CAPITAL ALLOWANCES REGIME REFORM

FLA Response

Summary

1. At the 2022 Spring Statement, the Chancellor of the Exchequer announced a plan to cut and reform taxes on capital investment. This would build on the momentum of the super-deduction for expenditure on qualifying plant and machinery assets, to further encourage business investment.

2. A new capital allowances regime can play a crucial role in unlocking business growth in the UK, helping a diverse range of firms. To provide a significant boost to businesses seeking to make large investments **it is imperative that any new regime allows business to benefit from expenditure on leased or rented assets.**

3. Any one of the proposed measures would go some way to meeting the Government's ambitious agenda on levelling up, solving the productivity puzzle and achieving the net zero transition. However, if businesses are not allowed to claim when leasing or renting then the Government will have missed a major opportunity to help businesses up and down the country. **Existing barriers to leasing and rental in the Capital Allowances Act must be removed.**

4. Capital Allowances can support business investment, but the current regime favours some forms of financing over others. This means that businesses may be incentivised into making choices about finance which may not be the most appropriate choice for their needs. **The method of finance should not be driven by the capital allowances regime.**

5. With considerable uncertainty about their future, many businesses will be reluctant to make large capital purchases and will want to hold onto their limited cash reserves. As a result, businesses may choose to lease or rent their plant and machinery. In 2020 there was £904m of leasing new business written for plant and machinery assets. This investment is ineligible for the super-deduction under the current rules.

6. For many businesses, including SMEs, acquiring plant and machinery via short-term hire firms is often the only realistic way for them to access the expensive specialist equipment they need for only the specific time it is needed. For example, 70% of construction plant and machinery is hired in[1]. The super-deduction provides no incentives for companies to do this.

[1] Construction Plant-Hire Association, 2021

7. Businesses which are unprofitable, but which seek to invest to grow their way into profitability cannot access capital allowances. Allowing leasing or rental providers to access the allowance and pass on the savings to their customers would resolve this.

8. The Government has set out several potential options for a reformed Capital Allowances regime in the Spring Statement. We consider each of these options below and outline how these could be best be implemented to support businesses wishing to lease or rent assets. Our priority is that any reforms should include leasing in their scope and should be simple to operate for businesses.

Plant and Machinery Investment

9. FLA members provided new finance to businesses for investment in plant and machinery of more than £7 billion in 2020. This included almost £2.4 billion for construction equipment and £1.9 billion for agricultural equipment. In addition, BVRLA members lease and rent over 1.75 million cars, nearly 800,000 vans and over 100,000 HGVs to UK businesses, representing 1-in-5 vans and 1-in-5 HGVs on UK roads.

Plant hire

10. In the construction industry in particular, businesses turn to short-term hire via plant hire firms. This is because certain assets may only need to be on site for very short periods of time, and many small contractors would find it too costly to own this equipment. According to the Construction Plant-Hire Association, approximately 70% of construction plant is hired in via plant hire firms.

11. Plant hire firms will often acquire plant and machinery, either through hire purchase or leasing due to the very high outright cost of the equipment and the short life of the assets. However, where an asset is acquired for leasing or hiring on to another customer, this expenditure was not eligible for the super-deduction.

12. This means that, especially in the construction industry, neither the user of the equipment, nor the purchaser, benefit from the super-deduction. Therefore, the deduction will only be beneficial in a small range of industries (see figure 1, below).

13. By enabling plant-hire firms to benefit from an enhanced capital allowances regime, these firms can increase the supply of plant and machinery they can provide to their customers, pass on cost-savings to end users, and invest in a newer and better equipment for firms to use.

Leasing

14. Businesses use leasing to fund their plant and machinery requirements as these assets are often expensive or highly specialized and only needed for specific projects. Where assets need regular renewal or replacement, such as IT equipment, leasing can be particularly attractive.

15. In 2020 there was £904m of leasing new business written for plant and machinery assets. This investment is ineligible for the super deduction under the current rules.

16. Under accounting rules, leasing is treated as capital expenditure. This recognises the true economic value of the lease to the business. The super-deduction excludes leasing from its scope as typically rental payments are classed as revenue expenditure by HMRC.

17. Any enhanced capital allowances regime for leasing would help to further encourage business investment. A major change to the rules of this nature will understandably lead to concerns regarding potential new routes for avoidance. However, we believe the risks of this to be low and we have previously supplied data to support this assertion to HM Treasury. Existing anti-avoidance provisions would also prevent potential abuse.

Car, van and truck leasing and rental

18. In the current economic climate, many firms do not have the funds to upgrade their car, van, or truck fleets. Fleet renewal is hugely expensive and complex, especially so when the vehicles are used in specialist applications. Many businesses will also be looking to upgrade their car, van or truck fleets to all-electric options but will be dissuaded from doing so due to the higher up-front cost of these assets. Incentivising the leasing or rental of these assets provides an attractive solution.

19. Leasing and rental firms help businesses access productive assets to which they may otherwise not have access. Currently neither leasing and rental firms nor their customers are able to take advantage of the super deduction nor the 100% first-year allowances for zero-emission cars and vans. Only those businesses able to afford outright or hire purchase finance options can benefit. This is both distortionary and does not serve the interests of the wider economy.

20. The distortion also potentially impacts SMEs far more than larger businesses. Larger businesses will generally have greater availability of cash and or access to cheap funding, making a cash purchase or debt a viable option. Given the leasing exclusion, the businesses most able to make use of the super deduction for van and truck fleets or the 100% FYA to decarbonize are not those struggling to invest and in need of its support. Instead, SMEs with

limited access to cash and finance, who need the most support, cannot access it as their fleet renewal requires a leasing or rental offering.

21. Leasing and rental also play a critical role in supplying productive assets to second users. Once initial lease periods have finished, or a rental firm disposes of a vehicle these vehicles remain within the broader economy. This renewal cycle ensures there is a flow of high-quality vehicles entering into productive second lives while new investment continues to occur. It also helps alleviate the significant delays in delivering equipment that are currently occurring.

22. The leasing and rental business model requires the vehicle must be well maintained and enter a second productive life while the incentive for an owner operator is to minimize expenditure on the vehicle and run it for as long as possible. Incentivizing businesses away from leasing and rental will in the longer term negatively impact the productivity of the downstream users.

Options for reform

Introduce full expensing, to allow businesses to write off the costs of qualifying investment in one go.

23. Whilst we recognise such a measure would be ambitious, this would be our preferred outcome from the review of capital allowances.

24. This measure could, if implemented fully, effectively remove the distinction between leased and non-leased assets with respect to capital allowances.

25. We believe that allowing businesses to deduct the cost of investments they make immediately rather than over the life of the asset, regardless of the type of finance used to acquire the asset – would lead to greater investment in new green assets and result in more rapid economic recovery, as the tax benefits of new investment would be realised much more quickly.

Increasing the permanent level of the Annual Investment Allowance

26. We would support a substantial increase in the permanent level of the Annual Investment Allowance. When the temporary threshold of £1 million comes to an end many businesses will face increased tax costs for investment.

27. Where a lessor or hire company has spent more than £1 million, they cannot claim the allowance and thus unable to pass this saving down the supply chain via the rental costs. It is common for lessors and short-term hire firms to spend far more than this amount given the nature of their business and the propensity for businesses to lease, rather than buy, expensive equipment. We would therefore recommend that the permanent level of Annual Investment Allowance is increased beyond the current £1 million threshold, and not reduced, as is currently proposed.

28. Further, the AIA does not provide any benefit for leased assets or assets on short-term hire. This is because the customer cannot draw on the AIA where there is no intention to purchase the asset. Reform to the AIA to allow this would support greater levels of investment into plant and machinery.

Increasing Writing Down Allowances

29. Increasing writing down allowances for main and special rate assets to 20% and 8% respectively would benefit those businesses for whom expenditure does not qualify for the Annual Investment Allowance.

30. It may be desirable to explore ways of incentivizing the use of the "special rate" to support investment into net zero assets and green buildings technology, by offering an enhanced special rate for these assets.

31. However, such a change would have limited impacts unless allowance rates were significantly increased beyond the 20% and 8% proposed.

Introduce a First Year Allowance for main and special rate assets where firms can deduct, for example, 40% and 13% in the first year, with the remaining expenditure written down at standard Writing Down Allowances, or, Introduce an Additional First Year Allowance, to bring the overall amount that can be claimed to greater than 100% of the initial cost.

32. We would strongly support these proposed measures as they would allow businesses to make significant investments especially in net zero assets and vehicles.
33. For such measures to be meaningful and effective in encouraging investment for all types of businesses, they must include leased or rented assets.

About the FLA

The Finance & Leasing Association (FLA) is the leading trade body for the UK asset, consumer and motor finance providers of leasing and hire purchase. In 2020, FLA members provided £113 billion of new finance to UK businesses and households, £37 billion of which helped consumers and businesses buy new and used cars, including over 91% of private car registrations. £86 billion was in the form of consumer credit, accounting for over a third of all new consumer credit written in the UK. £27 billion of finance was provided to businesses and the public sector to support investment in new equipment, representing over a third of the UK investment in machinery, equipment and purchased software in the UK last year.

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