

## **Tax relief for tangible fixed assets using accounts depreciation (Lecture B1072 – 10.34 minutes)**

The Office of Tax Simplification (OTS) recently published a detailed corporation tax computation review ('Simplification Of The Corporation Tax Computation'). As part of the research for this report, capital allowances were flagged up as an area of considerable complexity at almost every meeting between the OTS and businesses or their advisers.

A major source of this complexity turns out to be the uncertainty that exists around the various 'boundaries' for the relief – for example, the difficulty in determining whether a given asset qualifies for capital allowances and, if it does, at what rate writing down allowances should be applied.

Businesses also feel, the OTS found, that there is a disproportionate administrative burden in classifying assets when claims are made, with specific reference to the value of the tax relief. Other feedback received by the OTS indicated that businesses were often unclear about the broad policy intention of the capital allowances code, given that the tax rules are not consistent with commercial reality as reflected in business accounts.

In order to reduce the current burden and to create what hopefully will be a simpler system, the OTS concluded that the issues relating to the 'boundaries' for capital allowances relief and the Government's policy objectives are the areas that should be addressed. The OTS therefore proposed a number of practical steps towards simplifying the present capital allowances regime, but they also considered some broader and more radical approaches including, in particular, the replacement of capital allowances with accounts depreciation (which would of course extend their scope in the process).

The Chancellor's response on 14 August 2017 to the corporation tax review included a request that the OTS investigate in greater depth the problems of using accounts depreciation instead of capital allowances. The scope of this further review has now been agreed. The OTS say that their main aim will be '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, the OTS confirm, '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'. This assignment will also incorporate a consideration of options that distinguish businesses by size and sector.

Here are some of the consultation questions which the OTS would like contributing businesses to answer:

- Businesses submitting corporation tax or income tax returns base these returns on accounts prepared under one of several alternative accounting regimes (eg. FRS 102 or FRS 105) depending on the nature and size of the business. If tax relief is given for depreciation, what are the implications of businesses preparing their accounts under differing accounting regimes?
- Within each acceptable accounting regime, businesses apply accounting policies that may be mandatory or judgemental. When did the business last change the accounting policy to tangible fixed assets? What depreciation rates/asset lives are used in the business?

- There are various components of depreciation (eg. 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?
- Although accounts prepared in accordance with GAAP form the basis for determining taxable profits and tax-allowable losses, HMRC may on occasion challenge the application of GAAP. In some respects, corporation tax has moved closer to an accounts-based approach (for example, because of the intangibles regime introduced in FA 2002). What do examples such as this indicate about the merits or drawbacks of a depreciation-based regime for relief for capital expenditure on tangible fixed assets?
- In general, the fewer adjustments to accounts depreciation that are necessary to arrive at the tax-deductible figure, the greater is the potential tax simplification. This implies that assets currently not qualifying for capital allowances would, if depreciated, attract relief. However, some adjustments would still be necessary, for example to ensure that capital expenditure would continue to be based on cost (rather than valuation) and to exclude certain assets such as land and dwellings. What adjustments to accounts depreciation do businesses consider may be necessary and yet consistent with delivering simplification?
- Would a depreciation-based approach present particular issues for sole traders and partnerships submitting income tax returns?
- 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 present system?
- The current capital allowances regime has timing incentives for capital expenditure such as the annual investment allowance. Assuming that such a timing incentive remains desirable, a means of preventing a double deduction (ie. for depreciation and the allowance) would be necessary. Would this significantly compromise any potential simplification benefits of a depreciation-based approach?
- Should businesses be differentiated by size or in any other way when considering whether accounts depreciation as the basis for capital expenditure relief is or is not a simplification? If so, what distinctions would be appropriate?

As you can see, it is unlikely to be a straightforward exercise.

*Contributed by Robert Jamieson*