CAPITAL ALLOWANCES – FULL EXPENSING

17 MARCH 2023 ● ARTICLE

UK BUDGET 2023 – INTRODUCTION OF FULL EXPENSING

One of the main tax giveaways in the UK budget this week was the introduction of full expensing of capital allowances for the next three years. This is great news for companies that incur substantial expense on plant and machinery as, in many cases, they should be able to obtain a full corporation tax deduction in the year the expense is incurred.

"The new rules will allow many companies to fully expense their plant and machinery costs and access 50% first-year allowances for special rate expenditure."

Between April 2021 and April 2023, companies have been entitled to a 130% super deduction for main rate expenditure. This was due to end and, without legislative intervention, investment would have been discouraged as companies would have accessed main rate allowances at 18% and special rate allowances at 6%.

The new rules will allow many companies to fully expense their plant and machinery costs and access 50% first-year allowances for special rate expenditure. These deductions, combined with the impending increase in corporation tax, mean it is increasingly important for certain project companies to be tax grouped during capital investment intensive periods so that deductions may be fully utilised.

WHO DOES IT BENEFIT?

“Plant and machinery” is a broad term that includes many capital items from office furniture to windfarms. Therefore, many types of businesses will benefit from the new rules. However, given that the £1m annual investment allowance has been made permanent, the full expensing regime will predominantly benefit large businesses that invest substantial amounts in capital assets. It is therefore particularly beneficial for those establishing energy and infrastructure projects who incur substantial capital expenses.

Expenditure must be incurred by a company within the charge to corporation tax and the plant or machinery must be unused and not second-hand. Companies that buy plant and machinery to lease it are not able to access full expensing (except in cases of certain excluded leases), although they may make use of the (now permanent) £1m annual investment allowance.

"It is therefore particularly beneficial for those establishing energy and infrastructure projects who incur substantial capital expenses at the outset of asaid project."

Companies who use full expensing or access the 50% first year allowances will be subject to immediate balancing charges at disposal value if capital assets are sold (rather than adjustments being made through capital allowances pools). Anti-avoidance rules will apply to non-commercial arrangements.

EXTENDED MEANING OF "PLANT AND MACHINERY"

Those running construction projects will likely be familiar with the *Gunfleet Sands Limited* (2021) First Tier Tax Tribunal decision in which capital allowances were allowed on certain expenditure for studies and project management incurred prior to the construction of the windfarm. Whilst it is established law that capital allowances extend to expenditure ensuring the operation of plant, HMRC had denied deductions on the basis the costs were not directly related to plant. HMRC argued the various costs were incurred for other reasons, such as meeting regulatory requirements. The Tribunal found for the taxpayer (at least in part) and determined that many of the expenses were eligible for capital allowances including studies of the impact on tourism, transport and marine mammals.

"It is more valuable than ever for capital intensive projects to be structured within corporate groups or consortiums alongside companies that are generating profits."

Although Tribunal decisions are not binding precedent, the outcome gives a good indication that if a comprehensive analysis is undertaken to identify costs that have a direct relationship to the construction of plant, that expenditure is likely to be eligible for capital allowances. Such an analysis will be even more valuable from April 2023 with the introduction of full expensing and the increase in corporation tax to 25%.

MAKING USE OF DEDUCTIONS

Full expensing of capital allowances is only useful to the extent there are profits against which deductions can be relieved. Many construction projects have a lengthy lead-in time to the generation of profits which means there is a delay in accessing deductions. Although full expensing would potentially give rise to greater losses in early years, when those losses are carried forward, their use is restricted where group profits exceed £5m. Loss restriction reforms (introduced in 2017), combined with the now impending increase in the rate of corporation tax, make it more important for companies to be able to relieve deductions in the year in which they are incurred.

In practice, this means that it is more valuable than ever for capital intensive projects to be structured within corporate groups or consortiums alongside companies that are generating profits. Such structures accelerate the use of deductions arising from capital expenditure, thereby potentially sheltering group companies from effectively suffering the full impact of corporation tax at 25%.

KEY CONTACTS

CLAIRE MILES
PARTNER • LONDON

T: +44 20 3036 9801

CMiles@wfw.com

DISCLAIMER

Watson Farley & Williams is a sector specialist international law firm with a focus on the energy, infrastructure and transport sectors. With offices in Athens, Bangkok, Dubai, Dusseldorf, Frankfurt, Hamburg, Hanoi, Hong Kong, London, Madrid, Milan, Munich, New York, Paris, Rome, Seoul, Singapore, Sydney and Tokyo our 700+ lawyers work as integrated teams to provide practical, commercially focussed advice to our clients around the world.

All references to 'Watson Farley & Williams', 'WFW' and 'the firm' in this document mean Watson Farley & Williams LLP and/or its affiliated entities. Any reference to a 'partner' means a member of Watson Farley & Williams LLP, or a member, partner, employee or consultant with equivalent standing and qualification in WFW Affiliated Entities. A list of members of Watson Farley & Williams LLP and their professional qualifications is open to inspection on request.

Watson Farley & Williams LLP is a limited liability partnership registered in England and Wales with registered number OC312252. It is authorised and regulated by the Solicitors Regulation Authority and its members are solicitors or registered foreign lawyers.

The information provided in this publication (the "Information") is for general and illustrative purposes only and it is not intended to provide advice whether that advice is financial, legal, accounting, tax or any other type of advice, and should not be relied upon in that regard. While every reasonable effort is made to ensure that the Information provided is accurate at the time of publication, no representation or warranty, express or implied, is made as to the accuracy, timeliness, completeness, validity or currency of the Information and WFW assume no responsibility to you or any third party for the consequences of any errors or omissions. To the maximum extent permitted by law, WFW shall not be liable for indirect or consequential loss or damage, including without limitation any loss or damage whatsoever arising from any use of this publication or the Information.

This publication constitutes attorney advertising.