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Budget 2021

Capital allowance super-deduction

SPRING 2021 Budget

All companies should consider deferring investments into plant and machinery (which can extend to certain expenditure on buildings) into the period 1 April 2021 to 31 March 2023, following the introduction of a new temporary "super-deduction" initiative and a special first year allowance to boost the economy. Early advice is recommended in order to increase tax relief and maximise cash-flow.

Investment in that period is now expected to provide Corporation Tax relief of 24.7% on the entire cost (uncapped) in the year of the expenditure on many items of plant and machinery. At present, Corporation Tax relief is available at 19% in the year of the expenditure but only up to £1m; where expenditure exceeds £1m, the excess attracts relief but only over a significant period. From 1 April 2023, relief should be available at 25%, but we would only expect this to be relieved over a significant period.

Current position

As a reminder, there is currently an Annual Investment Allowance ("AIA") which relieves 100% of cost in the year of the investment. After this, the main rate of writing down allowance for main rate plant and machinery is 18% a year on a reducing balance basis. The special rate of capital allowances, which applies to certain spending on plant and machinery including integral features, long-life assets, thermal insulation, is 6% a year on a reducing balance basis.

This meant that ordinarily a company spent:

- £1m on main rate plant and machinery it would save 19% in Corporation Tax in the year of the investment; £190,000.
- Over £1m, it would still obtain Corporation Tax relief at 19% but the excess over £1m is written off at 18% per year. That equates to tax relief of just 3.42% (18% writing down allowance x 19%) per year for every £1 in excess of £1m over a significant period of time.

As such, tax relief on expenditure over £1m is generally relieved very slowly at present.

New reliefs from 1 April 2021

The new super-deduction is a 130% first-year allowance which is expected to apply from 1 April 2021 to 31 March 2023 for companies investing in qualifying plant and machinery expenditure which would ordinarily have been relieved at the main rate writing down allowance at 18%.

There is also a new 50% special rate first-year allowance which is expected to provide relief for qualifying expenditure that would ordinarily be relieved at the special rate writing down allowance. There are exclusions to these reliefs, which include expenditure on cars, second-hand assets, connected party transactions (as per existing legislation for first-year allowances) and expenditure on assets for leasing.

The new super-deduction means that where a company spends:

- £1m on main rate plant and machinery from 1 April 2021 to 31 March 2023, we would expect a company to obtain 24.7% of Corporation Tax relief in the year of the investment; £247,000 (or "25p per £1" as the headlines have said). Whilst Rishi said in his Budget speech that the super-deduction reduced a company's "tax bill", this was an error and sadly it has been confirmed that he meant "taxable profits"!
- Over £1m, the same effective rate of Corporation Tax relief (24.7%) continues to apply. We do not expect there to be a limit on the expenditure eligible for the super-deduction.

This should mean expenditure over £1m is more attractive, as the amount and speed of relief is accelerated, hence a cash-flow benefit is expected to be provided to the investor. The relief will not apply to contracts entered into prior to Budget day on 3 March 2021.

Disposals of assets relieved by way of super-deduction are expected to create balancing charges that, broadly, claws back tax relief. The tax rate on this balancing charge could be in excess of the rate of relief obtained initially. For expenditure in an accounting period that straddles 1 April 2023, the rate of the super-deduction is expected to be apportioned.

The new relief may create deferred tax liabilities which could be interpreted, for example, by third parties as an indication that the company is capital intensive. The impact of deferred tax may therefore need to be assessed.

Position from 1 April 2023

From 1 April 2023, the position is more bleak as the super-deduction and AIA are expected to have ceased, and Corporation Tax is expected to be at 25% for most companies.

This means that the Corporation Tax relief in the year of the expenditure on main rate plant and machinery is expected to be 25% overall. Whilst this is a more attractive rate of relief than those detailed above, in practice this relief would be given at an effective rate of just 4.5% (18% writing down allowance x 25%) per year over a significant period of time.

The expected position from 1 April 2023 is therefore likely to make it even more attractive to invest in the period 1 April 2021 to 31 March 2023 but care will be needed on the timing.

Whether the new rules will be extended to 1 April 2023 and beyond, or whether AIA will be extended, remains to be seen. Companies and their advisors will be keen to receive more guidance from HMRC on this.

Reminder

Elements of expenditure on buildings will often qualify for capital allowances. The new rules therefore represent a potentially significant opportunity to boost those allowances. We recommend seeking advice before undertaking any significant capital expenditure, particularly in relation to buildings where the use of a specialist could add significant value