

## The use of accounts depreciation instead of capital allowances as a way of giving tax relief for investment in tangible assets:

### *Scoping document for an OTS review*

#### Introduction

Corporation tax (CT), being a tax on net profit rather than turnover, allows relevant expenditure to be deducted.

Both for accounting purposes and for CT, capital expenditure on tangible assets is not deducted as the expenditure is incurred but, rather, over time - to reflect the way in which the value of the asset will fall over time.

However, while in accounts the expense is recognised in the form of depreciation, for tax purposes companies obtain relief in the form of capital allowances (CAs).

#### Background

During the OTS's corporation tax computation review, 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, published in July 2017<sup>1</sup>:

- 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.

Replacing CAs with a deduction for accounts depreciation would align the tax position with the accounts, removing the need for separate calculations.

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<sup>1</sup><https://www.gov.uk/government/publications/ots-review-on-simplifying-the-ct-computation>

This is the work to which this document relates. The question of how the cost of financing expenditure on capital tangible assets should be relieved for tax purposes is outside the scope of this review.

The use of accounting depreciation instead of capital allowances would be dependent upon resolving a number of significant issues arising from the change, including the potential for fiscal cost, avoidance opportunities and likely winners and losers.

The Chancellor, responding to the CT review on 14 August 2017, requested a review to further the debate in this area. The OTS aims to publish its report in Spring 2018.

### Scoping for the further review

The Chancellor has asked the Office of Tax Simplification (OTS) to undertake a review exploring the impact and challenges of replacing CAs with accounts depreciation, following on from its CT computation review.

### Aims and objectives

To explore the impact and challenges of moving to accounts depreciation, as a potentially simpler system, with a view to setting out various options as to how this may be achieved and their impacts.

The work will need to set out who might be better off or worse off (the 'gainers and losers'), including ways in which such a change could be made revenue-neutral, and the benefits and challenges involved including implementation and transitional issues. The work will include consideration of options which distinguish businesses by size and sector.

The report is dependent on the availability of new data analysis within the timescale, either based on deeper analysis of existing sources or on commissioning new data sets.

The report will enhance understanding and engagement within this area and prepare the ground for further debate.

### Framework for the review

The review will consider evidence already available, and commission and publish new analysis and data to encourage an informed debate on the issue. This will include consideration of a combination of technical and administrative questions and related non-tax issues including:

- The nature of accounts depreciation and the role of judgement in its quantification
- The current practices of companies in deciding on rates of depreciation and typical rates used for different types of assets
- The industry/sectoral impact of adopting accounts depreciation and whether this impact varies on region or size of a company
- The potential to mirror the effect or accommodate certain existing tax reliefs (such as the Annual Investment Allowance) within an accounts depreciation model
- The legislative, administrative and exchequer impacts of the options proposed, including in response to avoidance risks
- The transition arrangements required to move to a new system and their impact
- To what extent the proposed changes would impact unincorporated taxpayers

- The impact on the administration burdens on business and the operational impact on HMRC.
- International considerations and comparisons

### Resources and methodology

The OTS will work closely with data specialists, including HMRC's Knowledge, Analysis and Information ("KAI") experts. The OTS will also engage with HM Treasury, BEIS and policy specialists from HMRC. The team will work with the Administrative Burdens Advisory Board (ABAB) which advises HMRC.

The OTS will consult with representatives from impacted stakeholder groups and take account of relevant international experience. However, the nature of this project means that the emphasis will be on data analysis and testing and evaluating potential impacts. As always, the OTS will welcome contributions from interested parties.

A consultative committee will provide specialist guidance and challenge.