Tax Faculty

Tax Representation

# TAXREP 50/05

## LEASED PLANT AND MACHINERY

*Memorandum submitted in October2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a Technical Note issued on 21 July 2005 by HM Revenue & Customs*

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# LEASED PLANT AND MACHINERY

## INTRODUCTION

1. We welcome the opportunity to comment on the technical note **Leased Plant and Machinery** http://www.hmrc.gov.uk/consult_new/tech-note.pdf

2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in the Annex.

## GENERAL COMMENTS

3. We welcome the present proposals which we believe are a considerable improvement on the leasing proposals contained in the December 2004 Technical Note covering several different areas of Corporation Tax Reform http://www.hmrc.gov.uk/pbr2004/sup_ct-reform-tech-note.pdf We commented on the proposals in that earlier Technical Note in TAXREP 9/05 http://www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_78019

4. The improvements made to the definitions of funding lease in response to our comments in TAXREP 9/05 on the December 2004 paper are extremely welcome.

5. Finance leasing is extremely important for UK commerce and industry as was made clear in the Oxford Economic Forecasting report to the Finance and Leasing Association which we referred to in paragraphs 43 to 45 of our TAXREP 9/05.

## ARE THE PROVISIONS COMPLIANT WITH THE EC TREATY?

6. The revised long funding lease proposals were unveiled in a note of 21 July 2005, and are stated to be coming into force with effect from 1 April 2006.

7. The Tax Faculty has previously articulated its concern that the prior, PBR 2004, version of the long funding lease rules was contrary to the EC Treaty.

8. Notwithstanding the decisions in D(C-376/03) 5 July 2005 and Schempp (C-403/03) 12 July 2005, the Tax Faculty continues to believe that the revised long funding lease proposals are contrary to the EC Treaty free movement of capital for the reasons summarised below.

### Comparison of an entirely domestic lease with a cross-border intra-EU lease

9. Consider a lease of equipment that triggers long funding lease treatment between an unconnected domestic lessor and domestic lessee. As the domestic lessee (assumed to have UK tax capacity) will be able to receive a cash tax benefit for the capital allowances now transferred from the lessor to the lessee, such a lessee is likely to be prepared to pay higher rentals (in the same way that a lessor enjoying capital allowances currently is likely to accept lower lease rentals from a lessee).

10. Consider by comparison a cross-border long funding lease written by a UK lessor in favour of an unconnected third party French lessee. We understand that the French lessee will not qualify for French tax depreciation. Nor, assuming they are not trading in the UK through a permanent establishment, will they have UK tax capacity, and accordingly, they will not benefit from the transfer of the capital allowances from the unconnected UK lessor. They will therefore only be prepared/able to pay a lower rental, inhibiting their access to cross-border leased equipment.

11. Accordingly, the new proposals will discriminate against cross-border (intra-EU) situations, as compared with an entirely domestic long funding lease.

12. We do not consider that this analysis, shared with HM Revenue & Customs on 20 May at a meeting chaired by Diane Hay, is affected by the judgements in either the D or Schempp cases. The agreed notes of that meeting have been published as TAXGUIDE 3/05 http://www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_82578

13. In both cases, the ECJ brought forward a new defence of non comparability where, in the cross-border situation, Mr D's 90 per cent of net assets being situated in Germany in the D case, and Mrs Schempp's maintenance being received in Austria in the Schempp case, there is exemption. This is not the case with a cross-border lease, in so far as the lessee is in charge to corporation tax or indeed income tax locally. See, in particular, dicta of the ECJ in Manninen C-319/02 (7 September 2004), Lenz C-315/02 (15 July 2004) and Pusa C-224/02 (29 April 2004) regarding taxability in State B ensuring comparability with State A.

14. Nor do we consider that the ECJ's rejection of the most favoured nation (MFN) principle in the D case alters the analysis. The comparison we are adducing is between the entirely domestic situation, and the cross-border situation rather than between two non residents as in the D case (Mr D as the German resident, and a hypothetical Belgian resident).

15. Accordingly, we remain of the view that the long funding lease proposals are contrary to the EC Treaty and are likely to be found to be disproportionate on Gebhard grounds

**OTHER COMMENTS**

*Defining a plant or machinery lease (paragraph 40)*

16. The use of the accounting definition of a finance lease as one of the tests in determining the tax treatment is unwelcome, particularly at a time of uncertainty and change in accounting standards.

17. Practical application of IFRS to lease transactions in the UK is being considered for the first time at the moment and under the IASB's draft policy, Technical Corrections to an international accounting standard would be made after a 30 day comment period and would generally be effective immediately. Thus, the accounting treatment could change at short notice, causing a change to the tax treatment of a lease and a change to the commercial economics of the transaction.

## COMMENCEMENT AND TRANSITION PROPOSALS

18. We believe that the commencement and transition provisions are arbitrary and harsh.

19. The Technical Note is said to represent a reform of the basis of taxation, not a targeted anti-avoidance measure. However, the way in which transactions are to be taxed will, in many cases, change if they were not subject to a written agreement between the contracting parties before the date of publication of the proposals – as is typically the approach for anti-avoidance rules. The December 2004 Technical Paper had suggested that the existing lease tax regime would continue to apply to leases entered into before the start of the new rules. This was widely expected to be 1 April 2006, which date has been confirmed. Thus, many transactions were in an advanced state of negotiation in July 2005, but not yet subject to a signed agreement. It appears that some may still qualify for the existing rules (subject to the comment in paragraph 10 below) but uncertainty exists, which is not a satisfactory basis on which to conclude a commercial transaction, particularly as the economic viability of the whole deal may change under the proposed new rules.

20. Another aspect of transition is the requirement for the assets which were subject to pre-21 July 2005 agreements to be both under construction by 31 March 2006 and delivered by 31 March 2009 (or, in some cases, 31 March 2007). This does not cover a number of commercial transactions for large assets. For example, a large merchant vessel, the subject of an agreement signed in early July 2005, may well still be at the design or planning stage at 31 March 2006 and thus fail to get the tax treatment which was in force on the day of the contract.

21. The uncertainty caused by these measures, both in terms of the dividing line between what is or is not an ‘existing agreement’ as mentioned in paragraph 9 above and the lack of new revised draft legislation and final proposals is a considerable impediment to the proper functioning of the investment decision process of many UK companies.

22. We believe that the proposal should be finalised and draft clauses released as soon as possible, or the start dates for the various aspects of the new rules should be delayed.

23. As stated above, given that this is a reform of basis, rather than anti-avoidance, there is a strong argument that all of the dates involved should be postponed for 6 months, or even a year.

## SPECIFIC REQUESTS FOR COMMENT

24. There is a specific request for comments (paragraph 12 and repeated in paragraph 127) on some of the details of the regime which are dealt with in the present section of our Representation.

*The possibility of allowing businesses to elect in to the new regime or opt to be taxed on an accounts basis (paragraphs 51 – 53)*

25. We would welcome the ability of lessors to be able to elect into the new regime which would ease administrative burdens for certain classes of business.

*The proposals for hire purchase (paragraphs 59 – 65)*

26. We think that this section is somewhat unclear and does not accord with reassurances which some of our members have received from HMRC to the effect that there is to be no change to the ability of lessees to claim capital allowances in respect of equipment used under such contracts.

*The procedure for preventing double allowances (paragraphs 70 – 84)*

27. We agree that there should be rules to prevent capital allowances being claimed more than once in respect of the same asset.

*Possible changes to the availability of first year allowances for lessors of environmentally beneficial technology*

28. The potential removal of first year allowances from lessors in respect of environmentally beneficial technology seems questionable in terms of public policy.

29. The aim of these allowances appears to be to reduce or eliminate the additional net cost of using green technology as opposed to conventional equipment. Where the trader wishes to use leasing (whether because of a lack of its own immediate taxable profits or for other reasons) this incentive will be removed if the current proposal is adopted.

IKY
7.10.05

**ANNEX**

**WHO WE ARE**

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.