The Infrastructure Forum

TAXATION WORKING GROUP

CA CONSULTATION SUBMISSION

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INTRODUCTION

1. The Infrastructure Forum ("TIF") bring together the key players in infrastructure, whether investors, operators, contractors, economic regulators or professional advisors. It has become the meeting place for confidential and constructive discussion about ways to promote the development of infrastructure networks in the UK and to broaden the range of options available to policymakers and regulators.

2. The expertise of its team, the knowledge and experience of its specialised working groups, and its excellent trusted relationships with public authorities and agencies in the UK and internationally all contribute to its effectiveness.

3. The Tax working group of the Infrastructure Forum has engaged with H M Treasury and with HMRC at a policy level for a number of years, proactively and constructively contributing to the development and structure of key tax policies under the BEPS initiative such as the Corporate Interest Restriction and Hybrid legislation, the introduction of Structure and Buildings Allowances, Freeports, and the Super-deduction.

Investment in Infrastructure

4. Capital allowances, and incentives such as the 'super-deduction', remain highly relevant in supporting the role of infrastructure in the UK as a catalyst for growth, as a lever to provide support for training and employment opportunities, and to encourage investment; particularly important to the UKs commitment to energy transition and the journey to Net Zero. TIF explored in its report 'Super-charging the Super-deduction', which can be found **here**, measures to extend the super-deduction to allow Qualifying Infrastructure Companies to utilise the relief, and for the Government to consider an additional or further extended super-deduction incentives for 'green' investments.

5. The scale of investment needed to achieve net-zero targets whilst upgrading and, where appropriate, digitalising energy, transport, communications and water infrastructure is massive. The same can be said for the investment that will be needed to drive investment on the demand side for a transition, away from fossil fuels. It will need significant domestic and international private sector investment and for this to be

forthcoming on the scale required the UK taxation system, as well as its economic regulation models, will need careful (re)design. Innovative decisions now should be more than repaid through the opportunity for training and job creation that such investment will bring.

6. As set out at Spring Statement, the government acknowledges that the generosity of the permanent system of capital allowances compares unfavourably to international peers and wants to know what more the capital allowances regime can do to support business investment.

7. We welcome the opportunity to comment on the potential reforms to UK's capital allowances regime set out in the policy paper published by HM Treasury on 9 May 2022. In recent meetings and submissions to H M Treasury, the Taxation Working Group has considered the question of whether we need to go much further than the current 'tinkering' with existing legislation to support a Green Revolution in the UK. Whilst the impending end to the super-deduction creates a more immediate need to address changes to the capital allowance regime, we strongly recommend that this current consultation is used to drive a broader discussion that supports the ambition of the Tax Plan.

EXECUTIVE SUMMARY

8. Whilst the focus of the consultation is narrow, in that it looks solely on the role of capital allowances for plant and machinery, and the need for reform when the super-deduction ends in 2023, many of the comments below recognise that the question of what incentivises investment into the infrastructure sector goes far beyond tax relief for plant and machinery. In fact, in many cases, certainty that plant and machinery allowances will be available at all, or the extent of any such allowances, is perhaps one of the more pertinent challenges to investment in UK infrastructure.

9. Infrastructure operators and developers are primarily looking for certainty and simplicity. This can be best achieved by creating stability in the tax system, addressing the cliff-edge effect created by the uncertainty of the rate at which capital allowances will be available (or not), and by simplifying the practical application of the rules. Simplicity & certainty also allows investors to factor tax benefits into investment decisions, which they will not do if they are too difficult to claim or too long term.

10. The current capital allowance regime primarily incentivises capital investment by providing relief after the expenditure has been incurred, over a significant time period, and only in an entity with operating activity. Greater incentivisation might be achieved by providing the option for an upfront cash credit rather than subsequent tax relief.

11. Most larger infrastructure investments take many years of planning and development and even the smaller projects can be at least two to five years in development and often have construction and operating periods of over 20 years. Capital allowances can only be factored into those projects to the extent there is certainty as to how those allowances will operate over a period of at least that length.

12. Businesses considering whether to invest in infrastructure or projects in the UK, as opposed to another territory, will consider a much wider range of factors than just tax incentives. Incentivising the demand for new infrastructure, such as hydrogen and CCUS, is equally important as incentivising the infrastructure investment itself and our tax regime and capital allowances has a specific role to play.

13. Many infrastructure investments are assessed on a discounted cash flow basis and an acceleration of tax relief will not provide additional incentive unless that acceleration can be monetised in the short-term, and relied on with a high degree of certainty. Where there is uncertainty, this typically results in developers being prudent in their tax assumptions (which can impact the estimated returns and overall viability of the project thereon).
14. Capital allowance incentives in their broadest application, including the examples in the Spring Statement, provide no specific incentive that aligns tax relief to investment in priority areas of policy such as decarbonisation and sustainability. Leveraging other areas of UK legislation, such as the Qualifying Infrastructure Company definitions in the Corporate Interest Restriction rules, would allow for targeted incentives for future investment.
15. Whilst a longer term First Year Allowance, or Additional First Year Allowance, will provide some incentive for investment, if the government wishes to incentivise capital investment, it would be most effective if incentives were focused on particular types of expenditure, industry sectors or geographical areas, and delivered in a way that is practically simple and certain to claim.

INVESTMENT DECISIONS

16. Infrastructure businesses, like any other, need stability and certainty to manage their operations and plan for the future in an efficient manner. The long-term capital-intensive nature of infrastructure investment creates additional uncertainty. The lack of such certainty inevitably leads to additional cost as risks become priced into decisions made about future positions. The corollary is also true that risk around the availability of future incentives often means that the upside can't be properly factored in to modelling and becomes far less likely to influence decision making around an investment, seemingly defeating the core purpose behind the measure.

17. The current super-deduction, whilst a generous measure in concept, was compromised in its aim of incentivising infrastructure businesses to make decisions around increasing capital expenditure in the short term. This was in large part owing to the two-year window of availability, without any meaningful pre-warning, meaning for many businesses there was limited opportunity to accelerate or begin new capital projects to benefit from the enhanced tax relief. The complexity of applying the rules in practice is also a factor. For businesses focused on providing infrastructure assets, given the usually very long development and procurement times involved, the starkness of this point is perhaps amongst the greatest among business sectors. Whilst the measure may have provided a window of opportunity for some businesses, our sense is that for many it may only have provided a limited tax upside and one which may not have influenced already planned investment in any event.

18. As mentioned above, businesses that create and provide assets within the infrastructure sector are commonly involved in projects with very long lead-in times, often up to 5 years and beyond in some cases from concept design and securing funding to the ultimate delivery of the assets themselves. Many infrastructure investments are assessed on the basis of free cash flow that is available to return to investor and so cash tax profile is also important. Infrastructure investments are often funded over long construction and operating periods, in many cases 20-30 years or more.

19. Incentives that are available only for those in a tax-paying position, or only in a tax paying position a long time into the project lifecycle, often don't benefit such businesses

greatly either. That is for two possible reasons: significant capital expenditure may be incurred over many years before a business starts to trade, or commence a qualifying activity, and therefore unable to avail themselves of tax relief until that point and owing to the nature of the investments, the early years may well be heavily loss-making ones anyway. A tax credit regime, perhaps as a sacrificial alternative to future tax relief, could act as a real incentive and provide some help towards the initial funding costs of bringing infrastructure to life. Similar tax credit alternatives to accelerated and additional tax relief provisions have been in place to encourage businesses to remediate contaminated and bring derelict land back in to use for over twenty years and were also available to motivate businesses to invest in energy efficient technologies via the Enhanced Capital Allowances provisions.

20. A similar scheme could help influence behaviours in the infrastructure sector in a way that tax-relief measures alone might not.

IMPACT OF SUPER-DEDUCTION

21. As noted above, TIF explored in its report ‘Super-charging the Super-deduction’ measures to extend the super-deduction to allow Qualifying Infrastructure Companies to utilise the relief, and for the Government to consider an additional or further extended super-deduction incentives for ‘green’ investments.

EXISTING CA SYSTEM

22. 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.

23. However, history shows that capital allowances have, in fact, been a policy tool of successive Government 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.

24. 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. This went some way to address the policy gap but has not completely addressed the issue for many infrastructure projects, where inherent uncertainty still remains regarding the tax-classification of capital expenditure (in particular the distinction between short-life and long-life assets).

25. In the context of the need to drive a post pandemic recovery through the Governments Net Zero, ‘Levelling up’, and ‘Build Back Better’ policies, and to develop a more sustainable base to incentivise capital investment in the UK, there is arguably as greater role as ever for capital allowances, and initiatives such as the super-deduction, to play in future policy.

26. In the context of capital allowances, it is important to draw distinction between (i) the everyday business that the government would like to see investing in energy efficient

assets and in capital projects more generally; and (ii) those businesses/investors who actually fund and develop the associated infrastructure and technology.

27. Tax policy should seek to ‘reward’ green or energy-efficient investment by the general population, however, the scale of this activity will always be slow/limited if we don’t further incentivise those businesses that develop the related infrastructure/technology (e.g. EV charging points, battery storage, wind and solar farms, hydrogen production, and carbon capture) to ensure that technology becomes more affordable and readily available in the first place. In addition, if the dual incentives work as planned, additional investment in one creates or accelerates further investment in the other.

28. The crux of the issue was captured in the speech from Rishi Sunak during the annual Mais lecture at Bayes Business School on Thursday 24 February 2022;

“An analysis of the Net Present Values of different countries’ tax treatment of long-lived capital assets like plant and machinery shows that despite the UK’s highly competitive headline corporation tax rates, the overall tax treatment provided for capital investment is much less generous than the OECD average. It is unclear that cutting the headline corporation tax rate did lead to a step change in business investment; we need our future tax policy to be targeted and strategic.

So, as I develop a business tax strategy for the years ahead, it seems likely to me that a priority will be to cut taxes on business investment.”

SPRING STATEMENT PROPOSALS

29. All of the examples put forward in the Spring Statement suggest a level of refinement of the existing rates or profile of tax relief available under the Capital Allowance regime. ‘Tweaking’ the existing capital allowances regime in this way, whilst more appropriate for general application to businesses in the UK, is unlikely to truly incentivise investment in the UKs infrastructure or lead to a cut in taxes on business investment in the sector. A more bold/transformative policy is required to truly incentivise the scale of investment that s required in the UKs infrastructure sector, and one that goes beyond capital allowance rates.

30. None of the examples identified will necessarily help with the fundamental point of certainty and simplicity.

Increase annual investment allowance

31. An increase in the permanent level of AIA is potentially helpful re certainty, but would primarily target smaller businesses. Whilst the previous Annual Investment Allowance threshold of £1 million is understood to have applied to approximately 25% of Annual Investment Allowance eligible plant and machinery expenditure, in the infrastructure sectors, the impact is negligible.

32. **An increased allowance, provided on an entity basis rather than being available to each group, which could also increase depending on the level of expenditure or scale of the project, coupled with the ideas below to provide and electable cash credit for allowances that result in an increase in tax losses would have the potential to incentivise investment certain areas of the UK’s infrastructure.**

Increase writing down allowances

33. Whilst any additional tax relief in the form of increased WDA is welcome, and would benefit all businesses, it is not felt that this will promote additional investment or accelerate investment plans unless such changes were significant. **A more material increase in WDAs could be considered for targeted investment.**

34. **Enabling companies that are incurring significant capital expenditure before the business starts to trade to further optimise or monetise those allowances to more closely align with the economic cost of construction could provide greater incentive for investment. For example:**

    - **Creating the opportunity to carry forward unused allowance over a, say, 5 year rolling period which can be used as "free depreciation"; and / or**
    - **enabling companies that are incurring significant capital expenditure before a business starts to trade to claim allowances and surrender that relief for a tax credit could provide incentive for smaller infrastructure projects, or those delivered through SPV structures.**

First-year allowances

35. Again, whilst an acceleration of tax relief is welcome, and will likely incentivise some investment, Introducing a First Year Allowance (FYA) for main and special rate assets where businesses can deduct, for example, 40% and 13% in the first year, with the remaining expenditure written down at standard Writing Down Allowances may add a layer of complexity to the UK's capital allowances regime without providing any material incentive for investment. Generally speaking, **the earlier that the financial benefit of an allowance is received, the more of an incentive it provides to incur the related expenditure.** The level of incentive for the entity delivering the infrastructure project / investment will largely depend on its ability to monetise the benefit of the FYA, and any underlying uncertainty as to its application and availability.

36. **Aligned with an electable tax credit within the regime, similar to Land Remediation Relief ('LRR') credit or Enhanced Capital Allowance ('ECA') credit, which provides a specific percentage credit for the value of a loss generated though capital allowances, targeted FYAs for specific types of expenditure or locations could help to achieve other policy objectives around net zero, levelling up and innovation.**

37. **Such a combination could be a welcome extension to support the development of infrastructure projects which are often loss making in the early stages; at a time when financing and cash flow is most critical.**

38. **Removing the cliff edge that remains between the rates at which relief is available on plant and machinery, long life assets / integral features, and structures & buildings could also provide incentive for investment. Structured appropriately, an electable standard rate of WDAs for expenditure on non-land assets, for example, could provide an alternative WDA that provides simplicity and certainty for long term investment.**

Additional FYA

39. Providing relief for an amount in excess of the actual amount of expenditure could provide incentive but, as mentioned above, it is the often the timing of allowances or the ability to monetise the benefit that is asimportant as the amount; especially in the context of long term infrastructure investment. **In some cases, a 100% up-front allowance may provide more incentive than a 120% allowance spread over a number of years.**

40. **Many of the observations from the implementation of the super-deduction would be relevant in designing an additional FYA that can influence investment behaviour. Like the super-deduction, the benefit of year 1 relief would only be only helpful if there are sufficient profits to offset, or if it were linked to a tax credit mechanism.**

41. **In a previous submission, the Infrastructure Forum called for an extension of the super-deduction to at least 10 years from its 2021 creation and a simplification of its application. At the time, the super-deduction was widely praised and a big statement from the Government at a time when businesses needed a boost. Ending the relief before the projects that the Government needs to get built have had the chance to utilise it would thoroughly devalue the success of the policy.**

Full expensing

42. **Full, in year tax relief on all capital expenditure incurred on qualifying infrastructure could 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.** However, many of the inherent limitations referred to above in relation to FYA would apply to full expensing. **The behavioural impact of allowing a business to write off the costs of qualifying investment in one go will depend on when the infrastructure business is able to monetise the benefit of the relief, and hence the importance of a tax credit mechanism.** To manage any potential adverse impact regarding the carry forward losses restrictions, we would suggest giving flexibility to businesses to voluntarily disclaim part or all of the full expensing, which can then be claimed in later years. This flexibility would be in line with the current capital allowances rules which include an option to disclaim some capital allowances in a specific year.

OTHER PROPOSALS

43. The Infrastructure Forum has previously set out a number of suggestions for potential tax changes that could incentivise investment; most recently ahead of the Spring Statement. A copy of that most recent submission can be found here

Extension to super-deduction for all businesses

44. **A targeted extension that extends the relief for expenditure on 'green' or 'energy-efficient assets' would be cheaper and fully aligned with the net zero initiative. The aim of the policy would be to reduce the upfront cost of investing in green asset**s

(which tends to be higher than the traditional alternatives). This could potentially be structured in a number of ways;

- The 130% super-deduction becomes a permanent (or long term as noted above) feature of the legislation but only for ‘green’ or ‘energy efficient’ capital expenditure (and regardless of whether short-life/long-life).

- As an additional measure, and an alternative to the tax credit mechanism more generally, businesses could have the option to ‘surrender’ the excess 30% deduction in return for an immediate cash tax credit.

- In an ideal world, qualification for the relief would follow a principles-based approach (i.e. there would be a broad definition, perhaps leveraging the provisions related to the Public Benefit Infrastructure Election in the Corporate Interest Restriction rules) rather than a prescribed list of qualifying equipment.

45. A combination of 1 and 2 could create a scenario where investing in green assets gives rise to both additional tax relief and an acceleration of tax relief when compared to an equivalent investment in non-green assets. Such measures can, if structured appropriately and beyond the initial infrastructure investment (to align to other policy objectives such as levelling up for example), could also provide incentives to businesses that will need to transition to decarbonise and transition carbon intensive facilities and create the market demand for alternative fuels such as Hydrogen.

Capital allowances profile

46. Currently, if capital allowances available to claim are in excess of the amount needed to reduce tax payable to nil, they can either be claimed in full, in which case they are subject to the loss carry forward rules which restrict the offset in future periods to £5m plus 50% of the excess profits over £5m, or they can be disclaimed and used in later periods at the percentage that WDA’s can be claimed in future years. Depending on the group’s financial position, tax payment can be postponed for a longer period by disclaiming the WDA, than by claiming the WDA in full. **To remedy this position, a “free tax depreciation” pool could be considered, where the excess of capital allowances not required in a loss-making period could be accumulated to be offset against taxable profits in a later period as needed, without being subject to the carry forward loss restriction rules. This would accelerate the tax relief for capital spending, whilst retaining the loss restrictions for general trading activities.**

Special tax regime for developers

47. The concept of a special tax regime for the developers of critical infrastructure is a bolder initiative but one that is arguably needed in the current environment. This would need careful design but could revolve around the following principles:

- **Qualifying industries** – In a post Brexit environment the is potentially greater flexibility for Government to target those industries/sectors that are able to apply the regime. Given net zero and the current energy crisis, the inclusion of developers of energy-efficient equipment and renewable energy providers (e.g. generation and transmission), would seem an obvious policy to align to from a tax perspective but could potentially be extended to digital infrastructure and other critical sectors where material and urgent investment is needed. Structured over a longer period than the super-deduction, recognising the 2050 targets more generally, and protected from future legislative change, the approach would provide an element of stability and certainty to allow for new sectors or evolving technologies to be included

- **Longevity –** Given the lead times involved in some of these projects, any regime would need to have a medium/long-term focus to provide investors with sufficient certainty regarding the tax benefits. A special tax regime for renewable/energy-efficient infrastructure should run until 2050 (for full alignment with net zero targets), however, as a minimum it feels like qualifying companies would need certainty that they could apply and benefit from the regime for a period of at least 10 years.

- **Tax system** – An elective regime could operate in a similar way to the QAHC regime in the sense that all companies are prima facie subject to existing tax law but with those elected in being subject to special provisions. Such a system could include some of the capital allowances points noted above, including (i) a standard WDA that applies to all types of capital expenditure; and (ii) a cash tax credit mechanism that allows for a proportion of allowances in any given year (or the tax losses generated thereon) to be surrendered for an upfront cash payment.

SUMMARY OF RECOMMENDATIONS

- The concept of a special tax regime for the developers of critical infrastructure is a bolder initiative but one that is arguably needed in the current environment (see para 47)
- Whilst a longer term First Year Allowance, or Additional First Year Allowance, will provide some incentive for investment, if the government wishes to incentivise capital investment, it would be most effective if incentives were focused on particular types of expenditure, industry sectors or geographical areas, and delivered in a way that is practically simple and certain to claim (see para 15)
- Leveraging other areas of UK legislation, such as the Qualifying Infrastructure Company definitions in the Corporate Interest Restriction rules, would allow for targeted incentives for future investment (see para 14)
- A tax credit regime, perhaps as a sacrificial alternative to future tax relief, could act as a real incentive and provide some help towards the initial funding costs of bringing infrastructure to life (see para 19)
- Government must consider an additional or further extended super-deduction incentives for ‘green’ investments. A targeted extension that extends the relief for expenditure on ‘green’ or ‘energy-efficient assets’ would be cheaper and fully aligned with the net zero initiative (see para’s 4, 21, 44, 45)
- An increased AIA, provided on an entity basis rather than being available to each group, which could also increase depending on the level of expenditure or scale of the project, coupled with the ideas below to provide and electable cash credit for allowances that result in an increase in tax losses would have the potential to incentivise investment key areas of the UK’s infrastructure (see para 31)
- Enabling companies that are incurring significant capital expenditure before the business starts to trade to further optimise or monetise those writing down allowances to more closely align with the economic cost of construction could provide greater incentive for investment (see para 34)

- Aligned with an electable tax credit within the regime, similar to Land Remediation Relief ('LRR') credit or Enhanced Capital Allowance ('ECA') credit, which provides a specific percentage credit for the value of a loss generated though capital allowances, targeted FYAs for specific types of expenditure or locations could help to achieve other policy objectives around net zero, levelling up and innovation (see para 36)
- Many of the observations from the implementation of the super-deduction would be relevant in designing an additional FYA that can influence investment behaviour. Like the super-deduction, the benefit of year 1 relief would only be only helpful if there are sufficient profits to offset, or if it were linked to a tax credit mechanism (see para 40)
- Full, in year tax relief on all capital expenditure incurred on qualifying infrastructure could 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 (see para 42)
- Many infrastructure businesses would benefit just as much from simplification of the tax system, and clarity on the application of the rules, as they would from being provided with additional tax incentives.