Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Introduction of a one-year 40% First Year Capital Allowance	
Stage: Final	**Version:** 1.0	**Date:** 21 April 2009
Related Publications: None		

Available to view or download at:

http://www.hm-treasury.gov.uk.

Contact for enquiries: Rupert Gill **Telephone:** 020 270 5801

What is the problem under consideration? Why is government intervention necessary?

The economic downturn has had a negative impact on the level of investment in the economy. Total business investment decreased by 4.5 per cent year-on-year in the last three months of 2008. Investment is anticipated to fall further in 2009. Business investment is a driver of productivity and will be key to economic recovery. It is forecast to contribute one quarter of the growth in output from 2011. Temporary government intervention will provide additional support targeted on businesses that are investing now to support the future growth of the economy.

What are the policy objectives and the intended effects?

The objective is to encourage investment, by supporting businesses that invest in 2009/10 and providing an incentive for businesses to bring forward investment.

Since April 2008, businesses receive 100% tax relief each year for the first £50,000 of their investment in most plant and machinery under the Annual Investment Allowance (AIA). Most investment in qualifying plant and machinery above £50,000 can be relieved at the main writing-down rate of 20%. The Government will introduce a first-year capital allowance (FYA) at 40% for one year with effect from April 2009. This measure will allow businesses to relieve 40% of their expenditure on plant and machinery in 2009/10 (over and above that relieved by the AIA) that would otherwise have been relieved at the standard 20% rate.

The intended effect is to provide support to businesses that invest in 2009/10. Businesses will receive higher up-front tax relief on new investment than they would under standard treatment of capital allowances. This both improves cash flow in the short-term, and reduces the cost of investment in 2009/10 relative to future years.

What policy options have been considered? Please justify any preferred option.

1. Do nothing.
2. Introduce a 40% first year allowance for one year in 2009/10.

Option 2 was preferred as it provides substantial support to businesses that are investing in 2009/10 and will encourage businesses to bring forward investment, supporting the future growth of the economy.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? This is a temporary measure designed to provide support for investment in the current economic climate. This measure will not materially increase administrative burdens or compliance costs and therefore it has been decided that a review will not be necessary. The economic impact will be assessed when the relevant data are available.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

Stephen Timms

Date: 21 April 2009

Summary: Analysis & Evidence

Policy Option: 2	**Description: Introduction of a one-year 40% first year capital allowance**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	The measure affects businesses investing more than £50,000 in the financial year 2009-2010. We estimate that this will be around 60,000 businesses. We expect additional compliance costs for these businesses to be negligible.
£ negligible	1	
Average Annual Cost (excluding one-off)		
£ negligible		**Total Cost** (PV) £ negligible

Other **key non-monetised costs** by 'main affected groups' The only change for firms investing over £50,000 will be the rate at which they claim their usual capital allowance for plant and machinery. As a result we expect additional compliance burdens to be negligible.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	The measure affects businesses investing more than £50,000 in the year 2009-2010. We estimate that this will be around 60,000 businesses. The main benefit to them is delivered through higher up-front tax relief. It is estimated to support approximately £50bn of investment.
£	1	
Average Annual Benefit (excluding one-off)		
£		**Total Benefit** (PV) £

Other **key non-monetised benefits** by 'main affected groups' Not quantifiable.

Key Assumptions/Sensitivities/Risks The Businesses that would benefit from the FYA are assumed to already be claiming capital allowances at existing rates.

Price Base Year 2009	Time Period Years 1	**Net Benefit Range** (NPV) £ N/A	**NET BENEFIT** (NPV Best estimate) £ 0

What is the geographic coverage of the policy/option?	UK			
On what date will the policy be implemented?	1/04/09 or 6/04/09			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ Absorbed			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	N/A			
What is the value of the proposed offsetting measure per year?	£ N/A			
What is the value of changes in greenhouse gas emissions?	£ N/A			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro **Neg**	Small **Neg**	Medium **Neg**	Large **Neg**
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	**Net Impact** £ 0

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

Rationale for intervention

The economic downturn has had a negative impact on the level of investment in the economy. Total business investment decreased by 4.5 per cent year-on-year in the last three months of 2008. Investment is anticipated to fall further in 2009. Business investment is a key driver of productivity and will be key to economic recovery. It is forecast to contribute one quarter of the growth in output from 2011. Temporary government intervention will provide additional support targeted on businesses that are investing now to support the future growth of the economy.

Policy Objective

The objective is to encourage investment, by supporting businesses that invest in 2009/10 and providing an incentive for businesses to bring forward investment.

Since April 2008, businesses receive 100% tax relief each year for the first £50,000 of their investment in most plant and machinery under the Annual Investment Allowance (AIA). Most investment in qualifying plant and machinery above £50,000 can be relieved at the main writing-down rate of 20%. The Government will introduce a first-year capital allowance (FYA) at 40% for one year with effect from April 2009. This measure will allow businesses to relieve 40% of their expenditure on plant and machinery in 2009/10 (over and above that relieved by the AIA) that would otherwise have been relieved at the standard 20% rate.

The intended effect is to provide support to businesses that invest in 2009/10. Businesses will receive higher up-front tax relief on new investment than they would under standard treatment of capital allowances. This both improves cash flow in the short-term, and reduces the cost of investment in 2009/10 relative to future years.

Policy proposals

The lead option is to introduce a temporary 40% first-year allowance for capital expenditure on main-rate plant and machinery for 2009/10.

It was concluded that introducing a temporary first-year allowance at 40% for one year gives the best trade off between costs and benefits.

Costs & benefits

A temporary enhancement of capital allowances via a FYA brings two primary economic benefits:

1. It incentivises firms to bring forward investment into 2009/10; and
2. Provides a cash flow benefit to businesses that are investing in 2009/10 through higher up-front tax relief.

Introducing a first-year allowance for all new investment will benefit around 60,000 businesses that invest more than £50,000 in the enhancement year. Data on capital allowances claimed for qualifying investment indicate benefits would accrue particularly to utilities and communications sectors, which account for over one third of plant and machinery capital allowances claimed. Financial services, transport, manufacturing and distribution and retail account for most of the remaining investment.

Timing:

The timing of benefits will depend on the accounting period of the firm.

The measure provides a cash flow boost for firms that invest in the enhancement period by providing higher up-front tax relief for investment in qualifying plant and machinery.

Exchequer Impacts:

The Exchequer impacts of a one year 40% FYA are set out below. Whilst there will be reduced tax receipts in the short term, the FYA affects the timing of tax relief rather than the overall level of relief, so these reductions are offset by increased tax receipts in later years.

		2009/10	2010/11	2011/12	2012/13	2013/14
FYA at 40% £m:		-1640	-190	+380	+300	+240

Caveats and Risks

The proposal excludes the following types of plant and machinery from the FYA:

- Any investment that currently attracts enhanced investment allowances, including energy efficient plant and machinery, and expenditure on Research and Development.
- Investment that currently attracts capital allowances at the 10% special rate.
- North Sea investment would be unaffected as there are special investment incentives already in place within the ring-fenced regime.
- Cars are subject to a new capital allowance regime designed to incentivise the use of lower emissions vehicles, and are as a result explicitly excluded from the FYA.
- Expenditure on plant or machinery for leasing; such expenditure is normally excluded from FYAs.

The FYA would be available to companies and unincorporated businesses.

Administrative Burden

HMRC has targets to reduce one aspect of compliance costs in particular: the administrative burden of disclosing information to HMRC or third parties. This burden, specified on page 2, is assessed through the 'Standard Cost Model' (SCM), an activity-based costing model that identifies what activities a firm has to do to comply with HMRC's obligations, and estimates the cost of these activities, including agent fees and software costs.

This is a temporary measure for 2009/10 and does not impact on the admin burden baseline. There would be some minor compliance costs due to firms familiarising themselves with the new provisions and making their capital allowances calculations in a slightly different form, but these are estimated to be negligible.

Competition Assessment

A FYA benefits all firms, regardless of size, investing in main-rate plant and machinery. It applies to all main rate expenditure not already relieved by the AIA. All firms that invest under £50,000 will continue to enjoy full relief on their first £50,000 of investment in the year in which it is made under the AIA.

The measure is expected to have a negligible impact on competition.

Specific Impact Tests

Following initial screening tests, the following conclusions have been reached:

- The introduction of a FYA is not expected to have any legal aid impacts.
- The FYA is compatible with the Human Rights Act.
- The FYA would not significantly impact on health and wellbeing.
- Rural Proofing: the measure benefits firms that invest more than £50,000 in plant and machinery, regardless of their geographical location.

- Race equality, Disability equality, Gender equality, Religion in Northern Ireland: all firms, large or small, are affected in a fair way – there is no greater impact on any particular business regardless of size or specialism.

Environmental Tests

It is difficult to assess the extent of the environmental impact of this measure, but the measure may result in firms bringing forward investment, some of which may be more advanced, less polluting plant and machinery.

Sustainable development and other environmental concerns

This measure is intended to contribute to sustainable development by encouraging firms to bring forward investment, a key driver of sustainable economic growth. Some of the investment brought forward may also be for more advanced, less polluting plant and machinery.

Carbon Assessment

As above, the measure is anticipated to have a beneficial effect on carbon emissions as it aims to accelerate investment in new, potentially more efficient, plant and machinery. The precise impact is not currently quantifiable.

Small Firms Impact Test

The vast majority (approximately 95%) of firms invest less than £50,000 in any year. Their entire investment expenditure is therefore covered by the AIA. Around 60,000 firms that invest above £50,000 will have to adjust the rate at which they write off against taxable profits their capital expenditure on plant and machinery in 2009/10. However, the change is one of rate, rather than process. The change to the administrative burden they face is therefore estimated to be negligible. The major benefit to these firms of the FYA will be the increased relief they receive on their eligible investment.

Implementation Timetable

The new policy is scheduled to apply to all qualifying expenditure incurred on or after 1 April 2009 (for corporation tax) or on or after 6 April 2009 (for income tax).

Specific Impact Tests: Checklist

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes