Representation from the Chartered Institute of Taxation for Finance Bill 2021 Committee Stage

Corporation tax and the super-deduction

Clauses 6 and 7 (Corporation tax charge and rates)
Clause 8 (Rate of diverted profits tax)
Clauses 9 to 14 (Capital allowances: super-deductions etc)

Executive Summary

Clauses 6 and 7 increase the corporation tax rate for larger businesses and introduce a new small profits rate for companies with profits of less than £50,000.

The increase in the corporation tax rate for larger businesses from April 2023 is a big change in direction of government policy, following an acceleration of rate cuts in the last decade and the abolition of the previous small profits rate after 2014. The reintroduction of a small profits rate will obviously be welcomed by those who will benefit from it, but it will add to the complexity of the tax system and misses an opportunity to alleviate the 'three person problem'.

Clause 8 increases the rate of diverted profits tax to ensure that the rate of diverted profits tax will remain 6% above the main rate of corporation tax.

The super-deduction (clauses 9 to 14), alongside a new special rate and other temporary first-year allowances, will be a real incentive for companies to make or accelerate investment. It will make most difference to larger businesses, as smaller ones benefit proportionally more from the existing Annual Investment Allowance. The new allowances will remove a fiscal incentive for larger companies to defer investment until 2023 when the higher rate of corporation tax will apply, in order to attract the corresponding higher rate of relief. There is a case for reviewing the extent of exclusions from the super-deduction.

1 Corporation tax charge and rates (clauses 6 and 7)

1.1 Clause 6 (Charge and main rate for financial years 2022 and 2023) maintains the rate of corporation tax at 19% for the financial year 2022 before increasing it to 25% for the financial year 2023. Each financial year for corporate tax begins on 1 April.

1.2 Clause 7 (Small profits rate chargeable on companies from 1 April 2023) and Schedule 1 introduce a new small profits rate of corporation tax for companies that have profits of less than £50,000 with effect from 1 April 2023, that is to say the date that the main rate of corporation tax increases. The small profits rate of corporation tax is 19%, thus maintaining the current level of corporation tax for the smallest companies.

1.3 The increase in the corporation tax rate for larger businesses from April 2023 is a big change in direction of government policy, following an acceleration of rate cuts in the last decade

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and the abolition of the previous small profits rate after 2014. The reintroduction of a small profits rate will obviously be welcomed by those who will benefit from it, although it will add to the complexity of the tax system and misses an opportunity to alleviate the ‘three person problem’ (see paragraph 2 below).

1.4 The early announcement of the future increase provides some clarity, at least for the next three years, but some longer term indications of rates would be useful, especially considering the increase reverses the previous policy approach.

2 Missed opportunity: ‘three person’ problem

2.1 Reintroducing a ‘small profits rate’ of corporation tax, rather than allowing the increased rate to apply to all companies, misses an opportunity to reduce the imbalance between the tax burdens on employment, self-employment and those operating through a company (referred to as the ‘three person problem’). Few small companies that reinvest profits pay corporation tax because of the availability of the Annual Investment Allowance (AIA), but the rate is likely to be very relevant to those who are distributing profits which might otherwise have been more highly taxed as earnings, or rolling profits up in cash in the hope of even more tax-efficient access to it later.

2.2 Tax rates remain one of the factors motivating businesses to incorporate. A number of changes in recent years have mitigated the tax benefits of incorporation, such as the introduction of the dividend rate in April 2016, the reduction in the dividend allowance to £2,000 in April 2018, and cancellation of the proposed reduction in the corporation tax rate to 17%. But there remains, for some, a clear tax benefit in operating what is broadly the same underlying business, but within a corporate ‘wrapper’.

2.3 Although the upper limit of £50,000 annual profits to the new small profits rate is lower than it was in the past, it will still benefit many of those service providers who might have otherwise remained unincorporated (or might even have operated as employees) but for the fiscal benefits of incorporation.

2.4 We remain of the view that there needs to be a wide, open and very public debate on the tax treatment of different kinds of work structures. A key question is whether the tax and benefits systems should aim for a completely level playing field between employment and self-employment – and if ‘self-employed’ whether within or without a corporate ‘wrapper’ - or whether differentials should be accepted and the focus put on trying to reform and clarify existing distinctions. It is disappointing that this whole area was not addressed in the Budget or on ‘tax consultation day’.

3 Rate of diverted profits tax (clause 8)

3.1 Clause 8 (Increase in the rate of diverted profits tax) increases the rate of diverted profits tax from 25% to 31% from 1 April 2023. This change means that the rate of diverted profits tax will remain 6% above the main rate of corporation tax when the main rate increases in 2023.

3.2 Diverted profits tax is intended to be paid by large multinational enterprises with business activities in the UK who enter into contrived arrangements to divert profits from the UK. This rate change, maintaining the differential between the diverted profits tax rate and the main rate of corporation tax is intended to support the main policy objective of diverted profits tax, which is to discourage use of contrived arrangements that result in the erosion of the UK tax base.

4 Capital allowances: super-deduction etc (clauses 9 to 14) - overview

4.1 Capital allowances are the mechanism by which businesses are able to get tax relief for capital expenditure. This is done by allowing a proportion of the capital expenditure to be expensed against annual pre-tax income. Capital allowances are given for specified items of capital expenditure, and the expensing is usually spread over a period of years.

4.2 Clause 9 (Super-deduction and other temporary first-year allowances) introduces a new 'super-deduction', allowing companies to reduce their taxable profits by 130% of the value of their investment for two years, alongside a new 50% first-year allowance for qualifying special rate assets[1] (SR allowance) and a 100% first-year allowance for expenditure on the provision of plant or machinery used in part for ring fence trades (oil and gas extraction). These new allowances are introduced for the expenditure incurred in the two year period between 1 April 2021 and 31 March 2023. The significance of the 130% number appears to be that expenditure to which it is applied (in a period when the headline tax rate is still 19%) will then effectively be relieved at the 25% tax rate applying after 1 April 2023 (19% x 130% =25%).

4.3 Clause 10 (Further provision about super-deductions etc) sets out the scope of the further provisions in connection with super-deductions in clauses 11 to 14 of the Bill.

4.4 Clause 11 (Reduced super-deduction) sets out the rules for applying a reduced amount of a super-deduction if the expenditure is incurred in a chargeable period that ends after 1 April 2023. The relevant percentage of the super-deduction that a company will be entitled to claim will depend on the time apportionment of the chargeable period straddling 1 April 2023 before and after that date.

4.5 Clause 12 (Disposal of assets where super-deduction made) sets out the rules for what happens when a company disposes of plant or machinery in respect of which a super-deduction allowance has been claimed. Broadly, this clause ensures that disposal receipts are brought back into the tax computation as a balancing charge (and therefore, potentially, taxable profits, instead of being taken to capital allowances pools. The calculation also includes rules that treat only part of the disposal receipt as a balancing charge, if part of the original expenditure is claimed by these temporary allowances, or part is claimed by other capital allowances.

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[1] Special rate assets are those defined as such for purposes of capital allowances. These assets are usually entitled to a lower 6% special rate writing down allowance, as opposed to the 18% main rate writing down allowance. These assets include, for example certain building fixtures or integral features of buildings, such as electrical systems - wiring, lighting, heating or ventilation systems – and long life assets – equipment with an expected business life of 25 years or more

4.6 Clause 13 (Disposal of assets where SR allowance made) sets out the rules for what happens when a company disposes of plant or machinery where a previous 50% first-year allowance has been made, with similar apportionments where other allowances have been claimed in respect of the plant or machinery.

4.7 Clause 14 (Counteraction where arrangements are contrived etc) contains anti-avoidance provisions which apply if a company enters into relevant arrangements which give rise to a tax advantage connected with the super-deduction or SR allowance. For example, this can apply to the claim to the first-year allowance or the avoidance or reduction of a balancing charge on disposal of plant or machinery on which one of these allowances was claimed.

5 Super-deduction and SR allowance – CIOT comments

5.1 The super-deduction, alongside the SR allowance and other temporary first-year allowances, will be a real incentive for companies to make or accelerate investment. It will make most difference to larger businesses, as smaller ones benefit proportionally more from the existing AIA; indeed, the smallest businesses that invest often pay no tax as a result. The Chancellor may have feared that without this new stimulus, larger companies would have had a fiscal incentive to defer investment until 2023 when the higher rate of corporation tax will apply, in order to attract the corresponding higher rate of relief.

5.2 That said, in our view there has been too much tinkering with rules and rates of capital allowances, and frequent changes more often than not bring complexity and uncertainty, and undermine investor understanding of, and confidence in, what is on offer at any one time. These further temporary measures (alongside the extension of a 'temporary' increase in the AIA – legislated for in clause 15 of the Bill) leave unresolved the question of what is the ongoing permanent level of support through the tax system for corporate capital investment. We would welcome an indication of a stable environment post 2023.

5.3 There are some exclusions from the ability to benefit from these new temporary first-year allowances, in particular an exclusion for leasing and for electric cars.

5.4 The exclusion for leasing is a general one that applies in respect of all first-year allowances and applies equally to equipment leasing, and plant or machinery that is leased as part of a property. Thus excluding leasing from the benefit of the new super-deduction and the SR allowance is consistent with this existing policy. We also note that there are some circumstances where a lessee can claim capital allowances (for example under long funding leases and hire purchase contracts) and, in these circumstances, the super-deduction is available to the lessee. We understand that the prohibition from first-year allowances for leased assets is part of the government's wider concerns around opportunities for abuse in these sectors. This policy rationale can be understood in relation to equipment leasing, which is considered to be broadly akin to financing the underlying plant or machinery. Further the plant or machinery is generally moveable, which also gives rise to concerns as to where the equipment is being utilised, as the policy aim is to improve productivity in the UK. However, we suggest that the position of landlords of UK property, particularly in the current climate, is not analogous with equipment lessors. Property landlords are increasingly having to offer capital contributions and incur significant fit-out costs to support tenants. In light of this we think a case can be made for making the exclusion of leasing from the scope of the super-deduction more selective, given the policy purpose to stimulate capital investment at this time of particular economic uncertainty for the country.

5.5 In addition, in many sectors (for example the hospitality sector and the care sector) businesses commonly operate as 'opco/propco' structures[2] and these businesses will be unable to benefit from the new generous first-year allowances on capital costs incurred by the propco (landlord), despite the investment being made in respect of the underlying trading business (and, therefore, contributing to the productivity of the business). There are examples in other areas of the tax code where organisational structures within a group are ignored (for example in the rules relating to substantial shareholding exemption) and the same could have been considered here. We would also note that the built sector is the source of a substantial amount of emissions. Thus, while accepting that this particular policy initiative is aimed at encouraging productivity through tax relief for investment in plant or machinery, an opportunity could also have been taken to reflect the government's overall green agenda by using the capital allowances system to encourage landlords retro-fit properties to reduce emissions.

5.6 We understand that the policy decision to exclude cars (but not commercial vehicles more generally) is consistent with the policy that has always excluded cars from the AIA. This is on the basis that cars have their own capital allowance regime intended to incentivise investment in electric cars, by providing a specific 100% first-year allowance for electric cars (which has also recently been extended to 2025). Whilst accepting this policy distinction for cars, we note that the announced increase in the main rate of corporation tax will likely have different commercial impacts for investment decisions around a company's fleet of cars than for other plant or machinery which will qualify for the new super-deduction.

6 The Chartered Institute of Taxation

6.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

[2] In a typical opco/propco structure, a business is divided into two parts: a 'propco' company that owns real estate assets, that are then operated by another company, the 'opco' that undertakes the underlying operating business. Typically, the opco pays market rent to the propco and operates those assets under the opco business model.

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The Chartered Institute of Taxation
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