



Finance Bill 2007

Committee Stage Briefing, Clause 35

1. Clause 35 – Industrial and agricultural buildings allowances

The legislation withdraws with effect from 21 March 2007 balancing adjustments on sale in respect of both industrial buildings allowances and agricultural buildings allowances.

This measure is the first part of proposals announced in the budget to abolish these allowances, as part of a wider reform of the capital allowances system. However, none of the other proposals are included in this Bill. We understand that the timetable for withdrawal is as follows:

2007/08	elimination of balancing adjustments, but existing writing down allowances will continue;
2008/09	(legislation to be introduced in Finance Bill 2008) - rate of allowance cut to 75%;
2009/10	rate of allowance cut to 50%;
2010/11	rate of allowance 25%; and
2011/12	rate of allowances cut to 0%

ICAEW Issues

We recognise that the changes to the capital allowances rules are part of a balanced package that has also seen the headline rate of corporation tax reduced from 30% to 28%. Nevertheless, we have many concerns about the proposed changes and the underlying policy, particularly given that smaller businesses will not benefit from the 2% cut in the main rate of corporation tax. As far as smaller businesses are concerned, the Treasury believes that the new annual investment allowance (AIA) is very generous and will more than compensate the smaller businesses for the loss of any allowances under the existing regime. However, this will not assist businesses that have already invested.

Particular issues are as follows:

- Such a major change to the capital allowances rules should have been exposed beforehand for detailed consultation. We appreciate that reform of the capital allowances rules was mooted as part of the wider package of corporation tax reforms but no firm proposals were discussed and we think that most respondents thought it was a bad idea.

- Current tax policy appears to be aimed broadly at aligning the tax treatment of transactions with the commercial accounting treatment, in this case tax allowances with commercial depreciation. We agree with that approach. However, in respect of IBAs and ABAs, this proposal will mean that tax allowances and depreciation will diverge and Government will lose the benefit of a mechanism that allows them to encourage capital investment in buildings.
- Investment in, for example, industrial buildings is a long-term capital investment decision and the tax system needs to provide certainty. Past investment decisions will have been based on the availability of allowances and these changes will impact retroactively on the investment decisions that were made.
- The withdrawal of allowances is likely to impact upon a number of the UK's business sectors, including manufacturing base, farming and capital intensive sectors such as the hotel trade, which is currently anticipating the need for capital investment prior to the forthcoming Olympics. The changes will impact upon the profitability of those businesses (particularly if they do not pay corporation tax at the full rate) and may cause problems with existing loan covenants.
- We have not seen a regulatory impact assessment but believe that the measure will cause considerable upheaval for businesses in the relevant sectors at considerable cost and note that the revenue increase as per the 2007 Budget 'Red Book' is relatively modest at £75m for 2008/09 and £225m for 2009/10 (although we recognise that it will continue to increase until 2011/12).

We have set out in Appendix One some case studies of businesses that will be affected adversely by these changes.

Suggested amendment

The effect of this change would be alleviated by grandfathering existing assets. There are precedents for such an approach. For example, full grandfathering was introduced with the reform of intangibles, loan relationships and also with previous reforms to IBAs - even when the writing down period was cut from 50 years to 25 years, the 50 year period was continued for expenditure previously incurred.

However, there is a problem in that only this part of the measure has been included in the Finance Bill, with the rest of the provisions to follow in a future Finance Bill. It is not easy to see how a grandfathering provision can be included given that this clause seeks to make changes to the tax rules for that very same expenditure.

Given this, we think that the clause should be withdrawn from the Finance Bill so as to allow time for proper consultation and consideration with amended proposals to be introduced that provide for grandfathering of existing expenditure.

2. Future Public Bill Committee briefings

The ICAEW will be providing committee briefings for Clauses 50 and 96/ Schedule 24.

Further information

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Appendix One

Case studies on clause 35 – Industrial and agricultural buildings allowances

Case Study 1 – IBA Hotel Example

A hotel is acquired in 2003 for more than its original cost. There was expenditure of £360,000 qualifying for IBAs in 1993. As a result, the write off of this expenditure is over the remaining 15 years. There would have been a claw back of IBAs when the hotel was sold in 2003 as far as the previous owner was concerned. For the years 2003/04 through to 2007/08, there will be a writing down allowance of £24,000. Under the proposals, this allowance will drop to £18,000 in 2008/09, to £12,000 in 2009/10 and to £6,000 in 2010/11. For the remaining seven years, there will be no entitlement to allowances whatsoever. This will mean that of the expenditure in 2003 which was expected to qualify fully for allowances, only £156,000 of the total of £360,000 will now qualify for tax relief.

Case Study 2 – Diversifying Farm Business

A farm has diversified into cheese production and constructed a dairy. This has been part funded by EU regeneration monies. The impact of these changes will be a loss of both agricultural buildings allowance on the existing farm and IBAs on the newly built dairy. Tax relief on expenditure of £300,000 will be unavailable. At the same time, the business faces an increase in its corporation tax rate.

Case Study 3 – Environmentally Efficient Heating Product

A manufacturer of an environmentally efficient heat product has just relocated the business to a long disused mining site. It is a major regeneration project likely to create many jobs. The site was acquired earlier this year, but very little construction work has been carried out as yet. Some of the manufacturing will go overseas to Asia but the company wishes to keep some production in the UK. This will now be more difficult to achieve.

Case Study 4 – R&D Activity

A business undertaking R&D needs specialised buildings (laboratories and specialised machine shops) in which to undertake the activity. IBAs are claimed on this expenditure and the buildings contain substantial plant in the buildings. These buildings are unlikely to have any substantial resale value due to the level of conversion costs back to general use and contamination costs. The business does not make capital gains and so can not recover any capital losses. The business is continuing and so expenditure will remain in the plant and machinery pool for a long time.