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POTENTIAL REFORMS TO UK'S CAPITAL ALLOWANCE REGIME

Response by Association of Taxation Technicians

1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to provide comments on the HM Treasury policy paper 'Potential Reforms to UK's Capital Allowance Regime – Inviting views' ('the Policy Paper') issued on 9 May 2022[1]. The ATT joined a call with HMRC and HM Treasury and the CIOT on 26 May to discuss the Policy Paper. This response builds upon the issues raised during that call.

1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.

1.3 Overall, we believe it is important to clearly identify the aims of any reform of the capital allowances regime. For example, is there a desire to incentivise certain sizes of business, or specific industries or types of expenditure? The best path to take with reform will depend upon the answer to this question.

1.4 A key reason why defining the aim of reform is so important is the diverse nature of the population claiming capital allowances. This spans two different tax regimes (income tax and corporation tax) and ranges in scale from the smallest unincorporated sole trader to the most complex multinational corporate group. It is highly unlikely that any one reform will be to the benefit of the entire population – there is no 'one size fits all' solution.

1.5 The reform options set out the Spring Statement focus on the timing and level of relief for qualifying capital expenditure. Whilst these will be of great interest to larger businesses, they will have little to no impact on those smaller businesses which do not spend above the annual investment allowance ('AIA'). Instead, for those businesses a more important issue is the complexity of the current capital allowance regime. We would therefore encourage the Government to take the opportunity to look not only at how to incentivise greater capital investment by large-spending businesses but also at how the capital allowances rules can be simplified and made more coherent for smaller businesses.

[1] https://www.gov.uk/government/publications/potential-reforms-to-uks-capital-allowance-regime-inviting-views/potential-reforms-to-uks-capital-allowance-regime-inviting-views

1.6 In Sections 2 to 4 below we have set out our comments on the three areas of interest highlighted in the Policy Paper – investment decisions, the super-deduction and the current system of capital allowances. In Section 5 we have gone on to address the potential reform options outlined at the Spring Statement.

1.7 We would be pleased to discuss any aspect of this submission further. Relevant contact details can be found in Section 6.

2 Investment decisions

2.1 The Policy Paper invites views on how businesses make investment decisions, and the extent to which capital allowances are considered in those decisions? The answer to these questions will, generally, vary depending upon the size of the business.

2.2 For the smallest businesses, investment decisions are dictated by commercial needs, not capital allowance incentives. For example, if a plumber needs new tools or a van, they are likely to need them in the short term, rather than be in a position to plan for their acquisition months in advance. There may be an expectation that some form of tax relief will be available without a deep consideration of the technicalities. The availability of a specific capital allowance incentive is therefore unlikely to drive a decision as to whether to invest or not at that particular time as the business need is key. Where they may have an impact, however, is if there is a choice between different assets with one providing for a better capital allowances position than the other (e.g. a car vs a van) or in the timing of expenditure close to the end of the tax or accounting year, which may require the business to seek advice to understand their position, incurring advisor costs.

2.3 By contrast, larger businesses are more likely to plan expenditure further in advance and to have more sophisticated decision-making processes. As a result, capital allowances are likely to play a bigger role in their investment decisions. However, the recent tendency for changes to be made to the capital allowances regime at relatively short notice (such as cancelling planned decreases in the AIA threshold or the introduction of the super-deduction) make factoring capital allowances into these decisions very difficult in practice. In some cases, the decision to invest may already have been taken by the time changes are announced, making them a welcome 'bonus' rather than having any direct influence, or in the case of a decrease in available allowances creating cashflow issues.

2.4 For all sizes of business, more certainty would be welcome in the form of a capital allowances regime which is stable and not subject to frequent changes. This would remove an area of complication for smaller businesses where the AIA threshold is reduced (see 5.5 below) as well as facilitating easier investment decisions for larger businesses.

3 The super-deduction

3.1 The Policy Paper asks how the recently introduced temporary super-deduction has affected the investment making decisions of businesses.

3.2 Whilst we understand the rationale for the super-deduction in its particular context, we note that it has introduced significant additional complexity into the capital allowances regime. The complicated nature of the rules, especially around disposals, have led some companies to not claim it and instead just claim the AIA as usual. The AIA rules are generally much simpler and better understood, and there is no potential claw back of relief as there is under the super-deduction when an asset is later disposed of. We have however seen the special rate allowance claimed more widely, due to the very low writing down allowance rate special rate plant and machinery otherwise attracts (discussed further at 5.9 below).

3.3 In our experience, the super-deduction has therefore not had a particularly marked impact on investment making decisions. As noted at 2.3 above, the relatively late announcement of this relief compared to the long decision-making time scales of larger companies means it may have operated more as an unexpected benefit, rather than a driver of decisions.

4 The current system of capital allowances

4.1 The Policy Paper asks what the level of awareness of the current capital allowances system is, how simple it is to operate and understand, and whether it provides sufficient support for business investment?

4.2 In our experience, the current system can be confusing. Complexities occur in relation to the precise timing of expenditure, fine statutory distinctions between similar types of asset and the nature and structure of a particular business. It is also subject to frequent changes, making decisions on expenditure more complex. This has led to many viewing advising on capital allowances as a specialist field, in a similar way to R&D relief.

4.3 The main issue for smaller businesses is understanding whether a purchase is revenue or capital in nature, and, if capital, then what reliefs may be available. The AIA helps with this to a considerable extent, especially where businesses consistently spend below the limit, as the distinction between revenue and allowable capital expenditure is tax neutral The AIA itself is a relatively well known and simple concept. However, as outlined at 5.5 below, frequent changes to the thresholds can increase confusion and even result in an unexpected restriction in the amount of AIA available to a business where an accounting period straddles a reduction in the threshold. Small businesses are unlikely to be aware of the potential timing pitfalls when AIA limits are changed in this situation – particularly since the standard AIA limit may well be much higher than the cost of plant or vehicles in question such that the business may not feel they need to worry – and may, therefore, not seek the necessary advice before purchase which would pick up this sort of timing problem. We would therefore strongly recommend that a permanent AIA limit is maintained at a sensible level and that temporary increases should be completely avoided unless their transitional provisions ensure that the effective AIA limit for a business's qualifying expenditure cannot be less than the standard AIA limit.

4.4 As an example of the more technical complexities businesses face even with an apparently simple asset purchase, it is worth looking at the position for cars and vans which are treated very differently for capital allowance purposes. The purchase of a vehicle for use in the business is a common occurrence and likely to be one of the largest items of value in a small business. The question of whether a vehicle is a car or van should be simple, but it is not, and definitions for capital allowances are different to the definitions used for VAT purposes. Particular complexities have arisen as a result of the popularity of crew cabs which have both van-like and car-like properties as illustrated in the recent case involving Coca Cola[2]. Although this is primarily a benefit in kind case, the test being applied is not dissimilar to the test for capital allowances. This case to determine whether vehicles supplied to their staff were cars or vans was first heard in 2017 and was concluded in the Court of Appeal in 2020. This whole area is extremely confusing for small businesses and their advisers. HMRC had previously provided specific guidance on whether certain models can be a considered a car or a van[3] (the list applies for VAT, but it is commonly accepted that a vehicle listed as a van can be accepted as a

[2] https://www.judiciary.uk/wp-content/uploads/2020/07/HMRC-v-Payne-Ors-Approved-Judgment-002-2.pdf
[3] https://www.gov.uk/government/publications/hm-revenue-and-customs-car-derived-vans-and-combi-vans

van for other purposes) but the list is now seven years out of date. Addressing complexities and uncertainties in the area of cars and vans would be beneficial to many businesses, from the smallest to the largest.

5 Spring Statement options

5.1 The annex to the Policy Paper outlines five policy options for reform of the capital allowances regime:

1. Increasing the permanent level of the AIA threshold
2. Increasing the rates of writing down allowances (WDAs)
3. Introducing general first-year allowances (FYAs) for qualifying expenditure
4. Introducing an additional FYA
5. Full expensing

General comments

5.2 We note that all of these options effectively focus on the timing of when relief is given on qualifying expenditure. They do not however look to the more fundamental issue of what expenditure actually qualifies for relief and why. As outlined at 4.2 and 4.3 above, the current capital allowances regime is complex and can be confusing. We therefore believe there is a need to simplify and rationalise the current regime, rather than merely focusing on rates and thresholds.

5.3 Below we have discussed each of the above options in turn. However, which of the options is most appropriate will depend upon the intended target and aims of reform. As set out above, capital allowances play a very different role for different sizes and types of businesses when it comes to investment decisions. In order to identify which potential capital allowance reforms will drive investment, it will be necessary to first identify which businesses and expenditure are the intended target.

Option 1: increasing the permanent level of the AIA threshold

5.4 The Policy Paper proposes that the permanent level of the AIA could be increased from £200,000 to, for example, £500,000.

5.5 Whilst we would not object to such an increase, we would stress the importance of this permanent threshold then being maintained at the same level with no temporary increases. As noted above at 2.3, frequent (and often last minute) changes to thresholds reduce certainty and make investment planning and forecasting difficult for businesses. In addition, where a business has an accounting period which straddles a decrease in the AIA threshold, the transitional rules can result in a much lower overall AIA being available than would otherwise be expected. For example, when the threshold reverts to its permanent level on 31 March 2023, a business incurring qualifying expenditure on or after 1 April 2023 but in an accounting year which straddles 31 March 2023 could have an effective AIA limit of as little as £16,667 if all its capital expenditure was in the final month of its accounting year.[4] Even with a change in the AIA limit to £500,000 rather than £200,000, that same business could have an effective AIA limit of only £41,667

5.6 The 2018 Office of Tax Simplification (OTS) report on simplifying tax relief for fixed assets[5] highlighted that only 26,000 companies and 1,000 income tax payers spent over the current permanent threshold limit of £200,000. Therefore, whilst increasing the level of the permanent threshold would be a relatively simple initiative, it is unlikely to be of benefit to the vast majority of businesses whose expenditure never exceeds the current

[4] See https://www.att.org.uk/technical/news/new-end-date-higher-annual-investment-allowance-creates-opportunity-simplification

[5] https://www.gov.uk/government/publications/ots-review-on-simplifying-tax-relief-for-fixed-assets

threshold. For those businesses, the main issues with the AIA and capital allowances in general are determining what qualifies and what doesn't, and the effect of temporary changes in the limit noted above. It would be of more benefit to them to keep the AIA at a reasonable level and widen it to include other assets such as cars, minor property works etc.

Option 2: increase WDA rates

5.7 The Policy Paper proposes that the existing WDA rates could be increased from 18% and 6% to, for example, 20% and 8%.

5.8 Whilst this would be a relatively simple reform, we do not believe it would make a material difference to many businesses. As noted above at 5.6, the majority of smaller businesses already have their expenditure fully covered by the AIA, and a relatively small increase in WDA rates such as that suggested is unlikely, on its own, to have much impact on the investment decisions of larger businesses. This is especially the case given that any increase would ultimately be a timing issue rather than an increase in the overall relief available.

5.9 We do however believe that there is merit in considering whether the current 6% WDA rate for special expenditure could be increased. This rate is materially lower than the main rate, and appears to be lagging behind commercial needs. Allowances of only 6% per annum on a reducing basis for pooled assets means that it takes far too long to write down special rate assets, and in some cases businesses may never get to the point where they have fully written down an asset. This is a particular issue in the property sector, as well as retail and hospitality. For example, a retail / hospitality tenant who is refurbishing premises may have their lease expire before they receive full relief. One alternative approach to addressing this issue could be to extend the scope of short life asset elections, such that qualifying assets disposed of within a certain timescale (for example eight years for main pool assets, 15 years for special rate assets) would create a balancing adjustment rather than the unrelieved qualifying expenditure remaining in the relevant pools.

Option 3: general FYAs

5.10 The Policy Paper proposes that general FYAs could be introduced for qualifying expenditure on plant and machinery, for example a 40% FYA on main rate expenditure and 13% for special rate. It is not clear from the Policy Paper whether the intention would be for these FYAs to be available alongside, or replace, the AIA.

5.11 We would not support introducing general FYAs in place of the AIA. This would lead to increased complexity and lower relief for the majority of smaller businesses whose expenditure is currently fully covered by the AIA.

5.12 The main beneficiaries of general FYAs (which it is proposed would – like the super-deduction - be uncapped) would be those businesses who currently spend substantially over the AIA threshold. However, it is not clear to what extent such a system would incentivise expenditure by large businesses. As discussed above for WDA rate increases, any benefit would only be a timing difference rather than an increase in absolute relief.

Option 4: Additional FYAs

5.13 The Policy Paper proposes that an additional (or bonus) FYA could be introduced which would allow a percentage of qualifying expenditure to be claimed up front (for example 20%) with 100% of the expenditure also available to be pooled in the normal way.

5.14 This option, in effectively allowing more than 100% of qualifying expenditure to be deducted, would potentially provide a stronger incentive than changes to the timing of relief. However, it would also be open to abuse and would therefore have to be carefully drawn and incorporate anti-avoidance measures. We note that this option is also likely to have a higher cost to the Exchequer than the previous options discussed.

5.15 The introduction of additional FYAs would put something akin to the current temporary super-deduction on a more permanent footing. As discussed at 2.3 above, the super-deduction may not have had a marked impact on investment due to its temporary nature and the long time frame for investment decisions in larger businesses. However, a more permanent measure could have a greater effect. We would however strongly recommend that the scope of any additional FYAs be wider than the current super-deduction – in particular so that they are available to both incorporated and unincorporated businesses. We would also like to see the special rate allowance extended beyond April 2023, to ensure that special rate assets also continue to receive additional relief.

5.16 One area not considered in the Policy Paper, but which we would recommend giving additional consideration to, is whether an additional FYA could be converted into a payable tax credit for loss making companies (in a similar manner to the R&D regime). This would provide valuable support for growing businesses looking to invest, as well as helping smaller businesses who may not be able to utilise their allowances other than in the form of a carried forward loss. However, we note that this would come with an additional cost to the Exchequer and would have to be clearly defined to prevent abuse.

Option 5: full expensing

5.17 The Policy Paper proposes that full expensing of main rate plant and machinery could be introduced together with a 50% FYA for special rate plant and machinery. This would be uncapped, allowing all qualifying main rate plant and machinery to be written off in full in the year the expenditure is incurred.

5.18 In effect, this would introduce a limitless AIA for main rate plant and machinery. As such, the main beneficiaries would be those larger businesses who currently spend above the AIA threshold. It would be of limited use to the majority of businesses who never exceed that threshold.

5.19 This option would not constitute a major simplification, as it would still be necessary to identify whether expenditure is capital or revenue in nature, qualifying or non-qualifying etc. However, it could remove some of the current complexities in the AIA rules such as allocating the threshold amongst connected companies and the treatment of mixed partnerships.

5.20 One disadvantage of full expensing is that businesses would lose some of the flexibility in the current regime, which allows them to choose whether or not to claim capital allowances each year. The ability to 'disclaim' capital allowances, and therefore delay relief until later accounting periods, can provide helpful flexibility where a company is loss making, or has other reliefs (such as double tax relief) to cover its tax liability and which would otherwise be lost.

5.21 As with option 4, this option is likely to be expensive to the Exchequer and potentially open to abuse. For example, it could lead to boundary-pushing in building works if land and buildings were excluded. It would therefore be necessary to clearly define the scope of full expensing, as well as building in effective anti-avoidance measures.

5.22 One variation which might be considered would be to introduce a separate full-expensing regime for businesses with low levels of qualifying expenditure (for example within what would otherwise be the AIA limit) alongside the introduction of those reforms to the capital allowances regime which were most likely to achieve the government's objective of driving investment by businesses with higher levels of qualifying expenditure.

6 Contact details

6.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson on 07773 087111 or erawson@att.org.uk.

The Association of Taxation Technicians

7 Note

7.1 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 more than 9,000 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.