Office of
Tax Simplification

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TAX RELIEF FOR TANGIBLE FIXED ASSETS USING ACCOUNTS DEPRECIATION

Introduction

During the OTS's recent corporation tax computation review (report published in July 2017[1]) capital allowances (CAs) were flagged as an area of complexity in almost every meeting the OTS had with businesses and advisers.

The review found that a major source of this complexity is the uncertainty around the 'boundaries', for example, working out whether an asset qualified or not or which writing down rate should be applied.

It also found that businesses feel there is a disproportionate administrative burden in classifying assets when claims are made, in relation to the value of the tax relief. Other feedback received indicated that businesses were sometimes unclear as to the broader policy intention of the CAs regime as the rules are not consistent with the commercial reality as reflected in their accounts.

The report

- concluded that to reduce the current burden, and to create a simpler system, these issues of uncertainty as regards boundaries and policy objective are important ones to address,
- proposed a number of practical steps towards simplifying the current CAs regime, which if implemented, could simplify the current CT system, and
- proposed consideration of broader and more radical approaches, including replacing CAs with accounts depreciation (and extending their scope in the process), but cautioned that the impacts of this would need to be carefully considered.

The Chancellor's response[2] to the report included a request that the OTS explore in greater depth the challenges of using accounts depreciation instead of CAs. The scope of a further review has now been agreed[3].

[1] https://www.gov.uk/government/publications/ots-review-on-simplifying-the-ct-computation

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/640563/CX_letter_corporation_tax_August_2017.pdf

[3] https://www.gov.uk/government/publications/ots-starts-new-review-on-capital-allowances-and-depreciation

Depreciation review

The project relates to tangible fixed assets only.

We are looking at whether the use of accounts depreciation to provide relief for capital expenditure instead of capital allowances (CAs) would simplify the preparation of tax returns for incorporated and unincorporated businesses.

At a basic level it would no longer be necessary to allocate assets to various computational pools for CAs, instead the treatment of assets required for preparation of the accounts would flow through to the tax return. We know there is much more to consider however, and we want to explore this the help of all those who have a stake in this area.

We would be very interested in receiving input directly from businesses, and from representative groups and professional advisers, either in meetings or by way of written responses.

We would like to have arranged such meetings or to have your written responses by 30 November 2017, so if you'd be interested in meeting with us please get in touch as soon as you can. We can be reached at ots@ots.gsi.gov.uk.

We would expect to acknowledge those responding by including their names in an annex to the report, but no specific comments will be attributed to you unless we specifically agree that with you.

CONSULTATION QUESTIONS

We do not want to constrain contributors but the following questions may help guide your responses:

Background

1. What is your business activity, and if representing a group, how many members do you represent? What is the typical value of annual investment by your business in tangible fixed assets?

Generally accepted accounting principles (GAAP)

2. Businesses submitting UK corporation tax or income tax returns base the returns on accounts prepared under one of alternative accounting regimes (IFRS, FRS 101, FRS 102, FRS 105) according to the nature and size of the business. If tax relief was given for depreciation what are the implications of businesses preparing their accounts under differing accounting regimes?

3. Within each acceptable accounting regime businesses apply accounting policies which may be mandatory or judgemental. When did your business last change the accounting policy applied to tangible fixed assets? What prompted this? What depreciation rates/asset lives are used in your business?

4. There are various components of depreciation (for example, recognition, costs, revaluations, impairments, life, residual value). Would any of these present particular issues if depreciation is used to provide tax relief for capital expenditure?

5. Although accounts prepared in accordance with GAAP form the basis for determining tax profits and losses HMRC may on occasion challenge the application of GAAP. On the other hand, in some respects corporation tax has moved closer to an accounts based approach (for example the intangibles regime introduced in 2002 and the standardised treatment of deferred revenue expenditure).
   What do these examples (and any others you can provide) indicate about the merits or drawbacks of a depreciation based regime for relief for capital expenditure on tangible fixed assets?

General

6. In general, the fewer adjustments to accounts depreciation necessary to arrive at a tax deductible figure the greater, perhaps, is the potential tax simplification. This implies that assets currently non-qualifying (NQ) for CAs would, if depreciated, qualify for relief. However, some adjustments would be necessary, for example to ensure that capital expenditure would continue to be based on cost (and not on valuation) and to exclude certain assets such as land and dwellings. Please comment on the adjustments to accounts depreciation which you consider may be necessary and yet consistent with delivering simplification.

7. Would a depreciation based approach present particular issues for income tax returns?

8. Overall would the use of accounts depreciation make preparation of the tax return simpler or more complex? What features of such an approach would tend to greater simplicity or complexity compared with the current CA system?

9. Would tax compliance costs change if CAs were replaced with a depreciation based approach? By how much?

10. The current CA regime has timing incentives for capital expenditure, such as the Annual Investment Allowance (which accelerates tax relief). Assuming such a timing incentive remains desirable, a means of preventing a double deduction (for depreciation and the allowance) would be necessary. Would this significantly compromise any potential simplification benefits of a depreciation based approach?

11. Would there be other impacts of a depreciation based approach, for example the encouragement or discouragement of investment?

12. Should businesses be differentiated by size, or in any other way, when considering whether using accounts depreciation as the basis for relief for capital expenditure would be a simplification? If so, what distinctions would be appropriate?

13. Are there useful lessons from other countries which use a depreciation based approach?

Transition

14. Changing from one form of relief to another is potentially complex in respect of assets owned at the implementation date (ID) and a number of solutions are possible, including those below. Do you have views on any of these and are there further alternatives which should be considered?

	Transition method	Assets owned before ID	Assets acquired on and after ID
a	Current CA system ceases, new depreciation system starts.	Depreciation from ID	
b	As above, but no future relief for currently NQ assets.	Depreciation from ID on currently Q assets	Depreciation
c	Run out existing assets under existing CA structure for an unlimited period or a limited period.	CAs for unlimited/limited period	Depreciation
d	Run out existing assets with simpler structure, for example based on deferred tax balances at ID	Modified CAs for single or limited period	Depreciation

15. Long term projects may present particular issues, for example if they are commissioned on the basis of current rules but not commenced at the ID. What concerns should be addressed and how?

16. How much notice of a change from CAs to a depreciation based approach do businesses need?

Please let us know any other issues you wish to raise concerning a move from the current CA regime to an approach based on accounts depreciation.

We would like to hear your views by 30 November 2017
Please send written responses to ots@ots.gsi.gov.uk