

Capital Allowances: Feed-in Tariffs and the Renewable Heat Incentive

Who is likely to be affected?

Businesses that invest in plant or machinery to generate electricity or heat (or to produce biogas or biofuel) that attracts a Feed-in Tariff (FiT) or tariffs under the Renewable Heat Incentive (RHI) after April 2012.

General description of the measure

This measure will make changes to the capital allowances treatment of expenditure on plant or machinery to generate renewable electricity or heat to:

- designate expenditure on solar panels as special rate for capital allowances purposes; and
- ensure that enhanced capital allowances are not given for expenditure on plant or machinery where tariff payments are received under either of the renewable energy schemes introduced by the Department of Energy and Climate Change (DECC) – FiTs or the RHI.

Policy objective

Capital allowances are intended to provide tax relief that broadly reflects average rates of economic depreciation. There are two rates of writing down allowances - main rate and special rate. Designation of a particular rate is intended to provide certainty over the treatment of expenditure, in the light of the nature or general expected economic life of the equipment in question.

Enhanced capital allowances provide targeted incentives to encourage business investment in particular types of plant and machinery. To ensure value for money they are intended to complement, rather than duplicate the effects of other Government policies supporting such investment.

Background to the measure

A consultation on proposed changes to the capital allowances treatment of plant or machinery that could attract FiTs or tariffs under the RHI was announced at Budget 2011 and took place over the summer.

Detailed proposal

Operative date

Generally, the measure will have effect for expenditure incurred on or after 1 April 2012 (for businesses within the charge to corporation tax) or 6 April 2012 (for businesses within the charge to income tax). Though, for expenditure on combined heat and power equipment (CHP) only, the change to enhanced capital allowances will apply to expenditure incurred on or after 1 April 2014 (for businesses within the charge to corporation tax) or 6 April 2014 (for businesses within the charge to income tax).

Current law

Business expenditure on electricity or heat generating (or biogas or biofuel producing) plant or machinery may qualify for allowances under Part 2 of the Capital Allowances Act 2001 (CAA) as follows:

The Annual Investment Allowance (AIA) permits a 100 per cent allowance for such expenditure in the year in which it is incurred up to a limit of £25,000 a year (the limit from April 2012).

In addition 100 per cent first-year allowances (enhanced capital allowances or ECAs) are available in respect of expenditure on energy-saving plant or machinery that meets the criteria required by either of the Energy Technology Product or Criteria Lists maintained by DECC (section 45A CAA). ECAs provide a cash-flow advantage over writing down allowances and so act as an incentive to invest. With the exception of some micro-CHP equipment, technologies that qualify under the FITs scheme will not be eligible for ECAs. However, many of the technologies that could qualify for tariffs under the RHI could also qualify for ECAs.

Expenditure above the AIA limit (that has not been relieved by ECAs) will attract writing down allowances at either the main rate (18 per cent per annum from April 2012) or special rate (8 per cent per annum from April 2012). Section 104A CAA lists the categories of expenditure that are special rate. If expenditure is not special rate then it will attract main rate allowances. Expenditure on the provision of an integral feature in a building (defined in section 33A CAA) will be special rate. This could include equipment that generates heat that attracts RHI tariffs, as building space or water heating systems are within the definition of integral features. Also, the special rate applies to expenditure on defined long life assets – generally, equipment expected to have a useful economic life of 25 years.

Proposed revisions

Special rate expenditure

Legislation will be introduced in Finance Bill 2012 to ensure that expenditure on solar panels from April 2012 will be designated as special rate expenditure. The AIA will, however, continue to be available on such expenditure.

Enhanced capital allowances

From April 2012 (or April 2014 for CHP installations) ECAs will not be available in respect of expenditure on plant or machinery when it generates electricity or heat (or produces biogas or biofuels) that attracts tariff payments under either of the FITs or RHI schemes. ECAs may still be claimed (subject the other conditions of the ECA schemes) in respect of expenditure on such equipment as long as no tariffs are paid.

Any ECAs given, in respect of expenditure incurred from April 2012 (or April 2014 for CHP installations), will be withdrawn if FITs or RHI tariffs are paid subsequently.

Summary of impacts

Exchequer impact (£m)	2011-12	2012-13	2013-14	2014-15	2015-16
	This measure is expected to increase receipts by approximately £70 million a year. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2012.				

Economic impact	The changes have no significant economic impacts.
Impact on individuals and households	The impact on individuals and households is negligible as any changes as a result of this measure would only apply to businesses claiming capital allowances.
Equalities impacts	The changes are not likely to impact on the equality of protected groups. Any legislative changes would affect only businesses and businesses of all sizes and across all sectors.
Impact on businesses and third sector	<p>Businesses investing in certain RHI technologies that currently qualify for ECAs after April 2012 (or April 2014 for combined heat and power installations) will not be able to claim the ECA as well as tariffs. There is no impact on earlier expenditure.</p> <p>A further impact of this measure is on businesses claiming capital allowances in respect of expenditure on solar PV cells provided for use in a dwelling-house, hotel, office, retail shop or showroom that may not previously have fallen to be treated as special rate – these would suffer a slight cash flow disadvantage by the changes, if their annual spend on plant and machinery exceeded the AIA limit of £25,000, as the expenditure is written off over a longer period of time.</p> <p>The one-off compliance cost to business of the recommended change option would be expected to be negligible. The changes to ECAs will remove the administrative burden involved in claiming ECAs for some businesses.</p> <p>The overall impact on businesses' ongoing administrative burdens of this measure is expected to be negligible.</p>
Operational impact (£m) (HMRC or other)	There will be a small impact on HMRC to update guidance and instructions.
Other impacts	<p><u>Small firms impact test:</u> The changes will apply to small firms and any expenditure on solar panels could potentially be allocated to the special rate pool to the extent that it is above the AIA limit.</p> <p><u>Carbon assessment:</u> For some businesses, the cost of FiTs or RHI qualifying expenditure will be written off over a longer period after the change, which reduces the post-tax rate of return offered by FiTs/RHI slightly. The Government considers that the return is still sufficiently generous to act as an incentive to purchase qualifying equipment and therefore does not expect the change to substantially affect the take up of the environmental regime.</p>

Monitoring and evaluation

The take-up of the FiTs and RHI scheme is monitored by DECC and measured against the projected take-up for each technology. Any unexpected adverse effect on the schemes from the capital allowances changes would contribute to a lower than anticipated take-up that would be reviewed.

Further advice

If you have any questions about these changes please contact Sue Pennicott on 020 7147 2610 (email: sue.pennicott@hmrc.gsi.gov.uk) or Malcolm Smith also on 020 7147 2610 (email: malcolm.smith3@hmrc.gsi.gov.uk).

1 Allowances for energy-saving plant and machinery

- (1) Part 2 of CAA 2001 (plant and machinery allowances) is amended as follows.
- (2) In section 45A (expenditure on energy-saving plant or machinery), after subsection (1) insert—

“(1A) This section is subject to section 45AA (payments under Energy Act 2008 schemes).”

- (3) After that section insert—

“45AA Section 45A exclusion: payments under Energy Act 2008 schemes

- (1) Expenditure incurred on or after the relevant date on plant or machinery is to be treated as never having been first-year qualifying expenditure under section 45A if—
 - (a) a payment is made, or another incentive is given, under a scheme established by virtue of section 41 of the Energy Act 2008 (feed-in tariffs) in respect of electricity generated by the plant or machinery, or
 - (b) a payment is made, or another incentive is given, under a scheme established by regulations under section 100 of that Act (renewable heat incentives) in respect of heat generated, or gas or fuel produced, by the plant or machinery.
- (2) All such assessments and adjustments of assessments are to be made as are necessary to give effect to subsection (1).
- (3) If a person who has made a tax return becomes aware that, after making it, anything in it has become incorrect because of the operation of this section, the person must give notice to an officer of Revenue and Customs specifying how the return needs to be amended.
- (4) The notice must be given within 3 months beginning with the day on which the person first became aware that anything in the return had become incorrect because of the operation of this section.
- (5) Except as provided by subsection (6), the relevant date is—
 - (a) for corporation tax purposes, 1 April 2012, and
 - (b) for income tax purposes, 6 April 2012.
- (6) In the case of expenditure incurred on a combined heat and power system, the relevant date in relation to subsection (1)(b) is—
 - (a) for corporation tax purposes, 1 April 2014, and
 - (b) for income tax purposes, 6 April 2014.”
- (4) In section 104A (special rate expenditure)—
 - (a) in subsection (1), omit the “and” after paragraph (e), and after paragraph (f) insert “, and

- (g) expenditure incurred on or after the third relevant date on the provision of solar panels.”, and
- (b) after subsection (3) insert –
 - “(3A) The third relevant date is –
 - (a) for corporation tax purposes, 1 April 2012, and
 - (b) for income tax purposes, 6 April 2012.”

EXPLANATORY NOTE

ALLOWANCES FOR ENERGY-SAVING PLANT AND MACHINERY

SUMMARY

1. This clause provides that where feed-in tariffs or renewable heat incentive tariffs are paid in respect of electricity or heat generated (or gas or fuel produced) 100 per cent first-year allowances (“FYAs”) are not available under section 45A of Capital Allowances Act 2001 (CAA) for expenditure incurred on the plant and machinery (P&M) that generates or produces it. This change generally applies for expenditure incurred on or after 1 April 2012 (for businesses within the charge to corporation tax) or 6 April 2012 (for businesses within the charge to income tax) but where the expenditure is on combined heat and power systems the change applies from 1 or 6 April 2014.
2. This clause also provides that expenditure incurred on solar panels, on or after 1 April 2012 (for corporation tax purposes) or 6 April 2012 (for income tax purposes), is special rate expenditure for capital allowances purposes.

DETAILS OF THE CLAUSE

3. Subsection (1) provides for changes to be made to Part 2 of CAA. The changes are specified in subsections 2 to 4.
4. Subsection (2) inserts a new subsection 45A(1A) into CAA. This provides that section 45A is subject to the new section 45AA.
5. Subsection (3) inserts new section 45AA into CAA.
6. New subsection (1) of section 45AA provides that expenditure incurred on P&M on or after the relevant dates (see paragraph 9) is treated as though it never qualified for FYAs under section 45A if a payment is made or another incentive is given for the purposes of:
 - a. Section 41 Energy Act 2008, in respect of electricity generated by that P&M; or
 - b. Section 100 Energy Act 2008 in respect of heat generated, or gas or fuel produced, by that P&M.
7. New subsection (2) provides for the making of assessments, or amendments to assessments, that may be necessary to give effect to new subsection (1), for example if an FYA is given and needs to be withdrawn because a feed-in tariff or renewable heat incentive tariff is paid subsequently.

8. New subsections (3) and (4) provide that a person who has made a tax return, and later becomes aware that it is incorrect because of subsection (1), must give notice of the amendments required as a result to HMRC within 3 months of the day on which the person became aware that the return had become incorrect.
9. New subsections (5) and (6) define the relevant dates for new subsection (1). These are, generally, 1 April 2012 for corporation tax purposes and 6 April 2012 for income tax purposes. Where the expenditure is incurred on combined heat and power systems, these are 1 April 2014 for corporation tax purposes and 6 April 2014 for income tax purposes.
10. Subsection (4) amends section 104A CAA. It adds a new subparagraph 104A(1)(g) which designates expenditure on solar panels as special rate expenditure for capital allowances purposes. New subsection 104A(3A) provides that the amendment to 104A(1) takes effect from 1 April 2012 for the purposes of corporation tax and 6 April 2012 for the purposes of income tax.

BACKGROUND NOTE

11. Capital allowances allow the cost of capital assets to be written off in computing the taxable profits of a business. They take the place of depreciation charged in the commercial accounts, which is not allowed for tax.
12. Most businesses are entitled to an annual 100 per cent allowance, the Annual Investment Allowance (AIA), for their investment in most P&M up to an annual limit, which from April 2012 will be £25,000 per annum. For expenditure above that limit, writing-down allowances (WDA) are available, which from April 2012 will be given at the main rate of 18 per cent or the special rate of 8 per cent per annum. The legislation lists (in section 104A of CAA) the categories of expenditure that are special rate; special rate expenditure includes expenditure on integral features of a building and on long-life assets (generally equipment expected to have a useful economic life of 25 years). If expenditure is not designated as special rate then it will attract allowances at main rate.
13. First-year allowances (FYAs) may be available for expenditure on certain types of plant or machinery as an alternative to AIA and WDA. FYAs are special allowances, currently available at a rate of 100 per cent, which provide a cash flow advantage over normal WDAs (as all the qualifying expenditure may be deducted from profits in the year in which it is incurred), as a targeted incentive to invest in particular P&M. FYAs, commonly described as enhanced capital allowances (ECAs), may be claimed on designated energy-saving P&M that meets the criteria required by either the Energy Technology Product or Criteria Lists.

14. The Energy Act 2008 provided for incentives to encourage low carbon energy and heat generation. The Feed-in Tariffs (FITs) scheme was introduced on 1 April 2010 and is designed to incentivise small scale electricity generation. The renewable heat incentive (RHI) supports heat generation from renewable sources. Generally, technologies that qualify under the FITs scheme will not be eligible for FYAs. However, many, although not all, of the technologies that could qualify for tariffs under the RHI scheme could also qualify for FYAs.
15. FYAs are intended to complement, rather than duplicate, the effects of other Government policies supporting such investment. Therefore, the legislation is being amended so that FYAs will not be available for expenditure on P&M, where the P&M generates heat or electricity or produces gas or fuel that attracts a tariff under either the FITs or the RHI scheme.
16. Businesses will be able to choose whether to claim the benefit of FYAs or tariff payments but will not be able to receive both. Where an FYA is given and a tariff payment is made subsequently, then the FYA will be withdrawn by means of an assessment or an amended assessment.
17. This change will apply to expenditure incurred on or after 1 April 2012 for businesses within the charge to corporation tax, or 6 April 2012 for businesses within the charge to income tax. However, because the RHI tariff rate for 'renewable' combined heat and power (CHP) will not be finalised until after April 2012 FYAs will continue to be available for expenditure incurred on renewable CHP until 31 March 2013 for businesses within the charge to corporation tax and 5 April 2013 for businesses within the charge to income tax, even when RHI tariffs are paid.
18. Expenditure on solar panels incurred on or after 1 April 2012 (by businesses within the charge to corporation tax) or 6 April 2012 (by businesses within the charge to income tax) will be designated as special rate so that it attracts the lower rate of WDA. Capital allowances are intended to provide tax relief that broadly reflects average rates of economic depreciation, so special rate is considered to be the appropriate rate of WDA for these assets. Expenditure on solar panels is being specifically designated as special rate to ensure clarity of treatment for business. The rate of WDA appropriate for expenditure on other plant or machinery that generates electricity or heat that attracts FITs or RHI tariffs will be determined on the facts by applying the normal rules for plant and machinery allowances.
19. If you have any questions about this change, or comments on the legislation, please contact Sue Pennicott on 020 7147 2610 (email: sue.pennicott@hmrc.gsi.gov.uk) or Malcolm Smith also on 020 7147 2610 (email: malcolm.smith3@hmrc.gsi.gov.uk).