



## **Office of Tax Simplification (OTS) Review of tax reliefs interim report December 2010 – what does the future hold for capital allowances?**

Monday 13 December 2010 saw the long awaited interim report by the OTS as part of its review of all the tax reliefs, allowances and exemptions contained within the UK's tax system as part of the Government's drive to deliver a simpler tax system. So what could be the effect on capital allowances? A few thoughts on what the future may bring are discussed below.

### **Background**

The OTS was launched in July 2010 to provide the Government with independent advice on simplifying the UK tax system and one of the two initial reviews announced was a review of all tax reliefs. The first step in this review saw the publication on 8 November 2010 by the OTS of a complete list of tax reliefs, which amounted to 1,042 in total, and the criteria that would be used for future reports.

The interim report published on 13 December 2010, is designed to test whether the methodology and criteria adopted will produce sensible results and identify those reliefs which should be repealed or simplified to support the Government's overall objective of a simpler tax system for the UK.

A sample of 13 reliefs was chosen to test the methodology and criteria of which one related to capital allowances – enhanced capital allowances for energy and water efficient technologies.

In addition, the interim report also lists 74 reliefs which are planned to be included in the final report (due for publication in advance of Budget 2011) together with a list of 75 further reliefs which will be considered if time allows. This leaves 883 reliefs which will not be considered in detail, these include:

- Those subject to international agreements;

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- Those reliefs that are structural and an integral part of the tax system, e.g. to avoid double taxation;
- Those reliefs that are themselves a simplification;
- Reliefs that are subject to current HMRC/HM Treasury consultations, to avoid duplication; and
- VAT reliefs because of the particularly complex interactions between EU law and UK political commitments.

### **Capital allowances – enhanced capital allowances for energy and water efficient technologies**

Enhanced capital allowances (ECAs) enable a business to claim 100% first year allowances on certain plant & machinery during the period in which the expenditure was incurred or from 2008, take a payable tax credit if the company was in a loss making situation whereby the loss was surrendered for a tax credit equivalent to 19% of the cost of the asset. The methodology and criteria adopted for this review was to test:

- Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?
- Taxpayer take up and awareness; and
- Complexity, compliance costs and administrative burden

The review found that given the UK's legally binding commitment to reducing carbon levels up to 2050 it is clear the relief has a continuing rationale. However, the feeling is that it has very little impact on the decisions to buy, the tax credit for loss making companies has had minimal impact as assets included in the scheme are perceived to be more expensive than those that are not, manufacturers believe the process to get products included in the scheme is too bureaucratic, expensive and time consuming and the Annual Investment Allowance means that it's appeal to small businesses which make up the vast number of businesses in the UK is very limited meaning it will now mainly be medium and large businesses that will use ECAs. The conclusion reached in the review was that either the list of qualifying assets be simplified or the relief be abolished as the complexities of record keeping and asset identification mean the costs of claiming outweigh the benefits and suggested a number of



potential alternative methods to achieve the same policy objective in a simpler way, such as:

- Incentives in the form of grants for the purchase of “green equipment”;
- Adaptation of schemes such as the Feed in Tariffs, Renewable Heat Incentive or the Green Deal, to assist the installation of energy saving and water efficient technologies;
- Give an additional allowance to the manufacturer of “green” equipment; or
- A generally wider basis for the relief?

The review has posed some very interesting questions around the usefulness of the ECA scheme, some of which have been around almost since the scheme was introduced back in 2003. The major sticking points always seemed to be that the manufacturers of assets included in the scheme used it as justification for premium pricing and that it was too difficult and time consuming to identify the assets, especially in large scale construction projects and essentially it only represents a timing difference as the expenditure would already qualify as plant or machinery and so be eligible for writing down allowances (WDAs), which at that time were 25% and in many cases the assets could be included within the other first year allowance incentives on offer at any particular time. However, with the introduction of “integral features” with a WDA of only 10% from April 2008 (going down to 8% from April 2012) it now means that the timing effect becomes much more significant, especially in conjunction with the payable tax credit for loss making companies and the consensus that the costs outweigh the benefits is much less clear now.



## Capital allowances for the final report

Within the list of the 74 reliefs to be considered in the final report the following relate specifically to capital allowances:

<b>Tax or Duty</b>	<b>Relief Title</b>	<b>Statutory Reference</b>
Income tax & Corporation Tax	Capital allowances – business premises renovation allowance	CAA 2001 Part 3A
Income tax & Corporation Tax	Capital allowances - dredging	CAA 2001 Part 9
Income tax & Corporation Tax	Capital allowances – flat conversion allowances	CAA 2001 Part 4A
Income tax & Corporation Tax	Capital allowances – safety at sports grounds	CAA 2001 s30-32
Income tax & Corporation Tax	Capital allowances – short life assets	CAA 2001 Part 2 Chap 9

Of the allowances included in this table apart from safety at sports grounds, it comes as no real surprise that they are to be included. It has long been held that the short-life asset system is living on borrowed time and business premises renovation allowance, dredging and flat conversion allowances have not had the take up intended and it would not be a major shock if these were repealed.

The case of safety at sports grounds relief is much more interesting. Originally introduced back in Finance Act (No2) 1975 it did not really have an impact until the large scale rebuilding of stadia led by football following the Taylor Report into the Hillsborough disaster of 1989 which has then spread to other sports notably rugby and cricket. It has been the subject of much debate over the past few years with an inconsistent approach being adopted by HMRC inspectors to its applicability. The applicability of the relief to new stadia is already under close scrutiny by HMRC and we could see the OTS review as a convenient time for HMRC to do away with the relief.



### Capital allowances for the final report if time allows

Of the 75 reliefs which the OTS would like to consider if time allows the following relate specifically to capital allowances:

<b>Tax or Duty</b>	<b>Relief Title</b>	<b>Statutory Reference</b>
Corporation Tax	Capital allowances – ring-fence oil business trades, first year allowances for plant or machinery	CAA 2001 s45F
Income tax & Corporation Tax	Capital allowances – 100% first year allowance for cars with low CO2 emissions	CAA 2001 s45D
Income tax & Corporation Tax	Capital allowances – annual investment allowance	CAA 2001 s38A & 38B
Income tax & Corporation Tax	Capital allowances – mineral extraction allowances	CAA 2001 Part 5
Income tax & Corporation Tax	Capital allowances – mining & oil industries	CAA 2001 Part 2 Chap 13
Income tax & Corporation Tax	Capital allowances – research & development allowances	CAA 2001 Part 6
Income tax & Corporation Tax	Capital allowances - ships	CAA 2001 Part 2 Chap 12

The most widespread relief included in this table is the Annual Investment Allowance (AIA) which has replaced the system of first year allowances since its introduction in Finance Act 2008. Originally set at £50,000 per annum (increased to £100,000 from April 2010 and to be reduced to £25,000 from April 2012) it has been of significant benefit to small businesses meaning that for most businesses all of their annual capital expenditure on plant & machinery would likely be covered by the AIA. It would be a surprise given the delicate state of the economic recovery if the recommendation was to repeal the relief, though changes could be made to the overly complicated way the AIA is shared between groups or 'related' companies. R&D allowances could also be one that is repealed given the plethora of reliefs that are already in existence for R&D elsewhere in the tax system.

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### Capital allowances not include at this stage

Of the 883 reliefs that it is not proposed at this stage to consider further the following specifically relate to capital allowances:

<b>Tax or Duty</b>	<b>Relief Title</b>	<b>Statutory Reference</b>
Income Tax	Capital allowances – personal security expenses	CAA 2001 s33
Income tax & Corporation Tax	Agricultural Buildings Allowances	CAA 2001 Part 4; FA 2008 s84
Income tax & Corporation Tax	Capital allowances – 100% first year allowance for plant or machinery for gas refuelling station	CAA 2001 s45E
Income tax & Corporation Tax	Capital allowances – assured tenancies	CAA 2001 Part 10
Income tax & Corporation Tax	Capital allowances – capital contributions	CAA 2001 Part 11
Income tax & Corporation Tax	Capital allowances – computer software	CAA 2001 s71
Income tax & Corporation Tax	Capital allowances – Enterprise Zones	CAA 2001 Part 3; FA 2008 s84
Income tax & Corporation Tax	Capital allowances – gifts of certain assets to charity	CAA 2001 s63(2)
Income tax & Corporation Tax	Capital allowances – plant & machinery	CAA 2001 Part 2
Income tax & Corporation Tax	Capital allowances – ships and railway assets	CAA 2001 s94 & 95
Income tax & Corporation Tax	Capital allowances – thermal insulation of buildings	CAA 2001 s28
Income tax & Corporation Tax	Industrial Buildings Allowances	CAA 2001 Part 3; FA 2008 s84

It is positive to see that plant & machinery allowances fall into this table, as ever since the Conservative party released its manifesto prior to last year's general election,

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there has been a thought circulating that capital allowances could be repealed en masse and replaced with a form of depreciation allowances, despite there being no real support for this view from business and the professions.

### **Conclusions**

The issue of the interim report has proved to be a fascinating read and it is clear that the Coalition Government is fully committed to simplifying the tax system and that must be good for business in providing the certainty it needs to make the decisions to shape future directions whatever they may be.

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