Is anybody listening?

Alun Oliver discusses the recently published policy paper on UK capital allowances regime and encourages readers to respond to it.

The government recently published a consultation (tinyurl.com/hmtprukcas) asking for views from industry on the future of the UK's policy for capital allowances tax relief following the chancellor's announcements in the March 2022 Spring Statement. Rishi Sunak stated that the government's tax plan, 'sets out tax cutting options on business investment and innovation, with final decisions to be announced in the autumn Budget' as a key element of government policy to address the longstanding weakness of UK private sector investment and the resulting productivity gap against our international competitor countries – 'with UK investment considerably lower than the Organisation for Economic Co-operation and Development average of 14%'.

This initial step is very welcome in reversing the trend of eroding tax reliefs in this area, started by Gordon Brown with the, then, shock announcement of the abolition of industrial building allowances in March 2007 and dabbled with by successive governments (of all colours) at regular intervals since. Governments seem surprised by the outcome of unstable and short-term tax measures not being fully considered by industry.

It is hoped this latest consultation process will lead to clearer strategic thinking and what the majority are calling for – particularly if behavioural change is the desired outcome – long-term reforms. Tax legislation set out over ten years or more would provide businesses with more clarity and stability to understand, as well as time to act on the changes, before they lapse or are changed again and again every two years or so.

It is also billed as a response to the end of the 130% super deduction in March 2023. The government is considering reforms – to be announced later in the year – that robustly support business investment, seek to work with all sectors of industry on capital allowances to help foster a new culture of enterprise and growth in the UK, and to compete internationally.

The government is looking for feedback and evidence on the following:

Investment decisions – evidence from stakeholders on how firms make investment decisions, the relative importance of capital allowances in those decisions, and how they are taken into account, such as by reference to net present values, cash-flow benefits or impacts on effective tax rates.

Super deduction – the government wants to reflect on the impact of the 130% super deduction into any future proposals and is seeking views, again, on how the super deduction has affected the investment decisions of businesses.

Current system of capital allowances – as set out in the Spring Statement, the government acknowledges that the generosity of the permanent capital allowances available in the UK compares unfavourably to some international peers. It asks what more could be done through the capital allowances regime to support business investment. In particular, it would like to receive stakeholder views on how far capital allowances rates influence decisions by multinationals on which territory to invest in.

Levels of awareness of the current system – and how simple it is for businesses to understand and operate, and whether it provides adequate support for business investment.

Key points

- It is hoped this latest consultation process will lead to clearer strategic thinking and long-term reforms.
- Current capital allowances in our complex and convoluted tax legislation give businesses relief on qualifying expenditure on various capital assets.
- Full expensing may be best suited to businesses operating below the 'main corporation tax rate' of 25% and/or unincorporated small and medium-sized businesses.
- Longer-lasting reform will provide more stability and clarity for businesses.

Current capital allowances

Current capital allowances provided for in our complex and convoluted tax legislation give businesses relief on qualifying expenditure on certain capital assets, such as plant and machinery and integral features. These can currently be boosted through the 100% annual investment allowance (AIA) up to the cap of £1m until 31 March 2023. Where a company is a member of a group, only one AIA is available for the group.

Writing down allowances (WDAs) are normally available at 18% or 6% for plant and machinery or integral features respectively. These are currently accelerated through the super deduction of 130%, available to corporation taxpayers investing in qualifying new plant and machinery between 1 April 2021 and 31 March 2023. Investments in 'special rate' assets benefit from a 50% first-year allowance – the special rate (SR) allowance. The special rate pool includes long life assets, adding insulation to existing buildings (under CAA 2001, s 28) and integral features such as electrical installations and air conditioning.

Fully expensing

The government has also expressed an interest to hear industry's views on whether full expensing – estimated as peaking at £11bn a year – would work, or whether such 'investment' could be better spent elsewhere, or whether a more targeted approach could achieve a better 'return on investment' for any new fiscal incentives.

It may be more appropriate for full expensing to be available for those businesses operating below the 'main corporation tax rate' of 25% and/or unincorporated businesses within the small or medium categories – which might be less well placed to address the full spectrum of capital allowances or with more limited levels of (or more sporadic) capital expenditure. Setting AIAs at £500,000 may effectively achieve this relatively easily, with some minor exemption to the structures and buildings allowances (SBAs) for eligible businesses to include SBAs within the AIAs, which is currently restricted.

Lastly, the options will have different outcomes for different types of business and for the economy more widely. For instance, the effects of the options will vary depending on whether a business is incorporated or unincorporated, profit or loss-making, and the extent to which it values an immediate cash benefit. There has been no reference to a tax credit, for example, that had been available within the now defunct 'energy and water efficient enhanced capital allowances' and also remains with land remediation tax relief, whereby taxpayers could surrender losses for a payment from HMRC, equated to a net present value of the tax savings – in lieu of carrying the loss forward to a later period.

The government still fears abusive tax structuring and tends to address this by ensuring the allowances are not available to income taxpayers, shown by the current super deduction and SR allowance. These restrictions unduly affect many sectors of the economy that operate as individuals or partnerships such as medical, dental, professional services and farming. The alternative might be more focused prohibition and targeting of certain abuses, while allowing all business to benefit equally from the available tax relief, irrespective of their chosen legal structure.

Spill the beans

Advisers are encouraged to set out their views on these measures and how they affect them and their clients, citing sector, size, and the amount of capital investment undertaken annually, as well as the number and nature of people represented in the case of representative bodies.

Submissions should be made through the survey questionnaire within the document (tinyurl.com/hmtprukcas) by Friday 1 July. It will be important to discuss these issues with clients and respond to the government to ensure all views are heard and, it is hoped, inform any forthcoming Budget announcements.

Long-term view will gain more traction

While the super deduction has proved a valuable incentive, it has only really benefited those with projects already moving toward construction, not 'new' investment. In most cases the two-year window has been too short to enable businesses to make the most of it, in particular on larger projects that necessitate long lead times for site acquisition, planning approval (some of which are in excess of six to 12 months as local authorities grapple with the effects of Covid-19) and funding – all necessary before a spade hits the ground.

Clearly any longer-lasting reform will provide more stability and clarity so that businesses can plan with confidence of the longer-term relief and tax impacts on their investments across more realistic time frames. The current freeports initiative has a tax horizon only up to September 2026 to have facilities up and operational in order for the 'enhanced' capital allowances at 100% for plant and machinery and 10% a year for SBAs. Yet the first tax sites were only 'activated' in November 2021, with their business cases still to be ratified.

The short-term and changeable nature of the current rules with regular tweaks and adjustments has led to many businesses only viewing capital allowances after the fact – as 'icing on the cake'. For tax truly to drive growth and changes in behaviour and investment strategy, there has to be this longer-term perspective. Tax simplification – to many an oxymoron – needs to embed itself in new legislation that can strip away years of incrementable layers (and layers) to set a broad basis that supports UK business (irrespective of their corporation or income tax basis) to invest, grow and prosper.

The system needs to be reformed to achieve the government's stated ambitions. I really hope it will be genuinely listening to the views from business, property investors, advisers and other stakeholders about the short-termism of too many elements and ways to improve outcomes, so that this consultation is not simply a box-ticking exercise – before it announces a pre-determined set of amendments.

As the saying goes – speak now or forever hold thy peace.

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