The Infrastructure Forum's Taxation working group - Autumn Statement Submission

Our Submission makes representations on the taxation treatment of two major costs of infrastructure. These are interest and capital expenditure on structures and related buildings.

1. Interest deductions

Members of TIF Tax Working Group welcome the early engagement of HM Treasury and HMRC with industry ahead of publication of the OECD consultation document in December 2014.[1]

HM Treasury's stated position[2] is that any changes to the tax rules on interest would have to take into account the specific circumstances of sectors that would be significantly affected such as infrastructure.

We understand that the OECD objective is to identify best practices in the design of rules to prevent tax base erosion through the use of interest expense. UK does already have anti-abuse rules in place which apply for infrastructure as for all businesses. However we understand that 'structural' interest restriction rules may be considered as part of the OECD consultation which take no account of the fact that some businesses can commercially borrow more than others. Infrastructure businesses, and most particularly PPP projects, are able to support much higher levels of debt than other businesses. Such structural restrictions may potentially strike out tax relief for borrowings above a 'norm', which is not a commercial norm for infrastructure. PPP contracts bear the risk of non-discriminatory changes in tax law and so there would be a danger of default for many existing projects which would not be able to make tax payments which had not been anticipated when pricing was agreed with the Public Sector Client. The public and private sector pension fund investors in these projects would incur significant losses and understandably be reluctant to invest in new UK infrastructure. UK needs these investors to have confidence that UK public infrastructure is a low risk investment.

We are concerned about damage to investor confidence arising from prolonged uncertainty about whether UK may introduce such tax rules. While UK government has not indicated an intention to adopt any eventual OECD recommendations, it has endorsed the remit of OECD's Action 4, "to develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions….." We seek reassurance from HM Treasury, prior to publication of the OECD consultation document, that:

- it will seek to have UK's current approach, of targeted anti abuse rules and an 'arm length test' for related party financing, included as an option in OECD guidance

[1] OECD Base Erosion and Profit Shifting (BEPS) Action Plan. Action 4 Limit base erosion via interest deductions.
[2] HM Treasury and HM Revenue & Customs, 'Tackling aggressive tax planning in the global economy': UK Priorities March 2014

- it considers UK's existing anti abuse rules and 'arms length' test for related party financing are sufficient to meet the BEPS objective
- structural restrictions will only introduced if existing, long-term financing arrangements can be satisfactorily grandfathered under State Aid rules
- in any event, structural restrictions will only be considered in relation to connected party and not third party debt

2. Capital business expenditure on structures and related buildings

We continue to feel strongly that UK infrastructure plans would receive a boost if a tax deduction were available more consistently for this expenditure, incurred for business purposes.

In previous years we have presented a robust case for an allowance for expenditure on structures, and on buildings required for the use of structures or which house plant or machinery. The proposal is for a writing down allowance in the range of 2% to 4%. Certain buildings used primarily for human occupation would be excluded. In our assessment it should benefit a wide range of sectors of the economy, including infrastructure in the energy and roads sectors, and to a lesser extent the water industry.

All other G20 and almost every other advanced economy provides full relief for expenditure on such business assets, through tax depreciation, capital allowances or similar regimes. The UK's failure to offer such a relief to private investors in national infrastructure is very hard to comprehend, particularly when Government has ambitious plans for enhancing the UK's infrastructure and when there is (both politically and economically) limited scope to raise new taxes to pay for this. We do not say that all bidders for infrastructure projects will pass by or ignore UK projects and focus on other countries instead, although some may. What we do say is that the current tax cost is largely passed on to the UK Government and thus to taxpayers and users through the pricing of infrastructure projects, making these projects more expensive.

We note that a recent report issued by the Office of Tax Simplification recommends the replacement of capital allowances with a "simple" relief for depreciating assets by reference to their depreciation. We note that this suggestion if implemented could prove open to abuses unless tempered by complex tax rules on the accounting policies which would be satisfactory bases for allowable depreciation. This proposal does not remove any of the current disincentive to invest but rather adds to it.

We have spent much time discussing these proposals as a group, and with Government. We have assessed that the cost (an estimated £1 bn over 5 years) would be dwarfed by the benefits. Also we are of the belief that the relief is sufficiently general in applicability that EC State Aid concerns are not a valid objection, although clearly UK government will need to seek EC clearance on this in the usual way.

The Infrastructure Forum, Taxation Working Group
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