

The Infrastructure Forum

July 2023

The Infrastructure Forum's Taxation Working Group **Supporting UK infrastructure development through the tax regime**

1. The Infrastructure Forum (“TIF”) brings together the key players in infrastructure, whether investors, operators, contractors, economic regulators or professional advisors. The TIF Taxation Working Group of the Infrastructure Forum has engaged with HM Treasury and with HMRC at policy level, proactively and constructively contributing to the development and structure of key tax policies under the BEPS initiative such as the Corporate Interest Restriction and Hybrid legislation and the introduction of Structure and Buildings Allowances, Freeports, and the Super-Deduction itself.
2. It contributed to the recent consultation on Capital Allowances and in subsequent discussion with officials, called for full in-year tax relief on all capital expenditure incurred on qualifying infrastructure, as a powerful incentive for infrastructure investment. It is positive that this was announced at the Budget 2023.
3. TIF pointed out that taking into account procurement times, planning and mobilisation, investors need to be confident that such reliefs will not be reversed or removed after a two or three-year period. Infrastructure and Construction Projects on the Government Major Projects Portfolio take an average duration of 11 years to complete, according to the IPA’s Annual Report on Major Projects.
4. It is therefore key that the Chancellor fulfils his intention to make full capital expensing a permanent measure “as soon as we can responsibly do so”. Investors seek stable markets with consistent policy, regulation and tax regimes which are likely to provide the best chance of obtaining a fair return on their investments. Consequently, the UK tax regime needs stability, especially where long term projects such as those in infrastructure are concerned.
5. A key benefit of the US Inflation Reduction Act is that it provides businesses with the certainty to make long-term investments, which is clearly a challenge in the UK.
6. Whereas once the UK was a leader in long-term investment in renewables and other low-carbon technologies, supported by a tax regime that emphasised stability, and a tax regime that emphasised a competitive tax regime (e.g., the lowest headline rate), we have seen a slow-down in that growth, combined with ever increasing complexity, administrative tax burdens and higher tax rates. The tax regime should support the Government’s wider objectives, with an underlying principle of clarity and certainty.
7. This is important because the competition for investment in infrastructure projects is international. The US Inflation Reduction Act (IRA) contains billions in new spending and tax breaks that aim to boost clean energy. The majority of energy and climate funding is in the form of tax credits. It has changed the game in the market for global investment especially in the green transition. Rapidly increasing interest rates and associated costs of debt and equity in conjunction with high capital expenditure prices are making the economics for renewables development projects marginal in the UK. Additional uncertainty over the tax regime, and potential electricity market

reform further heightens risk for developers and will deter investment in the development of the projects needed to deliver on the UK's Net Zero plans.

8. It remains that the UK taxation system needs careful redesign. Innovative decisions now should be more than repaid through the opportunity for training and job creation that such investment will bring. In particular the Forum would like to see the introduction of a 'special tax regime' for qualifying businesses. A framework of how such a regime might work is explored in the following table, along with other priorities for the Forum's network.

A special UK tax regime

A special UK tax regime for infrastructure could be used to encourage investment in key sectors and could go some way towards replicating some of the tax benefits on offer in the US under the Inflation Reduction Act.

Such a system could broadly revolve around the following principles:

1. Qualifying businesses – The government should select the industries/sectors that are able to apply the regime. Such a list should target those industries where material investment is required, for example to help achieve net zero aspirations or to stimulate investment in new or evolving technologies. Some obvious examples include windfarms, solar PV, battery storage, & EV charging infrastructure, hydrogen and digital infrastructure and related technologies.
2. Regular review of the list – The government should then commit to regularly review/update that list which would provide an element of control and would also allow for sectors/technologies to be added or removed at a later date.
3. Tax system – The system could work similar to the QAHC regime introduced in 2022. All companies are *prima facie* subject to existing UK tax law, however, if they satisfy the qualifying criteria, they could make an election to apply the special tax wrapper provisions. An election would then put those companies into a new section of tax legislation as opposed to having to rewrite all of the existing legislation.

The concept of a Qualifying Infrastructure Company ("QIC") already exists in the UK CIR rules. A special wrapper would expand on that definition and broaden the remit of the tax incentives applicable to QICs – see below. The oil and gas and life sciences sectors already benefit from sector specific initiatives. For example, the decarbonisation allowance was explicitly designed to encourage investment in the decarbonisation of North Sea offshore platforms.

There are a number of special benefits which could be included within the tax wrapper:

- **Reduced corporation tax rate** – Companies within the regime could be subject to a reduced rate of CT (e.g. 15%). This would need to be assessed in conjunction with Pillar 2 initiative.
- **Capital allowances** – Capital allowances for QICs be simplified, for example a single pool where all fixed asset expenditure qualifies for tax relief. Simplicity is key here (i.e. no uncertainty on long-life v short-life, qualifying v non-qualifying).
- **Tax relief for financing costs** – This could be simplified and made friendlier for QICs – i.e. full exclusion from CIR rules, simplification and limitation of anti-hybrid and other unhelpful provisions where tax avoidance clearly is not a feature or purpose of the financing.
- **Tax losses carried forward** – Remove the restrictions on the use of carry forward losses for QICs
- **Cash tax credits** – Introduce the ability to surrender a percentage of tax losses and/or capital allowances for a cash tax credit from HMRC. This should also apply to businesses that are ‘pre-trading’.
- **Enhanced R&D or ‘clean energy’ incentives** – This could be linked to the cash tax credit above but could also take another form (e.g., a 30% super-deduction for ‘green’ expenditure).
- **Blanket exemption from UK WHT** – This could help to eliminate complexity and uncertainty, removing a potential barrier to international investment.
- **Employment tax savings** – Reductions in employer NIC costs for QICs
- **SDLT / Business Rates relief** - Extend to QICs (even if not in a Freeport Zone).

Make full expensing permanent

With the expiry of the super-deduction at the end of March 2023, and an increase in corporation tax, the new 100% capital expenditure deduction was a positive announcement at the Budget. There is however concern that full-expensing is currently only set to last three years, particularly among infrastructure organisations.

As TIF argued about the Super-Deduction, new renewable projects require investors to take a long-term view on investment with assets having a typical operational life of 25 or 30 years, or even longer. Investors therefore seek stable markets with consistent policy, regulation and tax regimes which are likely to provide the best chance of obtaining a fair return on their investments.

It is therefore critical that full expensing incentive is made permanent as soon as possible, to provide long term certainty to investors and those organisations undertaking major infrastructure projects in the UK. Forum members have raised concerns that without such certainty, projects will not go ahead.

A UK tax credit system

The Inflation Reduction Act in the US promoted the idea of green energy allowances to the top of the agenda. If the Government wants to keep investment flowing in the UK, there will have to be some compensatory adjustment. It has become increasingly apparent in the wider debate, as TIF has long argued, that investors need incentives and stability to make long term capital commitments. This is important with the number and size of green energy projects that need to be accelerated.

Some view the IRA as an existential threat, as they worry that the incentives offered by the IRA will cause a mass relocation of capital and expertise from European businesses to businesses in the US in clean hydrogen, carbon capture, and solar industries. Organisations including Volkswagen, Drax, Tesla and Northvolt AB have all publicly stated their intention to shift investment and manufacturing to the US to take advantage of IRA incentives.

The UK's current policies, as admitted by Government, are not enough and the UK will miss its net zero targets. This means that the UK's ability to meet its net zero target and therefore its reputation as a global climate leader is at stake. Many of the recent changes to the UK tax regime (corporate interest restriction, loss restriction and changes in direction to dramatically increase the corporation tax rate by 6%) have made it harder, not easier, to develop the critical infrastructure that is necessary to meet the Government's objectives.

The UK must learn from the unprecedented certainty and policy stability that the IRA provides. Most of the tax credits included within the IRA are available from 2023-32, providing certainty and predictability and coinciding with the critical decade for climate action. In order to compete with the IRA and EU Net Zero Industry Act, the UK system needs a fundamental change to enable a tax credit trading mechanism to be introduced.

Other mechanisms of the tax system should be utilised in conjunction to tax credits to ensure that supply chains set up in the UK. The rollout of offshore wind provides a key example. Whilst the price of offshore wind power reduced significantly following UK subsidies to build a critical mass, some of the benefits that could have been achieved by developing the supply chains in the UK went offshore. By utilising such an approach, job creation and increasing productivity would provide the payback to Government through increased tax receipts.

Other measures

In the infrastructure sectors, the impact of the Annual Investment Allowance (AIA) is negligible. An increased AIA - potentially up to £25 million on an entity basis or £100 million on a group would have the potential to incentivise investment in certain areas of the UK's infrastructure.

The rate of the Structure & Buildings Allowance is still relatively low at 3% and therefore often failing to act as a meaningful incentive.

This could be increased or an initial allowance introduced that would close the disparity between the plant and machinery rate and structures and buildings.