

## Finance (No.2) Bill 2021

### Representation from the Association of Taxation Technicians (ATT)

#### Clause 12: Extension of temporary increase in annual investment allowance

##### Executive Summary

The extension of the temporary £1,000,000 level of the annual investment allowance (AIA) is good news for the businesses able to take advantage of it, but the timing of the AIA's reversion to its permanent level of £200,000 on 1 April 2023 will now coincide with the abolition of basis periods, which will further exacerbate the arithmetic complexities and potential traps already inherent in the transitional provisions which apply when there is a change in the AIA limit.

As we explain below, the transitional rules can result in a business having its effective AIA limit restricted for a time to significantly less than *either* of the limits being transitioned between. The businesses most likely to be hit by this are the ones least likely to be able to benefit from the temporarily higher AIA limit because of their modest level of qualifying expenditure. Disproportionately, these will be unincorporated businesses (as distinct from limited companies) which means that they will also be ineligible for the super-deduction. The focus of this note is mainly on such unincorporated businesses but the amendment suggested would equally benefit limited companies whose annual qualifying expenditure did not exceed £200,000.

There is an opportunity to amend the transitional provisions in order to ensure that the many smaller businesses with lower levels of qualifying capital expenditure are not disadvantaged by a temporary increase from which they have received no benefit. We suggest an amendment which would ensure that a business has an AIA entitlement in a transitional accounting year of no less than £200,000 regardless of when in that year they incurred the qualifying expenditure.

#### 1. Background – a brief history of the AIA

- 1.1. Clause 12 extends the availability of the temporarily increased level of annual investment allowance ("AIA") by a further 15 months to 31 March 2023.
- 1.2. The AIA provides full tax relief on qualifying expenditure on plant and machinery in the chargeable period (accounting year) in which a business incurs that expense subject to a statutory limit. Expenditure above that limit is normally written off more slowly through a writing down allowance.
- 1.3. The AIA limit has been subject to much chopping and changing since it was introduced in 2008. Initially set at £50,000, after two years it was increased to £100,000 but, after another two years, it was cut to £25,000 (from 1 April 2012). FA2013 introduced the concept of a temporary increase in the AIA limit. The temporary £250,000 limit was intended to last for only 15 months from 1 January 2013 but FA2014 extended the availability by 21 months (to 31 December 2015) and increased the temporary annual limit from £250,000 to £500,000.
- 1.4. From January 2016, the AIA limit reverted to its non-temporary ("permanent") limit but that was increased at the same time from £25,000 to £200,000 by F(No2)A 2015. The £200,000 permanent limit applied for the three years to 31 December 2018. From 1 January

## Finance (No.2) Bill 2021 ATT Representation – Annual Investment Allowance

2019, a new temporarily increased limit of £1,000,000 was introduced for the two years to 31 December 2020. The first 2021 Finance Act extended the availability of that temporary limit for a further year to 31 December 2021. This Bill proposes keeping the £1,000,000 limit in place for a further 15 months, until 31 March 2023.

- 1.5. In summary, there have been seven different AIA limits since April 2008. Since its introduction in January 2013, the temporary limit will have applied for the equivalent of seven of the following ten years!
- 1.6. While the maintenance of a high AIA will be broadly welcomed by eligible businesses with high levels of capital expenditure, the wider picture is that the chopping and changing of AIA levels is unhelpful as it adds complexity to the system and creates traps that can disadvantage some businesses.
- 1.7. In particular, it is important to appreciate the impact of the transitional provisions which apply upon the return to the permanent annual limit of £200,000 from the temporary £1,000,000 limit. These transitional provisions will apply to any business which has a chargeable period which straddles 1 April 2023<sup>1</sup> and incurs qualifying expenditure on which it wishes to claim AIA. However, incorporated businesses (limited companies, etc) will be significantly insulated from the impact of the transitional provisions in respect of such expenditure if it is incurred no later than 31 March 2023 as they would have the alternative of claiming the super-deduction.
- 1.8. Any balance of qualifying expenditure above the AIA limit is normally written off more slowly through a writing down allowance (depending on the nature of the assets) of either 18% or 8% each year on a reducing balance basis. At the 18% rate, it takes seven years to write off 75% of the balance. At the 8% rate, it takes over sixteen years to obtain relief on 75% of the balance. By contrast, the AIA gives full tax relief on the whole of the expenditure for the chargeable period in which it is incurred.
- 1.9. In paragraph 62 of its [Tax after coronavirus](#) report, the Treasury Committee urge the Government *“to look favourably on further extension and possibly permanency [of AIA] at the existing level, which would provide welcome certainty to small and medium-sized enterprises.”* We agree. The further extension is welcome but, over the medium to long-term, stability is key to maximising the AIA’s benefits for smaller businesses.

## 2. Impact of the transitional provisions on the available AIA in the second straddling period

- 2.1. Some 97 per cent of UK businesses incur qualifying capital expenditure of less than £200,000 each year<sup>2</sup>. The temporary AIA limit of £1 million has not benefited these businesses – but the transition back from £1 million to £200,000 in 2023 could actively disadvantage them, by reducing their AIA limit *below* £200,000 for a period.

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<sup>1</sup> The chargeable period which straddles the end of the period in which the £1,000,000 maximum amount of AIA is available is referred to in the transitional provisions as the “second straddling period” to distinguish it from the chargeable period which straddles the beginning of the period in which that higher amount became available (the “first straddling period”).

<sup>2</sup> A report by the Office of Tax Simplification in June 2018 noted that only about 30,000 businesses incur more AIA qualifying expenditure than the permanent AIA limit of £200,000 whilst the other 1.2 million businesses spend less than the AIA limit.

## Finance (No.2) Bill 2021 ATT Representation – Annual Investment Allowance

- 2.2. This is because of the way in which the transitional provisions work in the second straddling period (the chargeable period straddling 1 April 2023). This is explained in relation to qualifying expenditure of £500,000 in a twelve-month chargeable period to 31 December 2023 in an HMRC [Policy Paper](#) published<sup>3</sup> on Budget Day 27 October 2021. This brings out the sensitivity of the timing of expenditure in the second straddling period – spend £500,000 in the three months to 31 March 2023 and get AIA of £400,000; delay it until the following nine months and the maximum AIA available is only £150,000.
- 2.3. What the HMRC example does not bring out is the range of outcomes depending on when the second straddling period ends. For a business with a year end of 30 June 2023 whose only qualifying expenditure in the year is (say) £100,000 all of which is incurred after 31 March 2023, the available AIA is just £50,000 (being three months' worth of an annual limit of £200,000)<sup>4</sup>. This demonstrates how a business whose annual qualifying expenditure is never more than half of the permanent AIA limit of £200,000 can be disadvantaged by the ending of a temporary increase in the AIA from which it could never benefit.
- 2.4. The arithmetic complexities and timing sensitivities inherent in the transitional provisions are not well understood by businesses – nor in some cases by their advisers.
- 2.5. This is given added significance by the observation in an OTS report of June 2018<sup>5</sup> that only about 30,000 businesses incur more AIA qualifying expenditure than the permanent limit of £200,000 whilst the other 1.2 million businesses spend less than the AIA limit. This means that the temporary increase in the AIA limit was unlikely to be of any benefit to over 97% of businesses. HMRC's Policy Paper of 27 October 2021 (see 2.2 above) confirms that the position is unlikely to have changed since 2018. The Summary of impacts section notes:
- “This measure is expected to have a negligible impact on an estimated 31,000 businesses by making available an increased level of relief for expenditure on plant and machinery at 100% of the cost for the tax period in which it was incurred.”
- 2.6. The impact assessment then ignores the implications of the extension of the temporary increase in the AIA limit on the great majority of businesses, confining its comment in the Small and micro business (SMB) assessment section of the Summary to the benefit arising to a small minority within that category:
- “the temporary increase in the AIA is expected to benefit the largest SMBs whose investments in plant and machinery regularly exceed the permanent £200,000 AIA limit. Without this change these businesses could only relieve their relevant capital expenditure through WDAs at a lesser rate.”
- 2.7. The impact of the arithmetic complexities of the AIA transitional rules referred to above is compounded for all unincorporated businesses with chargeable periods which straddle 1 April 2023 by the fact that the separate transitional provisions relating to basis periods<sup>6</sup> require the chargeable period in question to be extended to 5 April 2024 in order to

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<sup>3</sup> Annual Investment Allowance Extension, HMRC 27 October 2021. See:

<https://www.gov.uk/government/publications/annual-investment-allowance-extension/annual-investment-allowance-extension>

<sup>4</sup> If instead, the business year end was 30 September 2023 or later, the AIA available (six months' worth of the annual £200,000) would cover the whole of the £100,000 expenditure.

<sup>5</sup> [Accounting depreciation or capital allowances? Simplifying tax relief for tangible fixed assets](#) (OTS June 2018) See Paragraphs 5.21 and 5.22.

<sup>6</sup> The transitional provisions in relation to basis periods are in Clause 7 and Schedule 1, Part 6 of the Bill.

## Finance (No.2) Bill 2021 ATT Representation – Annual Investment Allowance

determine the assessable profits for the tax year 2023/24. That requires the aggregation of the taxable profits of the chargeable period which straddles 5 April 2023 with a time-apportioned part the taxable profits of the subsequent chargeable period.

- 2.8. The transitional provisions for the ending of the temporarily increased AIA in conjunction with the transitional provisions for the ending of basis periods produce the following outcomes assuming qualifying capital expenditure by an unincorporated business at the permanent AIA limit of £200,000 at differing times between the periods shown in the table below:

Effective AIA available in the assessment for tax year 2023/2024 on expenditure of:							£200,000
		Second straddling period				Next period	
		Before 1 April 2023		Between 1 April 2023		Any time in the 12	
		but after:		and:		months to:	
Accounts Year End:		£		£		£	
30 April		30.04.22	200,000	30.04.23	16,667	30.04.24	183,333
31 May		31.05.22	200,000	31.05.23	33,333	31.05.24	166,667
30 June		30.06.22	200,000	30.06.23	50,000	30.06.24	150,000
31 July		31.07.22	200,000	31.07.23	66,667	31.07.24	133,333
31 August		31.08.22	200,000	31.08.23	83,333	31.08.24	116,667
30 September		30.09.22	200,000	30.09.23	100,000	30.09.24	100,000
31 October		31.10.22	200,000	31.10.23	116,667	31.10.24	83,333
30 November		30.11.22	200,000	30.11.23	133,333	30.11.24	66,667
31 December		31.12.22	200,000	31.12.23	150,000	31.12.24	50,000
31 January		31.01.23	200,000	31.01.24	166,667	31.01.25	33,333
28 February		28.02.23	200,000	29.02.24	183,333	29.02.25	16,667
31 March	The transitional rules do not effect businesses with a year end of 31 March or 5 April.						

- 2.9. The maximum available AIA in the part of the second straddling period before 1 April 2023 is the aggregate of the time-apportioned part of the £1,000,000 and the time apportioned part of the £200,000 limit. That means it will always exceed the permanent £200,000 limit.
- 2.10. By contrast, the maximum available AIA in the part of the second straddling period after 31 March 2023 is restricted to the time-apportioned part of the £200,000 limit<sup>7</sup>. That explains why it increases in the table above from £16,667 (being 1/12 of £200,000) with a year-end of 30 April 2023 to £183,333 (being 11/12 of £200,000) with a year-end of 29 February 2024. It is important to appreciate that the AIA available in the part of the second straddling period after 31 March 2023 is limited in this way even if the business incurred no qualifying expenditure at all in the part of the period before 1 April 2023. Taking the example of an unincorporated business with a second straddling period of the year to 30 April 2023, if its only qualifying expenditure was in the month of April 2023, its AIA ceiling would still only be £16,667.
- 2.11. The reduction in the *effective* amount of AIA from expenditure in the chargeable period after the second straddling period (the “Next period” in the table) is not a result of the AIA transitional rules but the separate basis period transitional rules. As mentioned in

<sup>7</sup> The AIA available in the part of the period after 31 March 2023 is further restricted if the expenditure in the part of the period before 1 April 2023 exceeded the time-apportioned part of the £1,000,000 limit.

## Finance (No.2) Bill 2021 ATT Representation – Annual Investment Allowance

2.7 above, those require the aggregation of a time-apportioned part of the taxable profits (net of any AIA or other capital allowances) of the Next period with the (full amount) of the taxable profits of the previous (second straddling) period to determine the assessable profits for 2023/24. That time-apportionment applies generally to all constituent items of both income and expenditure including capital expenditure. That explains the reduction in the AIA effect of qualifying expenditure in the Next period from the year-end 30 April 2024 to the year-end 28 February 2025.

- 2.12. The table above demonstrates that the combined effect of the transitional provisions for both the ending of the higher limit of AIA and the abolition of basis periods is that an unincorporated business which incurs no qualifying expenditure in its second straddling period before 1 April 2023 has an effective limit of £200,000 of AIA in its 2023/24 tax assessment. For example, a sole trader or partnership with a 30 June year end would have a capped limit of £50,000 for its second straddling period and an effective limit of £150,000 in respect of expenditure in the Next period. By contrast, that same business would have had an AIA limit of £800,000 (being 9/12 of £1,000,000 plus 3/12 of £200,000) in respect of qualifying expenditure incurred on or before 31 March in its second straddling period plus the effective limit of £150,000 in the Next period, giving a total effective AIA limit in its 2023/24 tax assessment of £950,000.

### 3. Suggested amendment to Clause 12 to overcome the impact identified in 2.9 above

- 3.1. The reduction in the amount of AIA which is effective in the 2023/24 assessment (see 2.11 above) is an unavoidable consequence of the abolition of basis periods. It adds a complication in the context of the AIA but it does not involve any absolute loss of AIA. Any part of the AIA not given effect in 2023/24 is automatically picked up in the tax assessment for the following tax year (2024/25).
- 3.2. By contrast, the AIA restriction related to expenditure in the part of the second straddling period from 1 April 2023 (see 2.10 above) involves an absolute loss of AIA. Any qualifying expenditure above the restricted amount cannot attract AIA. It must instead be written off gradually for tax purposes over seven or sixteen years as noted in 1.8 above.
- 3.3. In order to prevent businesses being adversely impacted as described upon the return from a temporarily increased AIA limit of £1,000,000 to the permanent AIA limit of £200,000, provision could be made to ensure that, for the second straddling period, AIA would be available on expenditure of up to the permanent £200,000 limit regardless of when it was incurred within that year.
- 3.4. An illustrative wording to achieve that objective is shown below.

#### ***Amend Clause 12 by adding a new sub-clause (3) as follows:***

“(3) In paragraph 2(3) of Schedule 13 of that Act -

(a) after “second straddling period is” insert “the greater of (a)” and

(b) after “of that sub-paragraph” add “and (b) the amount (if any) by which the maximum allowance under section 51A of CAA 2001 for the whole of the second straddling period had there been no temporary increase in the allowance exceeds the AIA qualifying expenditure incurred before 1 April 2023.”

## **Finance (No.2) Bill 2021 ATT Representation – Annual Investment Allowance**

3.5. In consequence of the suggested amendment (together with the amendments proposed by the Bill), paragraph 2(3), Schedule 13, Finance Act 2019 would read as follows:

(3) But, so far as concerns expenditure incurred on or after 1 April 2023, the maximum allowance under section 51A of CAA 2001 for the second straddling period is the greater of:

(a) the maximum allowance, calculated in accordance with sub-paragraph (2), for the period mentioned in paragraph (b) of that sub-paragraph and

(b) the amount (if any) by which the maximum allowance under section 51A of CAA 2001 for the whole of the second straddling period had there been no temporary increase in the allowance exceeds the AIA qualifying expenditure incurred on or before 31 March 2023.

3.6. The inclusion of this suggested provision within schedule 13 of FA2019 would ensure that the total of qualifying expenditure which did not exceed the £200,000 permanent AIA limit (referred to in the suggested amendment above as “the maximum allowance under section 51A of CAA 2001 for the whole of the second straddling period had there been no temporary increase in the allowance”) and was incurred at any time within the second straddling period would attract AIA. It would not increase any entitlement to the AIA in excess of the permanent limit; it would however ensure that the transitional rules did not operate in a manner which disadvantaged businesses (particularly but not exclusively unincorporated businesses) with lower levels and less predictability of capital expenditure.

**Association of Taxation Technicians**  
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**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 9,000 members and Fellows together with over 5,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.