Budget 2021

The Chancellor's super-deduction

Opportunities and implications for business

March 2021

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In order to stimulate and encourage investment following the COVID-19 pandemic, the Chancellor announced two new first-year allowances for companies - a super-deduction of 130% for main pool expenditure, and a first-year allowance of 50% for special rate expenditure (including long life assets).

These new allowances have effect for expenditure incurred from 1 April 2021 up to and including 31 March 2023, but specifically exclude expenditure incurred as a result of a contract entered into prior to 3 March 2021.

The qualifying expenditure is subject to a number of exclusions, including a general exclusion on cars, second-hand assets and assets held for leasing. In addition, the changes announced do not apply to partnerships and sole traders. There is an anti-avoidance provision to counteract arrangements which are contrived, abnormal, or lacking a genuine commercial purpose and rules already exist to exclude connected party transactions from first-year allowances.

From a cash-tax perspective, the upfront super-deduction has the potential for companies to cut their tax bill by up to 25p for every £1 they invest. By way of an example, for a company incurring £1mn of main pool expenditure in July 2021, the super-deduction will provide an immediate deduction to taxable profits of £1.3mn compared to £180,000 under normal writing down allowances. However, unlike normal capital allowances, on the disposal of assets obtaining the super-deduction or first year allowance, a balancing charge may arise. The balancing charge in respect of assets obtaining the super-deduction may be increased if the disposal takes place in a chargeable period that commenced before 1 April 2023, with a view to recapturing some or all of the enhanced allowance that has been given.

As part of the Budget, there was confirmation that the Annual Investment Allowance (AIA) will remain at £1mn for a further year until 31 December 2021, though it is expected to then return to £200k.

It is important to assess the benefit of these temporary increases to the capital allowances regime in the context of all the tax attributes available to a group. This may mean consideration of the new temporary rules allowing loss carry-back and the existing rules restricting the use of losses carried forward. There is also a need to consider the interaction with other allowances and reliefs – not only the AIA but also relief for Research and Development (R&D) costs and intangible assets.

Those looking for new operating locations may also consider the eight Freeport locations announced for England (with the potential for more in Scotland, Wales and Northern Ireland). The new allowances do introduce an element of complexity when preparing tax forecasts and it will be necessary to model the after-tax returns at an early stage when factoring the allowances into investment decisions.

Businesses likely to benefit from the reliefs

The super-deduction will be welcomed by companies who already have plans to invest or are contemplating purchasing plant and machinery over the next two years. The tax definition of plant and machinery is wide ranging and can include assets such as computer equipment and software through to large scale manufacturing equipment, swimming pools and glasshouses.

The super-deduction

The super-deduction applies to investment in new and unused plant and machinery that is not special rate expenditure between 1 April 2021 and 31 March 2023 (but see also the section on the importance of the contract date).

There are measures to proportionately reduce the super-deduction available for accounting periods spanning 1 April 2023 e.g. for a year ended 31 December 2023 you would receive approximately 3/12 of the enhanced 30% element of super-deduction or 107.5%. This is to ensure that the relief given does not exceed the 25% corporation tax rate. The actual calculation is based on the exact number of days in a chargeable period falling before 1 April 2023.

Where plant and machinery on which a super-deduction has been claimed is subsequently sold or disposed of, a balancing charge will apply to reverse any super-deduction received based on the disposal value of the assets in accordance with CAA 2001 s.61-63.

Companies that regularly dispose of their assets on a second-hand market will need to bear in mind that future disposals will trigger a balancing charge that, on current plans, may be taxed at a higher rate in excess of the 25% previously announced. Existing measures, such as CAA 2001 s.198 elections, may be used to mitigate this for fixtures

The new special rate allowance

An accelerated first year allowance of 50% (the SR allowance) will be available to companies for special rate allowance expenditure incurred between 1 April 2021 and 31 March 2023, instead of the current writing down allowance of 6% per annum on a reducing balance basis.

Capital expenditure on assets allocated to the special rate pool includes:

- Integral features (such as electrical systems, space or water heating systems and lifts)
- Long-life assets (assets where it is reasonable to expect a useful economic life of at least 25 years)
- Solar panels
- Thermal insulation
- The provision of cushion gas

The accelerated relief is available for expenditure on long-life assets which will be welcomed by those sectors using assets in their trade with a useful economic life of at least 25 years; in particular the infrastructure, energy and real estate sectors.

The importance of the contract date and expenditure date

The reliefs are not available if the contract for the plant and machinery was entered into prior to Budget day, 3 March 2021.

Expenditure on contracts entered prior to this date are treated as being incurred for capital allowances purposes on the date when the contract was entered into (whether or not an unconditional obligation to pay it arises on or after that date) and therefore outside the qualifying period. The question of when expenditure is incurred as a "result of a contract" is complex and consideration will be required to check entitlement.

Care is needed where the plant and machinery forms part of a larger fit-out/construction project that is already underway or there are existing framework agreements in place.

The particular date that expenditure is incurred may also be important for entitlement to claim either the super-deduction or SR allowances. As an example, expenditure incurred before the commencement of trade that is usually treated as incurred on the first day of trading, does not attract the super-deduction or SR allowance unless it was actually incurred during the specified two year period and the company was within the charge to corporation tax..

Exclusions

Only companies can benefit from the reliefs, they are not available for partnerships or individuals. Furthermore, the reliefs are only available to the first company acquiring an asset from new.

As it stands the draft legislation excludes assets used for leasing and as a result, property rental businesses are currently excluded from this enhanced relief. We have raised this point with HMRC as landlords were previously allowed to claim first year allowances for certain assets.

On a similar basis to the measures introduced for Structures and Buildings Allowances, the super-deduction and SR allowance are not available for expenditure incurred in relation to a contract that was entered into prior to 3 March 2021 (see section above).

Additional restrictions have been introduced for assets acquired under hire purchase and similar types of contracts where possession of plant and machinery is transferred but not the ownership, impacting who is entitled to benefit from the capital allowances. This may impact large items of plant and machinery purchased under contracts requiring advance payment.

Expenditure on cars, the acquisition of second-hand assets and assets acquired from a connected party is excluded from attracting the accelerated relief and instead continues to attract relief at existing writing down allowance rates of either 18% or 6% per annum.

Anti-avoidance measures exist to prevent contrived arrangements being made whereby a company attracts the super-deduction or SR allowance or prevents the balancing charge from applying providing them with a tax advantage.

Interaction with other reliefs

Most companies invest in a whole range of assets and it will be necessary to examine the nature of the underlying expenditure and the various tax reliefs available to capitalise on the savings and avoid any potential pitfalls now or in the future.

Furthermore, there is an opportunity to look at how the super-deduction interacts with other reliefs, such as investment in computer software treated as intangible fixed assets or qualifying research and development capital expenditure, where it may now be more beneficial in the short term to claim the super-deduction under the capital allowances regime.

Losses

The accelerated reliefs should be considered in conjunction with the ability to utilise losses. For existing businesses this could result in a reduction of tax for a significant period or lead to the repayment of taxes paid in earlier years.

For new companies created to own and operate a large asset, such as a property or solar farm for example, this could generate significant losses in an early year of operation. Due to the interaction between capital allowances and loss relief rules for businesses, care should be taken to avoid inadvertently paying corporation tax earlier than necessary. Companies should take the opportunity to revisit financial models to establish the impact of the accelerated relief. It may improve the economics of a project to make it more attractive for financing and investors, pushing out the time period for when a large infrastructure project becomes tax paying. The ultimate position will depend on the ability of the company to utilise its losses created.

Annual Investment Allowance

The temporary increase to the rate of the AIA at £1mn will be extended for an additional year to 31 December 2021 and is expected to decrease to the earlier limit of £200k with effect from 1 January 2022.

The AIA interacts with the super-deduction and SR Allowance and should be allocated in the most tax efficient manner.

Checklist of considerations

It will be important for companies to proactively consider investment plans from a capital allowances perspective to ensure the benefits of these enhanced reliefs are available.

1. Will the expenditure be incurred in the two-year window (1 April 2021 – 31 March 2023)?
2. When was the contract for the asset entered into?
3. Do any of the exclusions apply?
4. Will the expenditure be capital for tax purposes, and who will own the asset for capital allowances purposes?
5. Is the expenditure main pool or special rate expenditure?
6. Is there opportunity to elect software expenditure out of the intangibles regime?
7. Modelling these enhanced allowances what does this do to the taxable profit/loss? Is there an opportunity to carry back losses?
8. What is the optimum hierarchy of reliefs taking into account the super-deduction, the SR allowance, research and development allowances and the AIA?
9. When are these assets likely to be disposed and for what disposal value (will there be a clawback of allowances)?
10. Is the expenditure in a designated Freeport area?
11. Has the Annual Investment Allowance been fully utilised?

Deferred tax implications

The benefits of the 130% first year allowance should be recorded in the tax line of the accounts. For the vast majority of companies, the assets qualifying for the 130% first year allowance will be fully depreciated to nil residual value over a period of time. Implicit in this accounting assumption is the expectation that at the end of its useful economic life the asset is scrapped for nil proceeds rather than sold. This is important because it means that for tax accounting purposes the issue of clawback should be ignored. In these cases, a deferred tax liability will be recorded equal to the remaining carrying value at the balance sheet date.

In principle, this will give an ETR benefit for the super-deduction element (i.e. 30 out of the 130) in year one which effectively makes it a permanent item. However, this will be partially offset by the tax rate differential insofar as much of the deferred tax liability will be measured at 25%; whereas the capital allowances only provide tax benefit at 19%.

Going forward, as with other capital allowance assets, there should be no ETR impact in subsequent years as the accounting depreciation is a temporary difference.

Example

Assume that Company A, whose accounting year end is 31 March 2022 purchases a qualifying asset for 1000 with an assumed 10-year life.

Company A records 100 of accounting depreciation in the year to 31 March 2022. A will obtain a deduction of 1300 in its FY22 tax return and record a deferred tax liability on the 900 NBV at 31 March 2022.

Its current tax charge will reduce by 247, i.e. 19% x 1300 of capital allowances, and its deferred tax charge will increase by 219 (i.e. 19% x 100 + 25% x 800 taking into account the 25% tax rate applicable from 1 April 2023). The total tax charge is thus reduced by 28 on an accounting loss of 100.

The ETR benefit is 9 being 57 (19% of the 300 super-deduction), less 48 (6% adverse rate differential applied to the 800 portion of deferred tax liability measured at 25%).

Please note, where the asset in question is not depreciated or partially depreciated (e.g. certain investment properties or pubs) the tax accounting considerations can be more complicated, and consideration should be given to the specific circumstances.

Further information

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