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# A Northern Big Bang

## – Full Expensing

EMEA – 18 February 2021

One of the principal recommendations in the paper "A Northern Big Bang – Unleashing Investment in the North", published by the Northern Research Group (NRG) in conjunction with the Centre for Policy Studies (CPS) on Monday 15 February 2021, was "allowing writing off of all investment against corporation tax for businesses in the North of England between now and 2025." It is the main tax policy proposal in the paper.

Very broadly, in any given year, a company will pay corporation tax on its profit. That profit is calculated by deducting the costs incurred during the year from the income received. However, different rules apply in relation to costs incurred on capital items (e.g. buildings and machines). Capital expenditure is relieved under the UK's system of capital allowances. The system requires a company to spread capital expenditure (and, therefore, allowable tax deductions), often over many years, in accordance with legislation designed to approximate the useful economic life of particular types of capital asset.

The rationale is to match the one-off cost of the asset to the multi-year revenue receipts it produces, but the regime is complex, cumbersome and inflexible. Restricting deductions means, in year one at least, a company's taxable profits are significantly larger than its actual cash-revenue stream. The need to spread tax deductions can weigh against capital investment decisions (especially where inflation means the real value of the deductions falls over time) and can artificially distort those decisions in favour of assets that attract the more generous allowances. In contrast, allowing capital expenditure to be "written off" in full simplifies matters and means the company is able to deduct 100% of the cost of investing in a capital asset in the year it incurs the expense. The result is that the company's tax position more closely reflects its cash-flow positon.

The justification for "full expensing" is relatively simple: it anticipates that businesses will be encouraged to invest (in a tax-neutral way) in the capital assets because the time value of money is taken out of the equation. The result, it is hoped, is that a company acquires the assets it needs to boost productivity and, with it, economic growth, employment and wages. The Northern Big Bang paper suggests (based on research carried out by the US-based Tax Foundation) that full expensing can be up to twice as beneficial as cutting the main rate of corporation tax. This is primarily because the incentive is tied to the investment that ought to boost future activity, rather than simply enabling a company to retain more of its profit (which might, or might not, be re-invested). The argument is especially relevant to manufacturing industries, more traditionally associated with the North.

Full expensing is not a new idea. It has already been incorporated into the government's tax offering for English Freeports – see our detailed analysis in UK Freeports – The Tax Angle – where, during a five-year period from 1 October 2021 to 30 September 2026, expenditure on qualifying plant and machinery will be fully tax deductible in the same tax period the cost was incurred. Expenditure on non-residential "structures and buildings" in Freeports also benefit from accelerated allowances, spreading deductions over 10 years (instead of the normal 33.5 years). In addition, in the US, full expensing formed a central plank of tax reforms in 2017, as enacted by the Tax Cuts and Jobs Act (TCJA). The TCJA allows full expensing for machinery and equipment (not buildings) but, again, only for a temporary period of time. Unless it is extended, full expensing will be slowly withdrawn between 2022 and 2026.

If the economic analysis is sound, there is little logic in limiting the scope of the policy by reference to time or location. Indeed, the preference of the CPS is for nationwide and indefinite full-expensing. However, the Northern Big Bang paper implicitly recognises the cost implications, and resultant HM Treasury concerns, in allowing widespread, open-ended, writing-off of all capital expenditure. In a sense, the authors of the Northern Big Bang are offering the North (as the region most likely to benefit) as a "sandbox" to prove the concept before permanent implementation of the policy across the whole country.

The Northern Big Bang paper exposes wider implications for UK tax policy too. "Lighting the touchpaper" of a "big bang" in the North will necessarily be assessed against the background of the impact of both COVID-19 and Brexit on the UK economy. The economic (and fiscal) dimension of the government's commitment to "net zero" also looms large. Such is the current pressure on the UK exchequer, and the widespread assumption that taxes will need to rise, that the grant of further tax incentives will need to satisfy policy makers that the long-term benefits clearly outweigh the up-front cost. Another way of looking at full expensing is that the government is investing directly in the capital assets acquired by the company claiming the allowance. By offering the incentive upfront, the government is betting on the boost in productivity, economic activity, profitability and, ultimately, taxable revenues it promises to yield – that necessarily means it will be more cautious in its analysis.

Of course, raising tax revenue depends on having sources of income, profits and gains to charge. Full expensing is no silver bullet. It is unlikely to be adopted in isolation. In Freeports, for example, enhanced capital allowances are supported by other tax reliefs for acquisitions of commercial property and for employment costs (in the form of relief from employer national insurance contributions). And, even if it is adopted, full expensing can (and should) only form part of a wider, holistic approach to tax policy, both nationally and regionally, that considers rates, reliefs and incentives alongside the taxation of income and capital, debt and equity, different business structures, sources of income and wealth, as well as the challenges posed by regional inequality (levelling-up), globalisation, digitalisation and climate change. Leaving aside any political considerations, ensuring the UK "builds back better", achieves "net zero" and realises its post-Brexit ambitions, means the seemingly unavoidable introduction of fiscal consolidation policies will require delicate timing. There is no single or simple solution, but the Northern Big Bang paper, and the proposals it lays out, is a very welcome contribution to the discussion on the shape of the tax change that is coming.

## Contact

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