Briefing from the Chartered Institute of Taxation
for Finance Bill 2023-24 Committee of the Whole House

Corporate Taxes

Permanent full expensing: clause 1
Research and development: clause 2 and Schedule 1
Pillar Two: clause 21 and Schedule 12

Executive Summary

Clause 1 – Permanent full expensing

The introduction of permanent full expensing is a welcome simplification of the business tax system. However it is not as beneficial as it might at first appear due to limitations such as only applying to expenditure on plant and machinery, and only applying to corporates.

Clause 2 and Schedule 1 – New regime for research and development carried out by companies

We support in principle the concept of a new merged R&D scheme, which would be a simplification to the UK tax code, but that is not what is happening with the current proposals, which will still leave two R&D tax relief schemes in the UK.

We have particular concerns around the treatment of subcontracting within the new merged scheme and suggest some amendments which could provide clarification around this.

Rushing the new merged scheme in will bring problems both for taxpayers and for HMRC. It risks undermining the policy aims of encouraging innovation and growth through R&D investment.

Clause 21 and Schedule 12 – Pillar Two

We are supportive of these changes, which have generally come from consultation with stakeholders. We are not aware of any issues or concerns with them. Nevertheless the new top-up taxes are complicated and will be burdensome. It may be helpful to press the minister during the debate on progress of Pillar One negotiations.

Clause 1: Permanent full expensing etc for expenditure on plant or machinery

1.1 Capital allowances allow certain capital expenditure to be deducted when calculating a business's taxable profits.

1.2 A temporary 'full expensing' regime for capital expenditure on plant or machinery was announced at the Budget in March 2023, and introduced in Finance Act 2023 for expenditure between 1 April 2023 and 31 March 2026.

1.3 Clause 1 makes the temporary full expensing regime permanent.

1.4 Full expensing provides first year allowances which are unlimited for 'main rate' qualifying expenditure on plant and machinery and 50% for qualifying expenditure on special rate assets[1] expenditure. It is intended to provide an increased incentive to invest in plant and machinery through providing higher rates of relief in the period the expenditure is incurred.

1.5 Full expensing is in essence an unlimited annual investment allowance (AIA) for all companies. It is a generous relief for the largest companies whose capital expenditure on plant and machinery is in excess of the limit for the AIA (currently £1m).

1.6 In response to temporary full expensing[2] we said this was a missed opportunity to deliver changes to the UK capital allowances regime that would bring stability to the tax system and a sustainably supportive treatment of business capital investment for business income and corporation tax purposes. The changes to the capital allowances regime in March did not deliver stability for all businesses, missing the opportunity to ensure businesses were confident of consistent levels of relief to help them plan and grow.

1.7 Therefore, we welcome the move to make full expensing permanent. It is our longstanding view that there has been too much tinkering with rules and rates of capital allowances. 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. Making full expensing permanent is a welcome move that enhances simplicity, stability and the incentive to invest in plant and machinery.

1.8 However, full expensing lacks the ability to target incentivisation at particular types of capital investment or business in line with the government's overall policy objectives. Also, it is hard to predict the extent to which it will incentivise investment, not least because of its significant exclusions and limitations.

1.9 The limitations of full expensing include –

- It only applies to expenditure on plant and machinery so will not help businesses that invest in other things – for example, structures and buildings or mineral exploration and extraction.
- Leased assets are excluded, as are various 'special rate assets' such as equipment with an expected business life of 25 years or more (long life assets).
- Most cars are also excluded.
- It only applies to corporates, so it will not benefit partnerships of individuals such as farming partnerships, that may have significant capital investment in equipment such as large dairy facilities, and accounting or law firms that may wish to invest in their IT infrastructure.

[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

[2] Finance (No.2) Bill 2023: Corporate Taxes - CIOT comments

- It is unlikely to be helpful to companies that are loss making in the first few years of a long-term project. This is because claiming the full expensing relief will only increase the amount of losses that will then be restricted in subsequent years as a result of the corporation tax loss restriction rules.

- Full expensing is only relevant to the 1% of companies whose qualifying expenditure on plant and machinery is above £1 million a year. The remaining 99% already get full relief from the AIA so gain no additional benefit from full expensing.

1.10 The exclusions reflect long-standing tax classifications and in some cases concerns about avoidance but not, so far as we are aware, any recently considered view as to national priorities for investment.

1.11 There was a consultation on *Potential Reforms to UK's Capital Allowance Regime*[3] in 2022. We are disappointed that the government has not used the opportunity of this review to decide on their longer-term strategy in relation to business investment and capital allowances. There is still no clarity around what business investment the government wishes to encourage, and the introduction of full expensing, now made permanent, does not illuminate any clear policy aims around what capital expenditure is being incentivised.

1.12 It would be helpful if the minister could set out how the government propose to measure the effectiveness of their investment in full expensing. What will be their measure of success and over what period will it be evaluated?

1.13 Although the Autumn Statement announced that there would be some further consultations in relation to capital allowances, these are limited in scope, focussing only on plant and machinery and not on other capital allowances such as structures and building allowances, nor similar reliefs such as research and development allowances. The government also said that it will continue to consider whether to expand the scope of full expensing to include assets for leasing, and will publish a technical consultation in due course to seek further input. However, the Autumn Statement said that substantive reform of capital allowances and other policy levers outside them are not being considered as part of this process.

1.14 While welcoming the increased certainty and stability from making full expensing permanent, the current position seems to have wasted the opportunity that the review in 2022 offered. There could have been consideration of a broader reform of some aspects of the capital allowances regime, and other tools (for example, some form of 'above the line relief', upfront grants or subsidies for particular types of expenditure and an ability for loss making companies to surrender allowances for a payable tax credit, similar to the SME R&D tax relief scheme). The review also provided an opportunity for the government to ensure that capital allowances are given to assets and expenditure that will help achieve the government's broader policy objectives, such as levelling up, reduction in CO_2 and energy efficiency (net zero), promoting innovation and high tech (high productivity) R&D industries, or improved and Increased house building. This has not happened.

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[3] The consultation document and the CIOT's response to it can be found at [Potential Reforms to UK's Capital Allowance Regime (tax.org.uk)](#)

Clause 2 and Schedule 1: New regime for research and development (R&D) carried out by companies

2.1 R&D relief is a long-standing form of government intervention into economic activity that is supported throughout the business world.

2.2 Clause 2 and Schedule 1 introduce changes to the R&D tax relief for all companies. There is to be a new merged scheme that will replace the existing small or medium sized companies ('SME tax relief'), and the R&D Expenditure Credit ('RDEC'), which is mainly claimed by larger companies. It also legislates for the new additional relief for R&D intensive SMEs that was announced at Budget in March 2023. This additional relief scheme will be based on the existing SME tax relief.

2.3 We support in principle the concept of a new merged scheme, which would be a simplification to the UK tax code, but that is not what is happening with the current proposals. Although the new merged scheme in this Bill does provide some simplification, the fact remains that, because of the way that the additional relief for R&D intensive SMEs will be provided, there will still be two R&D tax relief schemes in the UK. It is less a merger than the shifting of most SMEs into a revised scheme based on an 'RDEC' approach, with the SME scheme remaining for a smaller group of R&D intensive SMEs. Pushing back the implementation date (see below) might have enabled special provision for R&D intensive SMEs to be incorporated into the new scheme, resulting in a truly simpler system.

2.4 We have particular concerns around the treatment of subcontracting within the new merged scheme. The rules that will deal with subcontracting in the new scheme are changed from the current RDEC rules, and are largely based on the rules within the current SME scheme. Introducing subcontracting rules (an area which has a high level of uncertainty and is a current area of contention in the SME regime) across the whole R&D regime risks exacerbating the uncertainty.

2.5 We have concerns that introducing the SME subcontracting rules into the RDEC regime will mean that the government will not achieve the policy aims of increasing UK R&D and the numbers of associated high tech jobs. Many of our most innovative companies, from small start ups to large multinational companies, provide services and products to others and will no longer receive a direct incentive to support the R&D they undertake. This will impact on investment decisions to undertake R&D in the UK.

2.6 However, we also appreciate that there are different viewpoints from different types of businesses. This is why there needs to be more open discussion about the implications of the proposed merged scheme in order to minimise unintended consequences. From a policy perspective, it is important that the implications of the new scheme for the overall R&D spend by UK companies, and which companies will be able to claim the reliefs, is fully understood. This is why more time should have been allowed before the introduction of the new merged scheme (see below).

Timescale for introduction of changes

2.7 At the Autumn Statement the Chancellor confirmed that the government would be going ahead with the merged scheme for R&D from April 2024. This was not unexpected, but was disappointing. This decision was made in the face of representations by the CIOT and other

representative bodies, business groups, advisory firms and businesses, in favour of delaying the merged scheme to allow time for businesses to get to grips with the proposed changes, and, importantly, to iron out complexities and remaining uncertainties within the draft legislation.

2.8 The short timescale means the policy implications of some aspects of the scheme have not been properly scrutinised. Rushing the new merged scheme through will bring problems both for taxpayers and for HMRC. It risks undermining the policy aims of encouraging innovation and growth through R&D investment.

2.9 The start date for the new merged scheme is also too soon from a practical perspective, with companies having had little time to consider the new rules, and the detail of what will be required. The change in commencement date from 'expenditure incurred on or after 1 April 2024' to 'accounting periods starting on or after 1 April 2024' announced at the Autumn Statement is a welcome change but probably not enough. This change means that some companies, particularly larger companies with a calendar year accounting date, will have longer to prepare for the rules. It also makes more sense technically to bring the change to the rules for R&D relief in on an accounting period basis, because it avoids the need for complicated transitional calculations for companies. However, the change to the subcontracting rules also means that this approach potentially means that tax relief may be available twice on the same expenditure (see paragraphs 2.14 to 2.16 below).

2.10 In addition, the rushed introduction is unfair, giving some companies considerably longer than others to get to grips with the new rules. This would be less an issue if everyone had enough time to prepare, that is to say if the new scheme was delayed by a year, it would not matter so much that it would come in at slightly different times for different businesses.

Suggested amendment to the legislation regarding timing

2.11 There is no commencement date in Schedule 1 to the Finance Bill (other than in respect of the provisions dealing with assignments etc). Instead this refers to an 'appointed day' to be determined by Regulations. This opens up the possibility that the Regulations may specify an appointed day later than 1 April 2024. We understand that commencement has been dealt with in this way to allow for a fall back position if circumstances arise where it might not be possible to begin from 1 April – for example, IT availability or any delay to Royal Assent. However, dealing with the commencement in this way also means continued uncertainty for businesses.

2.12 We suggest that a delay should be confirmed in order to provide government and businesses with more time to prepare and understand the rules, and to ensure certainty.

Given the mechanism of using regulations, we suggest paragraph 16(2) of Schedule 1 is amended to read: 'In this Part, the "appointed day" is a day appointed by the Treasury in regulations, but shall not be before 1 April [2025]'.

2.13 The amendment would read –

Schedule 1, page 63, line 17, at end insert – 'but shall not be before 1 April 2025'

Explanatory statement – This amendment ensures the merger of the R&D scheme does not take effect until the 2025-26 financial year

Subcontracting - transition to the new rules

2.14 As noted above, the change in commencement date from 'expenditure incurred on or after 1 April 2024' to 'accounting periods starting on or after 1 April 2024' is welcome in terms of providing some more time for some businesses to prepare. Also, to a large extent it will make it easier for companies to change to the new rules for a new accounting period, rather than part way through one.

2.15 However, the staggered commencement causes a different issue as a result of the changes to the rules for subcontracting. The Finance Bill is unclear as to what happens where a company and the contractor have different/non-coterminous accounting periods which start either side of 1 April 2024 (the transitional period). As drafted, the legislation potentially allows both parties to make a valid R&D claim in the transitional period on the same costs. This arises as a result of two different companies that are party to a contract applying two different sets of rules to the same contract at the same time.

2.16 We suggest that some transitional provisions are required to prevent this. For example, the legislation could be amended so that it is clear that the principal can only include the subcontracted expenditure in its new RDEC claim where it applies to expenditure brought into account for an accounting period of the subcontractor which began on or after 1 April 2024. Taking additional time to put such provisions in place can also be seen as another argument for delaying the implementation of this measure from April 2024.

Subcontracting of R&D

2.17 We note above our concerns around the policy implications of adopting an approach to subcontracting along the lines of the SME rules. But having made the decision to adopt this approach, it is important to ensure that the rules defining subcontracted R&D are clear and unambiguous for taxpayers and for HMRC. The rules in the Finance Bill, as currently drafted, do not achieve this. The definition of contracted out R&D, which is in a new section 1133 to Corporate Tax Act 2009, is too subjective and vague. It will not provide clarity.

2.18 There is useful commentary in the Technical Note published with the Autumn Statement[4] around what is intended to be contracted out R&D, but the new section 1133 seems to contradict these policy intentions. In particular, the Technical Note says that 'it is important that the company making the decision to do the R&D and bearing the risk gets the relief.' We agree with this, and it seems clear from the Technical Note that which party should be able to make an R&D claim depends on who makes the decision or initiates the R&D activities.

2.19 However, the legislation itself is unclear: it is unclear how this decision maker will be identified. In particular, it is unclear who can claim R&D relief where a company contracts with another to provide a product/services that require development, and the 'customer' company is aware of the need for development in general/it is included in the contract, but

[4] Technical note on changes to research and development tax reliefs at Autumn Statement 2023 - GOV.UK (www.gov.uk)

they have limited/no knowledge of the R&D required to undertake the development because it is the supplier's responsibility.

2.20 The word 'contemplated' in the new section 1133(2)(c) is particularly difficult and too wide. For example, if a principal contracts a service and they are completely unconcerned as to whether R&D is needed, but the person they contract to tells them that R&D will be needed (perhaps to explain why the price will be so high), does the principal then contemplate that R&D will be undertaken? As currently drafted, the legislation is too imprecise to determine such marginal cases. How will HMRC be able to assert that something is 'contemplated' and how will the fact that it has not been be evidenced by taxpayer companies? It is difficult to prove a negative.

Suggested amendments to the legislation regarding subcontracting

2.21 More specifically, we suggest a number of amendments should be made to the draft legislation to provide more certainty.

Amendment 1

2.22 In section 1133(2)(a) the words 'a contract under which activities are to be undertaken for it' (emphasis added) are not very clear. If Company A contracts with Company B for Company B to sell a machine to Company A, does that mean Company B is undertaking activities for Company A? Does that change if Company B has to build the machine specifically for Company A first? The position may be clearer if the word "for" was deleted and replaced with "on behalf of".

2.23 The amendment would read –

Schedule 1, page 54, line 15, leave out 'for' and insert 'on behalf of'

Explanatory statement – This amendment would clarify the circumstances in which a person contracts out R&D

Amendment 2

2.24 Section 1133(2)(b) should be saying that the R&D activities are required by the contract. The current words "in order to meet the obligations" brings into scope R&D relating to the development of a product when the contract is for the supply of the product. This scenario is explicitly excluded from what is intended to be contracted out in the Technical Note.

2.25 The amendment would read –

Schedule 1, page 54, line 18, leave out 'undertaken in order to meet the obligations owed to the person under' and insert 'required by'

Explanatory statement – This amendment would clarify the circumstances in which a person contracts out R&D, in particular to exclude R&D relating to the development of a product when the contract is for the supply of the product

2.26 In section 1133(2)(c) a consequential amendment would also be required to remove the reference to the obligations, as the reference to these in section 1133(2)(b) would be deleted by Amendment 2 above.

2.27 The amendment would read –

> **Schedule 1, page 54, line 25, leave out 'undertaken in order to meet those obligations' and insert 'required'**

Explanatory statement – This amendment is a consequential change because of amendment 2 above.

Amendment 3

2.28 In section 1133(2)(c) the words "or contemplated" should be removed, as this is far too vague a term.

2.29 The amendment would read –

> ***Schedule 1, page 54, line 23, leave out 'or contemplated'***

Explanatory statement – This amendment would clarify the circumstances in which a person contracts out R&D

Amendment 4

2.30 The legislation should ideally include something around the fact that the contracting company must have a valid R&D project, to which the work contracted out forms part, as confirmed in the Technical Note.

Clause 21 and Schedule 12: Pillar Two

3.1 In October 2021 more than 135 countries in the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) agreed a two-pillar solution to reform international tax to deal with the challenges arising from the digitalisation of the global economy, aiming to ensure that multinational enterprises (MNEs) pay a fair share of tax wherever they operate and generate profits.

'Pillar 1' involves a partial reallocation of taxing rights over the profits of MNEs to the jurisdictions where consumers are located. The detailed rules that will deliver this are still under development by the Inclusive Framework.

'Pillar 2' intends to ensure that MNEs pay a minimum rate of 15 per cent corporation tax (or their version of it) in every country they operate in.

3.2 The multinational top-up tax and domestic top-up tax were introduced by Finance Act 2023 of the Finance Bill as the first tranche of implementation by the UK of the agreed G20-OECD Pillar 2 framework. It was envisaged that additional law and significant additional guidance will be required to supplement this tranche as negotiations were, and are still, continuing at the OECD on many technical and interpretive issues (the "Implementation Framework"), as

well as mechanisms for qualifying each country's implementation for the purpose of other implementing countries' rules.

3.3 The principle behind the Pillar 2 rules is that where a group company in jurisdiction A has paid less than 15% tax on its profits, then jurisdiction B where there is another group company, higher up the ownership chain in the corporate structure, is expected to impose a 'top-up tax'.

3.4 The Inclusive Framework published model legislation for the Pillar 2 Global Anti-Base Erosion (GloBE) rules in December 2021. The Inclusive Framework has subsequently published Commentary, which provided further technical guidance on the rules, in March 2022, and Administrative Guidance in February 2023. Throughout the process of implementing the rules in the UK, the government's approach has been to follow the Model Rules. We understand that the rationale for this is to ensure, so far as possible, the principle of consistency across the globe in respect of the GloBE rules.

3.5 Clause 21 of and Schedule 12 to the Finance Bill make changes to the multinational top-up tax and domestic top-up tax introduced in F(No.2)A 2023, to ensure that these new taxes work as intended and comply with the GloBE rules, commentary and administrative guidance agreed and issued by the Inclusive Framework. The amendments are those identified from stakeholder consultations. For example, the changes relating to securitisation companies and covered bond LLPs have been made in response to lobbying from UK Finance and the securitisation sector and provide the changes that were requested. Discussions with HMT and HMRC have been taking place for several months.

3.6 There has been positive engagement and consultation with HMRC in order to ensure the UK's legislation works as intended and is up to date with OECD commentary etc. HMT/HMRC have worked hard to ensure that this is the case and we are supportive of these changes – we are not aware of any issues or concerns. It is important and welcome that the UK's legislation aligns with the agreed OECD position. As the OECD guidance etc is coming out in tranches, this is not the last time that changes to the legislation will have to be made to ensure the UK stays up to date. In fact, the OECD published the third set of Pillar 2 Administrative Guidance on 18 December 2023 and we understand that it is the UK's intention that this latest guidance will be reflected in our legislation in due course.

3.7 However, while we recognise and support the government's efforts to ensure the UK legislation is up to date and aligned with the international rules, it must be remembered that work is against the background of the overriding fact that the new top-up taxes are very complicated and will be burdensome.

3.8 We also note that the draft legislation that will implement the undertaxed payment rule (UTPR) – the backstop for Pillar 2 - is <u>not</u> in the Finance Bill, although this has been consulted on. However, we support this position, as it gives the UK maximum flexibility around the introduction of the UTPR and an opportunity to more easily amend the draft legislation if circumstances change. The UTPR is not intended to come into force until 2025 in any event. Thus it is good that this legislation is ready to go and has been consulted upon, but we support that it is not yet being brought onto the statute books.

3.9 It may be helpful to press the minister during the debate on progress of Pillar 1 negotiations. Despite the publication of a draft multinational convention that will be required to

implement Pillar 1, there remains significant doubt that agreement between all major economies will be reached.

The Chartered Institute of Taxation

4.1 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.

4.2 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.

4.3 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.

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The Chartered Institute of Taxation
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