THE INFRASTRUCTURE FORUM

The Infrastructure Forum's Taxation Working Group – Supporting UK energy and infrastructure policy through the UK tax regime.

Targeted tax measures have a key role to play to complement and support future policy and economic stimulus for the infrastructure sector. Prior to the Budget in Spring 2021 The Infrastructure Forum's Taxation Working Group produced and shared with the Government a document outlining a number of ideas for targeted tax policy interventions, and has maintained a dialogue with Government since then.

The Working Group was particularly pleased with the Governments recognition of the need to incentivise investment through the UK regime for tax relief on capital expenditure. The 130% **Super Deduction** for company investment in plant and machinery, something that The Infrastructure Forum suggested to HM Treasury during discussions earlier that year, goes some way to acknowledge the importance of capital investment in stimulating economic growth, but we believe there is more needed.

We consider that this incentive remains 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.

Another key area of focus for the Working Group has been the Government's **Freeports** regime. TIF held a meeting with HM Treasury officials in November 2021 on this initiative with initial indications from its network being that the initiative was welcome but that there were a number of aspects which needed attention. On this subject, TIF released a report, linked **here**, suggesting opportunities to extend and improve the UK Freeport regime drawing on lessons from successful international models. As we start to see more of the English Freeports go live, and the announcement of two further Freeports in Scotland, there is more that can be done.

In recent meetings, the Taxation Working Group has begun developing ideas for the introduction of '**Special Tax Regimes'** for sectors in the UK economy needing major capital investment, building on the question of whether we need to go much further that the current 'tinkering' with existing legislation to support a Green Revolution in the UK.

It is clear that the UK fiscal position has been stretched by the challenges of economic support during the Covid pandemic and, since the group started to develop this paper, it is impossible to ignore the recent global developments that will drive changes that nobody would have contemplated.

Even without these recent factors the scale of investment needed to achieve net-zero targets whilst upgrading and, where appropriate, digitalising energy, transport, communications and water infrastructure is massive. 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.

To some extent, world events have overtaken us and it is increasingly possible, even likely, that that there will be energy shortages in Europe; including the UK. This will place even greater importance on the urgent need for the UK to assess its Energy supply chain, reduce its reliance on other territories, and accelerate initiatives to secure and stabilise the UKs energy need. To that end there is a more immediate need that we believe warrants a specific regime now to support a potential solution to the current energy crisis.

Extending the super-deduction

Ahead of the Budget in March 2021, The Infrastructure Forum put forward some potential tax suggestions for the infrastructure sector for HM Treasury to consider.

In the super-deduction, the Chancellor in principle gave even more than The Infrastructure Forum had proposed, and provided an incentive for investment in plant and machinery of great potential.

However, one of the biggest problems with the super-deduction that our group pointed out at the time is that it only lasts for two years with the enhanced reliefs due to end in April 2023. It is also inherently complex for many infrastructure developer and operators to administer. This is particularly important as the end of the super-deduction period coincides with the increase in Corporation Tax in April 2023 – perhaps making the super-deduction more about neutralising the incentive to defer investment rather than creating an incentive to invest.

We have found that many infrastructure operators expressed frustration at not being able to accelerate significant investments so as to benefit from super-deductions. With the typically longer project lead times in the sector, with a lot of infrastructure projects often being 5-10 years in the planning and development, and coupled with the current commencement / cessation provisions of the super-deduction legislation, the super-deduction has not achieved the behavioural shift that might have been hoped for.

More generally, whilst some businesses have brought forward investments already under consideration, questioning whether this is really the policy intent, this has only changed the timing of spend, not the total amount of capital investment or created new investment.

The 2-year super-deduction window is therefore a significant limiting factor and extending the window would realise far greater benefit for the UK from the infrastructure sector.

So, The Infrastructure Forum is calling for an extension of the super-deduction to at least 10 years from its 2021 creation. 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.

By the same vein it will also fail to incentivise the development of scale in the many industries that are key to greening the UK; Hydrogen, EV, CCUS, Nuclear, and biofuels for example. The Taxation Working Group also strongly believes that the Government should consider additional or further extended super-deduction incentives for ‘green’ investments and would be pleased to work with Government to help shape the design of such measures, building on the commercial insights from our members.

Since the abolition of the Enhanced Capital Allowances regime in April 2020, the UKs capital tax incentives geared toward investment in low carbon or other ‘green’

infrastructure are almost solely focussed on R&D. Whilst hugely important that the UK continues to innovate, it is equally important to see that innovation through to the development of the physical assets and new technologies.

This leaves an obvious gap between UK Government tax policy and stated commitments in respect of environmental and 'net zero' carbon emissions.

Offering extended or additional super-deductions for asset classes such as renewable energy generation, energy storage or electric vehicle charging infrastructure would further attract the necessary investment to allow the UK to meet its environmental objectives.

Under the current rules the plant or machinery must be owned in the chargeable period that the super-deduction qualifying expenditure is incurred and claimed on. Correcting an anomaly in the legislation that prevents the super-deduction being claimed on a deposit or stage payment made in an accounting period, when the asset is not owned in said accounting period, would be a welcome change to the current rules.

Extending the super-deduction with 'Infrastructure Development Expenditure Credits'

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 would be 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.

Infrastructure Development Expenditure Credits (IDEC) could provide greater support– providing an accelerated cash profile to fund development / financing costs at a time when income generation is low (or has not started) and funding requirements are often at their most significant. An IDEC could discharge liabilities of loss-making companies or result in a cash payment to support the development of infrastructure in the UK and could be ring-fenced for further investment in the project.

A similar credit mechanism could be explored in relation to losses more generally; realised and 'surrendered' to HMRC in return for a tax credit.

Adapting the Freeport regime

Early Indications from our network on the Freeport initiative were that the initiative is welcome but that there are a number of aspects which need attention. These included but are not limited to:

- Visibility of the initiative is somewhat limited, largely to those already involved in and around the designated areas
- The design of the initiative needs to recognise that larger projects have longer lead times than some of the tax reliefs available and;
- To be effective incentives, the taxation advantages need to be monetizable and benefit company tax flow sooner rather than later.

TIF suggested in its 2021 report, authored by Graham Mather, that the Government should consider adapting the regime to make it more comparable with the most successful international models.

In order to do this, TIF believe that Government should:

- Assess the take-up of sites with tax benefits at an early stage and consider increasing the boundaries of tax sites quickly if take-up does not meet expectations.

- Revisit the 12 conditions with which operators must comply set by the Government against a test of whether they are all necessary if operators consider them not to meet criteria of simplicity and minimum red tape.
- Set up a Freeport Centre within the government that should work to secure maximum take-up of Freeport benefits, assist in solving problems with other agencies, and monitor and report on the development of the programme.
- Encourage operating authorities to set up one-stop shops to streamline procedures especially in relation to HMRC requirements on Freeport sites themselves. It may also prove desirable in the light of experience to establish units in the Freeports and/or nationally in HMT to speed and promote use of the tax sites and address any challenges faced in taking up the tax benefits.
- Treat Freeports as pilots from which to learn in any future expansion of the initiative. To assess and secure the resulting benefits a central hub in government dedicated to the programme would be needed - the Freeport Centre, mentioned above, could serve working alongside policy officials in HM Treasury.

Many of the first Freeports announced in 2020 are only just starting to go live. With a number of the specific tax incentives dues to expire in 2026, there is an obvious benefit that could be realised by extending the tax incentives available in the Freeport zone.

Special tax regimes

The Infrastructure Forum's Taxation Working Group believes that 'tinkering' the existing rules may not be enough to support the UKs Levelling up and Net Zero ambitions. The UK already operate a number of targeted regimes within the existing tax systems and the Government should consider developing special Tax Regimes for the industries that need most investment and expansion over the next 10 years.

It is clear that there are a number of key industries, for example green energy and digitalisation that need to be supported if the 2050 target set by the Government is to be achieved.

Through these special tax regimes, a wrapper would be placed around specific sectors, meaning organisations within them could elect into a tax regime and be subject to more beneficial tax rules for a 10-year period; where both targeted reliefs and tax contribution can be addressed.

The incentives within each regime would differ, but there is an opportunity to be creative and impactful with the packages which might include incentives such as: Investment Tax Credits, increased Public Benefit Infrastructure Exemptions, Renewable Electricity Production Tax Credits, Infrastructure Development Expenditure Credits or Infrastructure Bonds.

As written by McKinsey in 2019, "anchoring incentives to specific sectors enables more thoughtful investments in related areas that can also boost economic growth—such as infrastructure improvements and targeted workforce-development programs to attract additional businesses in those industries". Moreover, Rhodium Group's 2021 report found that 10 years of tax incentives for new zero-emission electricity generation would transform the power sector.

In the US, the Clean Energy for America Act proposed in 2021 provides a good example of how such regimes might work, and could be nuanced for the UK, particularly for the clean energy sector.

The Act proposes major new tax incentives for clean electricity, electric vehicles, advanced manufacturing, and more, creating at least 10-years of full-value tax incentives for new and existing clean electricity generation.

Another example from the US shows how incentive packages can boost sectors and in turn create great benefit to the country. BMW chose South Carolina as the site for its $600 million automobile-assembly plant in 1992 and received an incentive package worth $100 million. The creation of this incentive meant that in the 25 years from 1992 to 2017, BMW invested $9 billion into the state and helped spur the creation of between 25,000 and 35,000 jobs across the state.

Special tax regimes – the immediate energy crisis

Recent global events, and the challenges that dominated the UKs energy supply sector before them bring into stark focus the question of whether the energy industry needs a tax system, or a more immediate regime change, that reflects the new world in which we find ourselves.

In short, to ensure that the UK Energy industry can respond quickly to the immediate priorities to safeguard the UKs energy supply, the industry requires a tax system, are a regime available to it, that provides tax relief for all of its economic costs. Some suggestions, which could be paid for through an increased rate of corporation tax over the longer term, include:

- Energy infrastructure should receive capital allowances for all capital spend (with the exception of land purchases).
- Simplicity and certainty for the sector through one capital allowance rate and one pool (for all plant, structures, buildings). Rate to be agreed.
- Removal of the CIR complexities and limitations for energy infrastructure groups to provide greater flexibility and access to funding – wherever they appear in the supply chain – generation, transmission, distribution and supply.
- Reduced, or zero NIC to incentivise big business to create jobs in the UK. Businesses that do not create jobs will be subject to a higher tax rate than those that do.
- Commencement of trade rules simplified to ensure economic activity that is needed now is given tax relief (i.e. tax losses) for costs as incurred.

Other changes

There are a number of areas of existing legislation where changes to the current rules could help further stimulate investment and ensure that businesses can achieve tax relief that is commensurate with the economic cost of developing, constructing and operating the UKs infrastructure. Some examples include;

- Specific refinement to the loss regime as applied to infrastructure operators / project SPVs could further incentivise investment; for example, removing the 50% offset restriction, increasing the £5m deductions allowance for qualifying groups, or applying the deductions allowance on an entity-by-entity basis for qualifying companies.

- An increase in the rate of Structure and Buildings Allowances from 3% would go some way to outweighing the significant complexity and compliance burden of implementing the claims.

- An extension of the existing rules that provide tax relief for pre-trading expenditure where the trade commences within a period of 7 years, to a period of say 10 years. With the long development and construction periods involved in some of the UKs most ambition projects; in particular the UKs most ambitious and innovative projects in offshore wind, nuclear, and carbon capture; there is a risk that tax relief for certain costs are never available, simple because the development of the project exceeds the 7-year period allowed for in the current legislation[1].

[1] s61 CTA 2009

- An amendment to the UK consortium relief rules to better align to the commercial requirements of JV investments.

- Many infrastructure projects are delivered through an SPV structure to enable a consortium of investors to come together to deliver the project. Inherent limitations in the current tax rules mean that such structures can often be prevented from using the UK rules for consortium relief. Specifically, a trading company which is a direct 90% subsidiary of a holding company owned by a consortium may itself be a ‘company owned by a consortium’ for these purposes[2]. But such trading company cannot benefit from the consortium relief rules where there are, for example, two holding companies between the company itself and the consortium of investors, even where that structure is required for commercial purposes or is required for the security structure of the external financing providers.

The changes suggested above could be targeted at specific sectors, regions, and/or for a specified period of time to encourage targeted investment.

The Infrastructure Forum
Taxation Working Group
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[2] s153(3) CTA 2010