicle charge points

7.1 This measure extends the relief for expenditure on the acquisition of new and unused electric charge-points. The measure was first introduced in 2016 and will now run until April 2023.

7.2 It is designed to encourage the use of electric vehicles by supporting the development and installation of electric charging equipment of such vehicles and, therefore, supports the government's overall policy aim of making the UK a more environmentally friendly place.

8 Clause 34: Qualifying expenditure: buildings, structures and land

8.1 This measure amends legislation in sections 21 and 22 Capital Allowances Act 2001 to clarify which expenditure on altering land may qualify for capital allowances for the purposes of

[2] https://www.gov.uk/government/publications/temporary-increase-in-the-annual-investment-allowance/temporary-increase-in-the-annual-investment-allowance

installing plant or machinery. It is intended to put beyond doubt the policy intention that land alteration expenditure may qualify for plant and machinery capital allowances only where the plant and machinery being installed also qualifies.

9 The Chartered Institute of Taxation

9.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,400 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
November 2018