SUPER-CHARGING THE SUPER-DEDUCTION

A REPORT FROM THE
INFRASTRUCTURE FORUM

with analyses from

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THE INFRASTRUCTURE FORUM

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Executive Summary

Ahead of the Budget in March 2021, The Infrastructure Forum put forward to HM Treasury some potential tax reliefs for the infrastructure sector that they might wish to consider. In the super-deduction, the Chancellor gave even more than The Infrastructure Forum had proposed, and provided an incentive for investment in plant and machinery of great potential.

The introduction of the super-deduction was widely welcomed by business, and the relief has achieved good progress in encouraging business both to accelerate existing investment and consider new expenditure. Complexities do remain however, particularly in the infrastructure sector, and not all businesses are yet convinced that the benefits of the initiative make it worthwhile to take up.

This report examines the impact of the super-deduction so far, providing examples of where it is being used, its benefits, limitations, and how it might be improved. Four special sections written by tax experts at Deloitte, EY, KPMG and PwC, draw on client case studies, practical experience and expert assessment.

Reflecting on the super-deduction the report identifies some of the key challenges of utilising the relief, which include:

- The super-deduction only applies to capital expenditure incurred between 1 April 2021 and 31 March 2023 for contracts signed on or after 3 March 2021. In the infrastructure sector, plant and machinery spend in the qualifying period will often form part of a larger fit-out or construction project that is already underway at 3 March 2021, or there will often be existing contractual frameworks in place. There is concern that these arrangements could prevent claims for the super-deduction

- One of the biggest problems with the super-deduction is that it only lasts for two years with the enhanced reliefs due to end in April 2023. Larger investments require long lead times. It is expected that some businesses will bring forward investments already under consideration, but this will only change the timing of spend, not the total amount of capital investment.

- The super-deduction is forecast to cost £12.3 billion in 2021/22, rising to £12.7 billion the following year, but dipping to £2.4 billion in 2023/24. The new rates of corporation tax will raise £11.9 billion in 2023/24, rising to £16.25 billion in 2024/25 and to £17.2 billion in 2025/26. For large business, the relief does provide a stimulus to invest, but savings will then be clawed back in the years to come.

- HMRC has not yet published guidance on the super-deduction which is particularly unhelpful, leaving an environment of uncertainty surrounding this relief and a remaining lack of clarity regarding the reliefs rules.

In the report it is suggested that HM Treasury should consider the following options, to relieve remaining concerns and increase the overall benefit of the initiative.

- HM Treasury should consider an extension of the super-deduction window to better reflect the long lead times of infrastructure projects. These Infrastructure projects spend billions in expenditure and bring in huge tax take. An extension of the relief so that it lasts for closer to 5 years, would far

far lessen the challenges of procuring and incurring the expenditure in a short time frame. This would make it far easier for businesses to plan and allow the infrastructure sector to make far greater use of the relief, creating a significant benefit to the UK.

- HM Treasury should consider offering an extended or additional super-deduction, structured specifically to incentivise investment in carbon reducing technologies and infrastructure.

- The super-deduction legislation be updated to provide the option to surrender tax losses arising from the super-deduction for a cash tax credit.

- HMRC should publish detailed guidance on the super-deduction as a matter of urgency.

The challenges discussed in the report do not devalue the relief. The Infrastructure Forum are releasing this report now as we believe that with some adaptations, the infrastructure sector in particular could be a significant beneficiary. This would ensure increased investment into the longer term, incentivising infrastructure providers to invest in new equipment and new projects and helping the UK to achieve its key policy goals of levelling up the UK and achieving net zero by 2050.

Introduction

Until 1878, there were no capital allowances available in the United Kingdom. It was in 1878 that the first example in the 'wear and tear' deduction was introduced. This allowance represented the diminished value of wear and tear during the year. Similarly, a deduction based on annual value became available for expenditure on mills and factories. The deductions gave relief for an amount broadly equal to the actual economic depreciation suffered (1).

Following the Second World War, government looking to reinvigorate the UK economy and assist the reconstruction of British industry after the war passed the Income Tax Act of 1945. This launched a system of capital allowances to encourage business investment.

It was stated "The passage into law of the Income Tax, 1945, fulfils the promise of the late Chancellor of the Exchequer that he would assist the industrial regenerations of this country by amending the law relating to income tax so that industrial and other concerns would be enabled to charge against their taxable receipts the cost of capital expenditure incurred on the installation of new building and plant" (2).

In 1984, Nigel Lawson began a series of tax reforms. He said, "My proposals for reform are guided by two basic principles: first, the need to make changes that will improve our economic performance over the longer term; second, the desire to make life a little simpler for the taxpayer" (3). Corporation tax was cut from 52% to 50% and it was decided that in the future it would fall to 45, 40 and then 35% in successive years. Capital allowances were restructured in three annual stages. In the case of plant and machinery and assets whose allowances were linked with them the first-year allowance was reduced from 100% to 75%, reducing further to 50% the following year. In 1986 there would also be no first-year allowances and all expenditure on plant and machinery would qualify for annual allowances on a 25% reducing balance basis (4).

Other than the phasing out of the first-year allowance from 1984, different arrangements for short life and long-life assets and rules to encourage socially desirable expenditure, the UK corporate tax system did not change significantly until 2008 (5). The 2008 reforms included major changes to capital gains tax, introducing a new single rate of tax set at 18%, and withdrawing 'taper relief', which had been designed to encourage longer-term investment in business assets (6). The changes included the introduction of an Annual Investment Allowance, which was effectively a 100% allowance for business expenditure on plant and machinery (7).

In 2008, the Industrial Buildings Allowance (IBA) was abolished in 2008. IBAs were not perfect, being restricted to particular types of buildings, but the system had the advantage of having been defined and tested over many years. The Infrastructure Forum lobbied on the reintroduction and adaptation of the old IBA legislation for a number of years, as the removal of IBAs meant that there we no tax reliefs for structures and eventually in October 2018, a Structures and Buildings Allowance (SBA) was introduced for qualifying expenditure incurred on or after 29 October 2018

Also in 2018, capital allowances were reviewed by the Office for Tax Simplification. Its conclusions were summarised: 'Replacing capital allowances with depreciation would be a radical change. It could be done but it is not clear that it should be done. The long-term benefits it would deliver would not be enough to make the disruption worthwhile. However, nothing in the review has made the structure of the capital allowance regime seem simple. It is complicated and at times unfair as between different businesses. The only benefit of the way that tax relief is currently given is that it exists already and some people are familiar with it. The capital allowance system should be improved' (8).

Further significant changes were set out in the Finance Act of 2020, including changes to the Structures and Buildings Allowance, an extension of the Annual Investment Allowance and the 100% allowance for ECAs in Enterprise Zones remaining available for expenditure incurred in relation to all designated assisted areas. The Infrastructure Forum's Taxation Working Group was actively involved in the discussions which led to these changes.

Tax policy aligned to future infrastructure delivery models can play a key part in encouraging investment into UK infrastructure, and in helping achieve the broader manifesto and policy goals. Tax relief for capital spend and associated finance costs are priorities in any major project. In order to encourage investment into the UK's infrastructure, it is important that entities incurring expenditure in key infrastructure projects are able to achieve tax relief commensurate with their economic investment, both in terms of amount and timeliness. Certainty and simplicity in tax policy, and the implementation of that policy, when considered in the context of infrastructure decisions can help ensure that, irrespective of the model used to deliver it, the long-term benefits significantly outweigh the immediate costs.

The Infrastructure Forum therefore put forward to HM Treasury some areas to consider ahead of the Budget in March 2021. The suggestions were focused on encouraging capital investment in infrastructure, simplifying the tax treatment associated with commercial financing arrangements, as well as specific suggestions to support policy aims around devolution and a fairer tax system. In particular, it was recommended that a full in-year tax relief on all capital expenditure incurred on qualifying infrastructure would be a powerful incentive for infrastructure investment. Such a relief would ensure that tax relief is given in line with the often significant upfront expenditure on infrastructure projects. This initial idea was developed during conversations with HM Treasury.

In March 2021, the Chancellor of the Exchequer released his 2021 Budget, with one of the more significant announcements being this significant boost to capital allowances.

The government said that since the COVID-19 pandemic, previously low levels of business investment had fallen further, with a reduction of 11.6% between Q3 2019 and Q3 2020. "Making capital allowances more generous works to stimulate business investment, and as a result, these measures can promote economic growth and counter business cycles. The super-deduction will give companies a strong incentive to make additional investments, and to bring planned investments forward" (9).

For expenditure incurred from 1 April 2021 until the end of March 2023, companies can claim 130% capital allowances on qualifying plant and machinery investments. Under the super-deduction, for every pound a company invests, its taxes are cut by up to 25p. This change makes the UK's capital allowance regime more internationally competitive, lifting the net present value of its plant and machinery allowances from 30th in the OECD to 1st (10).

In the super-deduction, the Chancellor's Budget gave even more than The Infrastructure Forum had proposed, and provided a potentially major incentive for investment in plant and machinery.

Tony Danker, Director-General of the Confederation of British Industry noted "The super-deduction should be a real catalyst for firms to greenlight investment decisions. The boldness of the Chancellor on this measure is to be admired". However, "moving Corporation Tax to 25% in one leap will cause a sharp intake of breath for many businesses and sends a worrying signal to those planning to invest in the UK" (11).

Who might utilise the relief?

The super-deduction can be utilised by a wide range of companies. Investment computer equipment; farming equipment, lorries and vans; tools; office chairs and desks; electric vehicle charge points; refrigeration units; and other manufacturing machinery will be covered (12), all of which will benefit infrastructure and manufacturing companies. This is irrespective of business size with SMEs able to benefit from the relief.

There are however exclusions, including equipment that is planned to be leased or rented out as well as structures or buildings themselves (13). Additionally, partnerships including many accountants, lawyers or architects, and sole traders and other businesses not paying corporation tax, cannot claim the relief (14).

Companies must also meet specific compliance requirements. Careful planning and accurate record-keeping are essential for businesses seeking to take advantage of the relief. Assets disposed of before the end of the relief term could generate a higher tax bill (15).

A number of potential beneficiaries of the super-deduction are explored in this section, along with some early signs of take up.

Fibre Rollout – Shortly after Budget 2021, Openreach announced it was accelerating plans to deliver full fibre broadband to the UK. This included bringing direct fibre broadband to 25 million UK premises by 2026, while helping to create 7,000 new engineering jobs. This was thanks to support provided through the super-deduction (16).

Clive Selley, Openreach CEO said: "This is a hugely complex, nationwide engineering project, second only to HS2 in terms of investment - and it needs the full force of government and industry to get the job done. That's why we welcome the Government's support – particularly in the form of the super deduction" (17).

BT are expecting to invest significant amounts of capex in plant and machinery over the next several years, and the super-deduction could result in a significant reduction in their corporation tax bill for its 2021/22 and 2022/23 financial years (18). It has been estimated that the relief could be worth about £500 million to BT, according to Jefferies Bank analysis (19).

Construction – A relatively slow pace of investment in purchasing the latest generation of construction equipment has been attributed to Covid concerns (20). The super-deduction provides manufacturers, infrastructure and construction companies with an incentive to renew factory equipment to meet renewed post-covid demand.

Much construction plant and machinery is hired or leased. The super-deduction will not be available on purchases of equipment to be hired or leased and the expenditure would usually qualify at the normal main pool or special rate pool rates (21). When an operator is provided under a hire or lease agreement, however, the transaction qualifies as a service and HMRC consider that the super-deduction is valid at the time of purchase of equipment to be provided with an operator.

One of the greatest benefits of the super-deduction for construction firms is that it does not affect a company's R&D claim, and companies can claim both. While the super-deduction mechanism bears some similarity to the R&D scheme, the two schemes apply to different cost types and have no effect on one another, meaning a company can benefit from both schemes simultaneously (22).

Construction businesses have expressed concern that the super-deduction's limited life span of two years does not align with many larger projects which take significantly more time to complete.

Fleet and Electric Vehicle Charging – Fleet operators buying vans and trucks benefit from the super-deduction, with new heavy and light commercial vehicles qualifying for the relief.

Company cars are not treated as 'main pool' plant and machinery and therefore are not eligible for first year allowances, and do not qualify for super-deductions although they may benefit from favourable company car tax treatment.

The super-deduction can be applied to electric vehicle workplace charge points, and can also apply to chargers installed at employee homes.

This makes upfront investment in EV charging infrastructure more attractive. When combined with other Government grants and subsidies it gives businesses an incentive to transition their fleet to electric ahead of the 2030 ban on Internal Combustion Engine Vehicles.

The tax situation on investing in EV charging infrastructure is however not straightforward. The availability of a super-deduction can hinge on whether or not the charging point is incorporated into a building. Standalone electrical charging points would be classified as main rate assets, meaning the expenditure can potentially attract the 130% super-deduction. But if the charging point is incorporated in the building, then the situation is more open to interpretation. If it were decided that the expenditure relates to 'integral features', it would qualify only for the lower 50% deduction, with the remainder of the expense being written down at 6% on a reducing balance basis (23).

Logistics – Pandemic-related increases in e-commerce have driven up both the variety and volume of products handled through UK warehouses. With tight labour supply automation becomes of high importance (24). The super-deduction provides an incentive to invest in automation, which can provide significant benefit to customers and to the UK economy.

A wide range of companies of all sizes in retail and distribution are likely to make use of the relief, including Tesco, which has announced it is planning to employ 16,000 permanent workers to staff its expanded online shopping operation. Amazon might utilise the relief to invest across its distribution network and has just acquired a new 2.3m sq ft. distribution centre on the outskirts of London with a likely workforce of over 1,000. Royal Mail plans to spend £500m in the next few years as it shifts towards more parcel deliveries, with a portion of that investment now eligible for a super-deduction (25).

Data Centres – In building data centres the cost of land and buildings is a relatively small proportion of the total cost. It is the plant and machinery required to operate the data centre which is expensive : that is why data centres are typically constructed in phases as more demand is identified (26).

Data centres could be benefit significantly from the super-deduction. Data centre expenditure generally has a very high proportion of plant and machinery expenditure (sometimes up to 90%) and so businesses constructing or refurbishing data centres in the next two years should be able to benefit materially from this relief (27).

Dentistry – The super-deduction can help dental practices to save tax on any new equipment purchases. Dentists already have access to the Annual Investment Allowance, receiving 100% tax deductions for most of their equipment purchases, but the extra 30% super-deduction will help with the purchase of equipment.

Farming – There is potential for farms to utilise the super-deduction. Many farmers were already deferring purchases of new machines last year due to the uncertainties caused by the pandemic and Brexit, but the super-deduction presents an attractive reason to consider buying now.

Rodney Brown, head of agribusiness at Danske Bank, said: "After the year that many industries have experienced, with many sectors on hold for part of the year or operating on reduced capacity, purchasing new plant and machinery to grow their business perhaps hasn't been a priority and might seem like a big step as we start to emerge from lockdown. With new government tax advantages now in place, farmers should consider whether the time is right to start making those investments" (28).

The Central Association for Agricultural Valuers (CAAV) argue that the "tax regime should be neutral between business structures and seeing the economy is crying out for investment to improve productivity and achieve recovery, we do not see why a large part of business, notably but not solely rural and small businesses, and a larger number of businesses are excluded in this way. Investment by LLPs, other partnerships and sole traders is just as wanted and just as valid. The super-deduction capital allowance should be open to all" (29).

The Financial Secretary to the Treasury has noted that the super-deduction has safeguards within the legislation to prevent abuse, including the exclusion of connected party transactions and second-hand assets. The legislation also introduces a new anti-avoidance provision that applies to counteract arrangements which are contrived, abnormal, or lacking a genuine commercial purpose (30).

As highlighted, there is lots of expenditure that can qualify and benefit across a wide range of sectors, but there are broader challenges, especially with the construction and time period for the super-deduction that potentially limit the ability for it to influence decisions in respect of major investments in infrastructure. This is explored further in section three.

Building on the initiative

The potential beneficiaries of the super-deduction are wide and varied. Although, some of the system's characteristics do limit its potential success.

Positively, HM Treasury has already responded to points made by industry representatives across a range of sectors.

There was for example significant concern from commercial landlords that the leasing exclusions in the initial draft legislation also excluded companies from claiming these reliefs on plant and machinery included within a property lease. However, HMT amended the legislation so that the leasing exclusion does not apply to 'background plant and machinery' within a building, which was great news for property investors and corrects what seemed to be a strange exclusion, considering the intention of the policy is to stimulate investment and help kick-start the economy (31).

Nonetheless a number of challenges remain

Corporation Tax Increase – The super-deduction is forecast to cost £12.3 billion in 2021/22, rising to £12.7 billion the following year, but dipping to £2.4 billion in 2023/24.

The new rates of corporation tax will raise £11.9 billion in 2023/24, rising to £16.25 billion in 2024/25 and to £17.2 billion in 2025/26

It has therefore been noted that "in a nutshell, what the Government is saying is 'we'll give you this initial super-deduction as a stimulus, but we'll then claw it back" (32).

British Chambers of Commerce quarterly forecast Q2 2021 forecasts business investment to rebound in 2021 and 2022, driven by the boost from the reopening of the economy and the introduction of the super-deduction incentive. However, business investment is projected to slow sharply in 2023 as the super-deduction incentive ends and corporation tax increases (33).

	2020	2021	2022	2023
Investment	-8.8%	9.0%	5.1%	1.6%
Of which: Business Investment	-10.2%	4.1%	6.8%	1.2%

Table 1: BCC Economics. Quarterly Economic Forecast Q2 2021

Pooling – Related to this and a key issue with super-deduction is that there is no pooling. Usually, if you make a disposal of an asset, things get absorbed within the pool. But with super-deduction, you have to keep your assets separate. The result is that if you sell the asset in 2023, after the corporation tax rise, the claw back will happen with a potential balancing charge at the new 25% rate and you'll end up losing money. For those buying large assets that don't depreciate quickly, this could be a big issue (34).

Framework Agreements – The super-deduction only applies to capital expenditure incurred between 1 April 2021 and 31 March 2023 for contracts signed on or after 3 March 2021. In the infrastructure sector, plant and machinery spend in the qualifying period will often form part of a larger fit-out or construction project that is already underway at 3 March 2021, or there will often be existing contractual frameworks in place. There is concern that these arrangements could prevent claims for the super-deduction.

Infrastructure companies are often engaged in these framework agreements which are contracts used as a multi supplier agreement, establishing a long-term relationship to deliver works as an approved supplier for the buyer, removing the need to go through the tender process each time. There is concern lest these arrangements could inhibit claims for the super-deduction, even where the investment decision, or the requisition of specific plant and machinery, arises after 1 April 2021.

Limited Time Frame – One of the biggest problems with the super-deduction is that it only lasts for two years with the enhanced reliefs due to end in April 2023. Larger investments require long lead times (35). It is expected that some businesses will bring forward investments already under consideration, but this will only change the timing of spend, not the total amount of capital investment.

HMRC – HMRC has not yet published guidance on the super-deduction which is particularly unhelpful, leaving an environment of uncertainty surrounding this relief and a remaining lack of clarity regarding the reliefs rules.

Introduction

Many businesses, based on Deloitte's experience, are actively reviewing their capital expenditure programmes with a view to prioritising and accelerating capital expenditure. From this perspective, the first impressions are that the policy objectives of investment-led recovery set out by the Government, in response to the challenges presented by Covid-19, are having an impact. We do anticipate the super-deductions being used widely by businesses as a lever through which they can manage their tax exposure and also potentially mitigate the increase in corporation tax to 25% in 2023.

However, practical issues in the detailed legislation combined with a lack of certainty arising from HMRC not yet publishing detailed guidance on the super-deductions do need to be addressed.

Matt Smith

Peter Millwood, Partner, Tax

Matt Smith, Partner, Tax

Andy Brook, Partner, Tax

Deloitte

Client Experiences & Analysis

Case Study 1

One particular client is actively looking at their capital expenditure programme as a result of the super-deductions provisions being introduced and will look to accelerate expenditure where possible. However, as the relief is limited to a 2-year window, then procuring and incurring the expenditure in this time frame is a logistical challenge.The client will, on paper, benefit significantly from the super-deduction. However, as they are highly innovative and benefit from the patent box regime, there are questions as to whether the group will be able to fiscally benefit from this relief. From a policy perspective, it would therefore have been helpful if the interaction of reliefs had been built into the incentives.

Case Study 2

We have been working with a major logistics group to consider the application of the qualifying criteria for the super-deduction to a variety of procurement routes and asset acquisitions by the business. We focused on the practical challenges inherent in applying the commencement provisions including a consideration of the extent to which related pre-commencement commitments might taint post-commencement orders. For this group, which acquires large volumes of fixed assets, with multiple suppliers, identifying relevant contracts is not possible for every line item, particularly where no formal contract exists. It was, therefore, necessary to consider the most appropriate methodology for assessing contract commencement across large populations of expenditure of varying types. We also considered the practical challenge of tracking additions and disposals, in particular, to ensure that the relevant disposal rules are applied. This needs careful consideration to ensure that additions are tracked as accurately and efficiently as possible, whilst minimising the administrative burden.

Case Study 3

On behalf of an infrastructure client, Deloitte have consulted with Tax Counsel on a number of 'grey' areas within the rules including:

- The inclusion of installation and transportation costs (and other expenditure on the 'provision' of the plant);
- The application of the pre-commencement contract exclusion to different contract types (e.g. earlier MSA/framework agreements, with orders for specific works/ assets being placed subsequently); and
- The availability of super-deductions in respect of expenditure on software (both third-party adapted proprietary software and internally generated software)

Partner Comments

'The super-deduction is not so much a nice freebie from Government as a reaction to the natural inclination for businesses to shelve their investment plans as tax relief usually comes at the prevailing tax rate and a future increase in the corporation tax rate means more tax relief at that point. That would have conflicted with the Government's plans to kickstart the economy from day one whilst taxing corporates at a roughly 30% higher rate in two years' time.

Furthermore, the initial omission of property lessors from the super-deduction first-year allowances would have also been fairly self-defeating to the Government's aim to draw in investment to critical areas of the economy where large swathes of the real estate are owned not by the operators but by infrastructure investors.'

Peter Millwood, Tax Partner

'The most common feedback from clients from a range of industries is the lack of certainty due to HMRC not publishing guidance. The relief is for a 2-year window with the policy intention to accelerate capital expenditure. To do so, groups require certainty and this means HMRC need to provide further guidance soon on the more nuanced areas of the relief.'

Andy Brook, Tax Partner

Suggestions for Further Development

HMRC guidance - It would be helpful if the lack of certainty arising from HMRC not yet publishing detailed guidance on the super-deductions could be addressed in the short-term.

'Green' investments - There are many opportunities which will lead to significant investment requirements from the infrastructure sector. This includes, but is not limited to, carbon reduction which ties into the Government's net zero strategy. A 2-year super-deduction window is unlikely to be sufficient to incentivise the level of investment required. Noting that the recently withdrawn Enhanced Capital Allowances regime was largely agreed not to be achieving its policy aims, a new relief, or an adaptation of the super deduction, which could be applied to the entire carbon reduction supply chain rather than targeted to specific assets could be transformative in supporting the Government strategy.

Tax credits - These can be valuable as many infrastructure projects are not tax paying in the early years as the technology is established. Currently tax credits are available on R&D but there is limited applicability to capital expenditure; Widening tax credits to a broader range of targeted expenditure could incentivise further expenditure.

Longer term - When we look at the implications of the super-deduction in the context of the infrastructure sector, the fiscal value of the relief is somewhat diminished. The super-deduction is a temporary 2-year relief, however a lot of infrastructure projects are 5-10 years in the planning. Therefore, the temporary nature of the relief can make it difficult for businesses to model and plan. On the other hand, the prolonged period of investment that was announced for freeports, whereby qualifying expenditure will attract a 100% FYA (up to 2026 currently), makes more sense from an infrastructure perspective and we expect pockets of the infrastructure sector to benefit from the freeports announcements.

Interaction with tax losses - Finally, as referred to above, many infrastructure projects are loss making in the early years. Therefore, the super-deduction serves only to increase losses in the early years for businesses to then carry forward against future profits. This is helpful when managing the increase in the corporation tax rate to 25%, however the loss restriction rules mean the losses available cannot always be fully utilised. A future development looking at the use of losses derived from claiming capital allowances could in part address this.

Introduction

There is a long-standing view that capital allowances are a proxy for accounting depreciation, a view which was reinforced recently when the desire to simplify the tax system led to the Office of Tax Simplification (OTS) suggesting the regime should be scrapped in favour of tax allowable accounting depreciation.

However, history has shown that capital allowances have, in fact, been a policy tool of successive Governments to incentivise investment, stimulate certain sectors or regions, or more recently invest in environmentally beneficial equipment; and are much more than a proxy for accounting depreciation.

Graham Wright, Partner, Tax

Katie Selvey-Clinton, Partner, Tax

Building a better working world

Client Experiences & Analysis

Whilst the OTS concluded that abolishing capital allowances was not the right course of action, they did identify that the 'cliff edge' between an asset being considered plant and machinery (and getting tax relief) and the alternative of no relief at all was not helpful for businesses. From October 2018 a structures and buildings allowance (SBAs) was introduced providing a 2% (subsequently increased to 3% in 2020) straight line tax deduction; and going some way to address the policy gap.

In the context of the need to drive a post pandemic recovery through the Governments Net Zero, 'Levelling up', and 'Build Back Better' policies, there is arguably as greater role as ever for capital allowances to play in future policy.

The introduction of the super deduction was widely welcomed by businesses. For businesses that incur large volumes of on-going equipment spend, and those that are contemplating one off capital projects, it has certainly sparked consideration of new and accelerated expenditure to take advantage of the cash tax savings that the super deduction could provide. In response, we are seeing businesses:

- Looking to identify projects that could be accelerated to take advantage of the SD, or new projects for investment

- Examining procurement methods and contracts to consider those projects that are eligible
- Reviewing their software expenditure, and forecast software expenditure, and considering the interaction of the enhanced SD with intangibles and R&D regimes
- Accelerate planned procurement and project activation to take advantage of the two year window
- Reviewing their tax instalment payment profile by modelling the impact of the SD

However, the super deduction does not help all businesses, and arguably doesn't go far enough to drive the role of UK infrastructure in economic recovery:

- Those that are loss making already gain little advantage,
- The cliff edge of what is considered plant and machinery or not comes into sharp focus (130% PMAs versus 3% SBAs). We have seen through the courts recently that the question of 'what is plant' remains unclear and strongly contested in certain circumstances,
- A two year window in the context of a large capital projects is incredibly short. Taking into account procurement times, planning (if applicable) and mobilisation, many businesses will struggle to activate projects in a way that enables them to benefit from the incentive in this time frame. In some circumstances, the policy could actually encourage some businesses to defer their investment.
- The SD itself does little to specifically incentivise those sectors that are at the heart of the Governments Net Zero, 'Levelling up', and 'Build Back Better' policies.

Suggestions for Further Development

In our view, there are a number of options that could be considered to address the above and, in fact, there are precedents for many of the solutions:

- Payable tax credits for surrendering losses created by the SD. The mechanism already existed for the now abolished enhanced capital allowances and the legislation drafting could easily be adapted
- The rate of SBAs is still relatively low at 3%. This could be increased or an initial allowance introduced that would close the disparity between the plant and machinery rate and structures and buildings.
- There are already calls for the two year window of the SD to be extended. It is no coincidence that the current two year period ends when the corporation tax rate increases from 19 to 25% so there will be real cost to the Treasury from such an extension. Any extension would need to be implemented carefully to avoid undermining the current successes of the SD, by creating an incentive for businesses to defer their investment.
- Under the UK's new post-Brexit subsidy control regime, it may be possible that these solutions could be targeted at certain industries (in the same way IBAs was) assuming the policy objective is to encourage investment in certain sectors or regions.

- Any future SD policy could also be combined with complimentary tax policy changes to encourage investment; a temporary removal or increase in the ability to offset losses created by the SD in future periods for example, or the introduction of a payable tax credit as referred to above.

Conclusion

As it stands, the SD is a temporary measure and whilst it is having some short-term influence in investment decisions there is certainly merit in exploring a policy evolution of the concept. At the same time, consideration could be given as to how capital allowances can support and encourage longer term capital investment into the UK. For many years the UK has lagged behind other jurisdictions in the generosity of its 'tax depreciation' system, favouring low corporation tax rates. With the tax rates increasing it is time to consider some more permanent changes.

Introduction

The Budget of 2021 proved to be a landmark event for tax practitioners who specialise in capital allowances with the introduction of the Super-Deduction. The previous decade had been a relatively benign period of the regime with stable rates and only minor tinkering with the rules except for the introduction of the Structures and Buildings Allowances. At a stroke Rishi Sunak's announcement has meant clients have been grappling with their investment plans to see if more value can be created for their business using the Super-Deduction.

Harinder Soor, Partner, Tax

KPMG

Client Experiences & Analysis

The Infrastructure sector, so hugely capital intensive from a tangible assets perspective, is one of the key sectors that the Super-Deduction measure is aimed at. The government want capital investment in plant and equipment to drive economic activity and so the success or otherwise of this measure will be a very important factor in the post pandemic economic outlook.
Based on client conversations the sector is grappling with several specific areas. These are inter alia:

- Entitlement to claim the Super-Deduction.
- The compliance cycle on long term contracts.
- Procurement of long lead plant and equipment.

The rules for claiming the Super-Deduction are complex and require careful consideration. The one area that has hugely impacted the Infrastructure sector is the rules on pre-commencement contracts. The government, very reasonably, included a condition that expenditure resulting from contracts entered into before 3 March 2021 (Budget Day) would not qualify (there are also other criteria that must be satisfied).

The difficulty for the Infrastructure sector is that it is common practice for parties to enter into framework agreements with a suite of suppliers, contractors and professional services providers. These agreements provide a broad legal structure for how the parties may contract at some point in the future: if they do in fact so contract, they will need to agree the final scope including price, programme, and scope of work at a specific site.

The question being asked by the Infrastructure sector is whether a pre-existing framework agreement precludes their claims for the Super-Deduction? As with all tax matters care will be needed to review the documents that form any agreements reached, together with any subsequent and related correspondence, emails, letters of intent etc.

It is critical that this matter is reviewed and documented at the outset to ensure that if a company is subsequently challenged by HMRC to prove its entitlement, it can provide evidence to support any claims for the Super-Deduction.

Self-assessment is at the heart of the tax compliance process and based on conversations with HMRC it is clear that their expectations are that taxpayers will be required to validate any Super-Deduction claims with detailed analysis and supporting documentation. This will be hugely challenging for the Infrastructure sector because:

- The Super-Deduction will only apply to qualifying capital expenditure incurred in a two-year window - between 1 April 2021 and 31 March 2023 inclusive. Given this, an assessment on what expenditure is incurred and what element of that qualifies for the Super-Deduction will have to be made in real time with less opportunity than usual to revisit approximations on the costs and what assets have been supplied and installed, given that claims for Super-Deduction will become out of time.
- HMRC will expect the basis of companies' claims for Super-Deduction to be to be actual expenditure as opposed to estimates. This will be challenging given that it is normal to use initial contract sums and/ or high-level estimates/ assessments.
- Many in the sector 'true up' the capital allowances position once the works are 100% complete and final costs are agreed with the contractors. In the world of Super-Deduction that will be problematic given that project may finish outside of the two-year window and beyond the enquiry window for the relevant accounting periods' tax returns.

All of the above sounds challenging in the Infrastructure sector for a company with only one project but many will have lots of projects on the go at any one time: they will be at different stages of the investment cycle and they will have different profiles of expenditure - some may be all or nearly all plant and machinery whereas others may comprise a mix of plant, structures and non-qualifying elements.

This comes on top of managing the capital allowance process outside the Super-Deduction on capital works commenced or contracted for before 3 March 2021. In short many will have to run parallel compliance processes to cover Super-Deduction and non Super-Deduction. This is likely to put a huge amount of pressure on internal teams, their systems and the data that they use to prepare claims. This point is underscored by HMRC's expectation that taxpayers will adhere fully to the law on self-assessment.

The sector embarks on projects of huge size and scale which often means plant and machinery is being acquired directly from suppliers with a very long lead-in period. The contractual arrangements are such that there is usually a deposit payment, say 20% on confirmation of the order and then stage payments of say, 50% of the contract price during the manufacturing period and then the balance is paid on delivery of the asset at which point legal title passes from the supplier to the purchaser. It is that final point that is most important – one of the central tenets of plant and machinery allowances is that to be entitled to claim you need to a) incur capital expenditure and b) own the asset as a result of incurring it. For the example noted above this basic principle is problematic however in normal circumstances relief is given at section 67 of Capital Allowances Act 2001 ("CAA2001") where the deposit and the payments made before title passes are eligible for allowances when paid provided the payer 'shall or may become' the owner of the plant and machinery on the performance of the contract.

However, this aspect of s67 CAA2001 has been amended in relation to the Super-Deduction. The Super-Deduction instead requires there to be a hire purchase as defined in s1129 Corporation Tax Act 2010. This requires there to be a bailment or in Scotland a hire, i.e. a lease in the eyes of a lawyer. That is not the case for the long-term build contracts referred to above. Parliament is thus allowing standard HP hirers a Super-Deduction when the hired/leased plant is brought into use (s67(3)). In the case of staged payments the intention appears to be to prevent Super-Deduction being claimed until ownership has passed.

Further clarification is being sought from HMRC on a number of other areas of the new rules. The main one impacting the Infrastructure sector is where capital expenditure is incurred in a pre-trading scenario, under a contract entered into on or after 3 March 2021 and the trade commences post 31 March 2023. This is a significant point where companies are investing in new infrastructure assets and the entity is a NewCo or JVCo (or similar).

Conclusion

The introduction of the Super-Deduction was, by far, the standout announcement in this year's Budget – it has now become law and the Infrastructure sector will be required to embrace it for the next couple of years. The challenges noted should not be allowed to dilute the value at stake and whilst the regime's design is not perfect the sector is likely to be a significant beneficiary from this measure.

Introduction

The announcement of the super-deduction as part of March Budget 2021 has been warmly welcomed by both PwC and the vast majority of our clients holding a significant UK fixed asset base. Since the Budget, we have been working alongside those clients (including infrastructure clients) to support them in making informed investment decisions, which factor in the UK tax benefits arising from this new tax relief.

Elisabeth Hunt, PwC's Infrastructure Tax leader, comments:

"The super-deduction announcement has been welcomed as an attractive regime and one which is significantly more generous than the equivalent measures introduced after the GFC. The amounts of relief available have encouraged many of our clients to consider accelerating their investment plans; investing now for future growth and productivity gains.

Going forward consideration must be given to how we can build on this platform to develop a more enduring regime that can sustain the levels of investment needed to meet the challenges of energy transition".

Our discussions with clients since the super-deduction announcement have centred on helping them determine their eligibility for the relief, and also modelling the expected tax benefits. Clients have been understandably keen to get more certainty on whether their projects would qualify for super-deductions, prior to making / accelerating investment decisions. PwC's interactions with HMRC's capital allowances policy team have been helpful in this regard, however the detailed guidance from HMRC, which is typically published alongside new legislation, has yet to be issued at the time of writing. This has presented a particular challenge for our clients, who are looking for HMRC policy to provide detailed guidance and clarification on a number of points.

Notwithstanding this point, a large number of our clients have been eager to take advantage of the enhanced tax relief offered by super-deductions, with some accelerating major capital investment programmes, fulfilling the policy objective of this temporary relief.

Elisabeth Hunt, Partner, Deals Tax, Energy, Utilities & Infrastructure

Philip Sullivan, Director, Deals Tax & Capital Allowances

Darren Barker, Senior Manager, Deals Tax & Capital Allowances

Case Studies & Analysis

Case study 1 - UK grid-scale battery storage developments

Overview - A UK based infrastructure provider is developing a number of grid-scale battery storage projects, adding capacity to smart energy systems in proximity to low carbon energy generation developments.

Super-deduction impact - PwC worked with the client to assess their eligibility for super-deductions against draft / final tax legislation. The expectation is that the projects should qualify for super-deductions, and as a result, the client intends to accelerate the construction timescale on their pipeline of developments, to maximise the investment impact. Without the benefits derived from super-deductions, the projects would likely have been spread over a 4 year period, which is now targeted to reduce to 2 years.

As expected with any new regime / change in legislation, our discussions with infrastructure sector clients have highlighted several recurring points which they are seeking to navigate through in order to determine whether to make a claim. Philip Sullivan of PwC's Innovation and Capital Incentives team comments:

"Our clients have shown huge interest in the new regime. Specifically, in respect of our clients in the real assets space, they have been keen to model whether accelerated tax relief now now outweighs forgoing tax relief when corporation tax relief rises to 25% (from the current position of 19%). Furthermore, our clients have been keen to understand how much additional will be put on them through the tracking of assets for disposal purposes and how to overlay any super deduction claims with existing longstanding agreements with HMRC in the infrastructure and utilities space (e.g. Water UK / HMRC agreement)".

The recent removal of legislative restrictions to claiming super-deduction on background plant and machinery which is 'leased', has been very well received by our clients, particularly in the real assets sector. We have seen lots of examples of the positive impact this change has driven, in terms of further encouraging investment in UK infrastructure projects.

Case study 2 - UK data centre developments

Overview - An international infrastructure investor is in the planning/design phase for a number of data centre developments across Europe. Total capex allocated to the UK projects (including associated fibre optic infrastructure) is into the hundred of millions (£), with future UK investments possible. The anticipated holding structure of the assets involved a number of leases, which would mean the assets were 'leased' for super deduction purposes.

Super-deduction impact - Under the initial draft super-deduction legislation, PwC assessed that the leasing of fixed assets would fail the super-deduction eligibility requirements. Now that the leasing restriction has been largely removed from the final legislation, the Client should be eligible to claim super-deductions on a large proportion of the planned projects. Further, the availability of super-deductions on such projects makes the UK a more attractive jurisdiction from a tax perspective for this Client which, if the regime were to be extended, would positively impact their decision on project capital allocations to the UK.

Suggestions for Further Development

Working collaboratively with our clients, we would welcome additional consideration to be given to the following:

Additional / extended super-deduction incentives for 'green' investments - Since the abolition of the Enhanced Capital Allowances regime in April 2020, there are only a few remaining capital tax incentives geared toward investment in low carbon or other 'green' infrastructure. This leaves an obvious gap between UK Government tax policy and stated commitments in respect of environmental and 'net zero' carbon emissions. Offering extended or additional super-deductions for asset classes such as renewable energy generation, energy storage or electric vehicle charging infrastructure would further attract the necessary investment to allow the UK to meet its environmental objectives.

Extending the initial 2 year super-deduction window - Many of our infrastructure clients have expressed frustration at not being able to accelerate significant investments so as to benefit from super-deductions. This problem arises particularly for the infrastructure sector, given the typically longer project lead times and coupled with the current commencement / cessation provisions of the super-deduction legislation. The 2 year super-deduction window is a limiting factor in achieving the policy objective, and extending the window would realise far greater benefit for the UK from the infrastructure sector.

Option to surrender tax losses for cash tax credit - It has been common practice for most enhanced capital allowances legislation (for example, Enhanced Capital Allowances; Contaminated Land Tax Relief) to give taxpayers the option of surrendering tax losses generated in return for a cash tax credit. This was a valuable option for many of our clients and further incentivised project investment, particularly when taxable profits were not anticipated for a number of years. Adding this option onto the super-deduction legislation would have the same effect of giving the infrastructure sector further commercial rationale to accelerate UK investments.

Conclusions & Recommendations

The introduction of the super-deduction tax break is being, and will continue to be embraced by the infrastructure sector, providing a much-needed boost to UK investment. Complexities do remain however, and not all businesses are convinced that the benefits of the initiative make it worthwhile to take up.

Following The Infrastructure Forum's conversations with a wide range of stakeholders, it is suggested that HM Treasury should consider the following options, to relieve remaining concerns and increase the overall benefit of the initiative.

HMRC guidance – The lack of clear guidance from HMRC has been one of the biggest hindrances to investor confidence in the super-deduction, with further clarification being sought on a number of areas of the reliefs rules.

Recommendation 1: HMRC should publish detailed guidance on the super-deduction as a matter of urgency.

Extending the two year window – There have been many calls, particularly from across the infrastructure sector, for the super-deduction relief to be extended beyond its current two-year window. Many infrastructure projects face particularly long lead times, often taking between 5 and 10 years in planning. The 2-year window therefore means that project leaders are not able to accelerate significant investments.

Achieving the government's net zero target will require significant investment in infrastructure. Again, the short 2-year window for claiming the super-deduction will not do enough to incentivise the required amount of investment. In our conversations it has consistently been noted that there is an obvious need for capital tax incentives aimed at increasing investment in green infrastructure since the Enhanced Capital Allowance (ECA) regime was withdrawn.

Recommendation 2: HM Treasury should consider an extension of the super-deduction window to better reflect the long lead times of infrastructure projects. These Infrastructure projects spend billions in expenditure and bring in huge tax take. An extension of the relief so that it lasts for closer to 5 years, would far lessen the challenges of procuring and incurring the expenditure in a short time frame. This would make it far easier for businesses to plan and allow the infrastructure sector to make far greater use of the relief, creating a significant benefit to the UK. This extension could be specifically targeted at the infrastructure sector, or certain sub-sectors within it.

British Chamber of Commerce predicts that business investment is projected to slow sharply in 2023, in line with the corporation tax increase, and further estimates suggest that the corporation tax increase could create an additional burden of around £22 billion each year for business (33). It is incredibly important that infrastructure providers mitigate their share of this, on which the extended relief would have a significantly beneficial effect. Major projects are a huge catalyst for further investment and maintaining the longevity of investment in infrastructure, and in particular green infrastructure will act as a further enabler for broader investment in the UK beyond 2023.

Recommendation 3: HM Treasury should consider offering an extended or additional super-deduction, structured specifically to incentivise investment in carbon reducing technologies and infrastructure.

Losses – It is commonplace for most Enhanced Capital Allowances legislation to provide an option to surrender tax losses in return for a cash tax credit. This is particularly relevant to incentivising infrastructure investment as infrastructure projects are often loss-making in early years.

Recommendation 4: The super-deduction legislation be updated to provide the option to surrender tax losses arising from the super-deduction for a cash tax credit.

Businesses across a number of sectors are grateful for the announcement of the super-deduction and here is evidence that the relief has accelerated investment programmes. The challenges discussed in this report do not devalue the relief but highlight some of the areas where the relief could be further optimised to deliver investment in UK infrastructure. With some adaptations, the infrastructure sector in particular could be a significant beneficiary. This would ensure increased investment into the longer term, incentivising infrastructure providers to invest in new equipment and new projects and helping the UK to achieve its key policy goals of levelling up the UK and achieving net zero by 2050.

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