Potential Reforms to UK's Capital Allowance Regime – Inviting views

Due 5pm 1st July 2022

https://www.gov.uk/government/publications/potential-reforms-to-uks-capital-allowance-regime-inviting-views/potential-reforms-to-uks-capital-allowance-regime-inviting-views

1. Please select the category that best describes you

Trade association or business representative organisation

2. [If appropriate] What is the name of your organisation? Please put N/A if you're not an organisation.

UK Petroleum Industry Association Ltd

3. [If appropriate] Where is your capital equipment located? Select all that apply, or if UK-wide, select UK-wide only. If you have selected more than one region, where possible please indicate the proportionate split between locations in the comment box. *

N/A

4. [If appropriate] What sector do you operate in? Please select all that apply *

Manufacturing

Other – Fuel Supply

5. [If appropriate] If you're a business, how many people do you employ? If you're a representative body, how many businesses do you represent? *

Fewer than 10

6. [If appropriate] What is your annual turnover?

n/a

7. [If appropriate] What is your total annual capital investment (including plant, machinery, structures, buildings, land, intangibles)?

n/a

8. [if appropriate] What is your total annual capital investment in plant and machinery?

n/a

9. With reference to the guidance published on gov.uk, which area of interest does your response relate to? Please select all that apply. *

Question 9.

- [ ] Investment decisions – evidence on how businesses make investment decisions and the relative importance of capital allowances in these decisions
- [ ] The super-deduction – evidence on how the super-deduction has affected business investment decisions
- [x] The current system of capital allowances – your assessment of the effectiveness of the current system in encouraging business investment, including how simple the system is to understand and awareness of the current system
- [x] Spring Statement 2022 options – views on the options set out at Spring Statement. If sufficient funding were to be available, the government is interested in stakeholder views about whether this would be best spent on full expensing or better targeted through other options. Similarly, the government welcomes views on how best to target our approach if less funding is available.
- [ ] Other (please specify):

10. To assist with our analysis, please summarise your response in no more than 250 words. You will also be given the opportunity to upload a file with a fuller response. *

To meet Net Zero for our sector requires transformational investment in the UK of plant and machinery, as well as other key infrastructure. Enhanced Capital Allowances (ECAs) may be a way to support capital intensive investment where larger projects can cost hundreds of millions of pounds. In this context we would highlight the following from our response:

A move to project (rather than component)-based ECAs could be better utilised by large industrial sectors.

We share the government's perception that the UK's current capital allowances regime compares unfavourably with some of its peers.

Simple models for a revised system would be welcomed as existing modelling under discounted cash flows (DCF) often used in our sector can be complex and decision-making is often made at the international level so ensuring capital allowances are easily understood and fed into investment decisions is important.

The introduction of a general First Year Allowance (FYA) would contribute positively to investment decisions as could targeted capital allowances e.g., CCUS and hydrogen projects (but these should be open to all emissions-reducing investments). Given such projects are often long-term, we would encourage review of the current rate of allowance of 6% per annum on a reducing balance which should be increased to attract investment. An additional FYA or introduction of full permanent expensing would also be beneficial as could an increase in the rate of Writing Down Allowances (WDA) subject to the terms, although the Investment Allowance (AIA) changes are not expected to be impactful for our sector.

11. Upload your response here, if possible as a Word Document. If possible, please name the file with the name of your organisation.

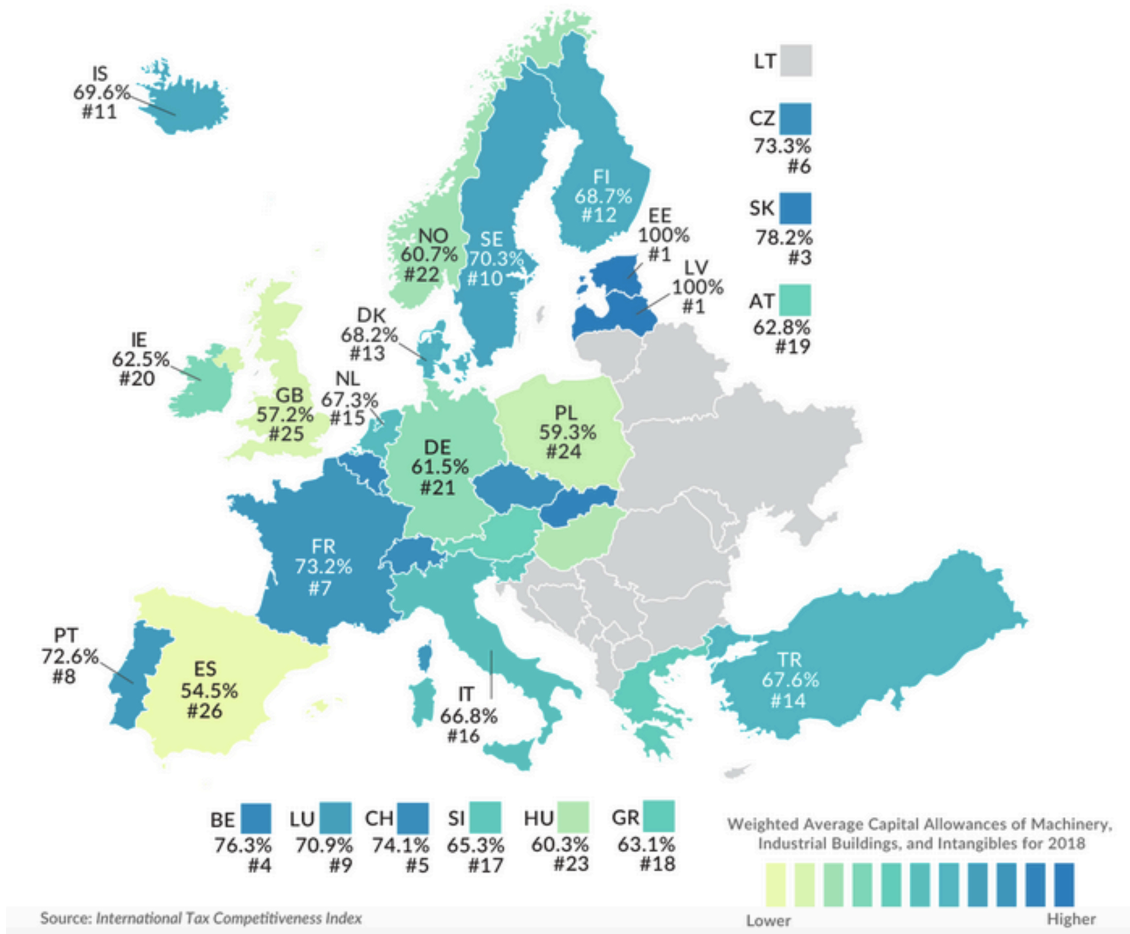
UKPIA represents companies involved in the manufacturing, supply and retail of fuels responsible for 96% of current transport energy usage as well as other petroleum products (lubricants, plastics, synthetic rubbers, solvents and others) used in a range of sectors across the economy. In order to meet Net Zero for our sector requires transformational investment in the UK of plant and machinery, as well as other key infrastructure. Enhanced Capital Allowances (ECAs) may be a way to support capital intensive investment where larger projects can cost hundreds of millions of pounds.

A move to project (rather than component)-based ECAs could be better utilised by large industrial sectors. This action was proposed in BEIS' 2017 Oil Refining Action Plan (and other action plans for energy intensive industries)[1], however, saw little progress. The UK's previous ECA system, which ended in April 2020 was limited in impact for the downstream oil sector as the Energy Technology List was narrow and unable to account for the investment of energy efficiency and decarbonisation technologies in our sector which is often delivered via bespoke design and engineering solutions which - although they may include technologies covered by the ETL - are usually sourced through specialist contractors and technology providers.

For a revised ECA system, we share the government's perception that the UK's current capital allowances regime compares unfavourably with some of its peers as has been considered by the Tax Foundation in 2019[2] (see summary overleaf), which at the point of analysis indicated only Spain had a less favourable system than the UK.

[1] Joint Industry – Government Industrial Decarbonisation and Energy Efficiency Roadmap Action Plan
Oil Refining Action Plan, BEIS and UKPIA, 2017, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/652109/oil-refining-decarbonisation-action-plan.pdf (accessed June 2022)

[2] "Capital Allowances in Europe", Tax Foundation, 2019, https://taxfoundation.org/capital-allowances-europe-2019/ (accessed Jun 2022)



<u>Investment Appraisal</u>

Simple models for a revised Capital Allowance system to feed into modelling for investments for business would be welcomed as existing modelling used in our sector can be complex.

As was explored in the Industrial Decarbonisation and Energy Efficiency Roadmaps project by BEIS, in the oil refining sector the majority of the refiners operating in the UK are headquartered overseas. "Energy efficiency projects, as with all of its capital investment projects, are usually only undertaken if they are economically viable and satisfy internal investment criteria, return rates, and payback periods, which can be as short as six months. The short payback times are imposed due to low refinery margins, restricted capital funds and the need to focus on operational related investment"[3]. As a result, competition for investment capital within companies is important and allowances that can be relatively easily accounted for in investment proposals within companies may have a greater chance of success if they are properly understood. It should also be noted that as well as investment capital

[3] Industrial Decarbonisation & Energy Efficiency Roadmaps to 2050 - Oil Refining, BEIS, 2015, p32, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/416671/Oil_Refining_Report.pdf

competition within the traditional sector, there may see increased competition for capital within global companies considering new forms of energy projects whether that be in EV charging or windfarms seeking to meet energy transition objectives. Making sure that the ECA system is as attractive as possible stands the best chance of securing increased levels of investment in the UK.

First Year Allowances and full permanent expensing would appear to be most attractive for this consideration while Writing Down Allowances appraisal will depend on a number of factors including the level of the increase and the level of capital spend under appraisal.

Spring Statement Options

Assessing the options outlined in the Spring Statement, the introduction of a general First Year Allowance (FYA) would contribute positively to DCF analysis and would be welcome and particularly for Net Zero targeted capital allowances e.g., CCUS and hydrogen projects (but these should be open to all emissions-reducing investments). Given such projects are often long-term, we would encourage review of the current rate of allowance of 6% per annum on a reducing balance which should be increased to attract investment. An additional FYA or introduction of full permanent expensing would also be beneficial, as could an increase in the rate of Writing Down Allowance (WDA) although as noted above the latter will depend on a number of factors including the level of increase in allowance and the capital spend under consideration. The Investment Allowance (AIA) changes are not expected to be impactful for our sector due to the relatively low limits as indicated in the annex (£200,000 to £500,000) given our sector's base level of non-discretionary capital expenditure on safety / environmental regulatory compliance.