



Response from ICAS

Lease Accounting Changes: Tax Response

28 October 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to contribute to the consultation "Lease Accounting Changes: Tax Response" issued by HMRC on 9 August 2016.
3. The present consultation only considers plant and machinery leases but IFRS 16 has a wider scope. Additionally, as noted in the consultation document, it is unclear whether UK GAAP will be changed in line with IFRS 16 – if it is, the earliest date for the change would be 2022. In order to arrive at the optimal solution, it might be preferable to have a wider consultation on the full picture arising from IFRS 16 – possibly at a later date (once it is clear what the position will be for UK GAAP).
4. Any changes to the treatment of plant and machinery leases potentially affect the proposed new rules on restricting relief for interest. Depending on the final approach adopted to the restriction of interest deductions and the nature of the leasing changes there could be unintended consequences for some lessees who might find their interest deductions restricted (or that they would have to use the group ratio rule to mitigate this).

Do you think the criteria in 1.11 are the right criteria to use and are there any other criteria that the government should take into account?

5. We do not disagree with the criteria in 1.11 but we believe there are other criteria which should also be taken into account. In particular, the true economic impact of changing the current regime needs to be considered in depth.
6. Consistency between taxpayers should also be a consideration. Options 2 to 4 in the consultation document would involve the removal of capital allowances for lessors. This will make leasing less attractive for lessors providing medium to long term assets such as aeroplanes and trains – but could benefit short term lessors (such as vehicle hire companies). This would not appear to be in line with government policy aims.

Specific discussion points

Option 1

Option 1, unlike the other options, involves capital allowances still being available to lessors, except under long funding leases. What merits are there in maintaining this current approach to the allocation of capital allowances?

7. Maintaining the current approach would retain capital allowances for lessors (other than for long funding leases) and the provisions have been in place for some time so they are familiar to lessors and lessees. However, changes would need to be made to the legislation, particularly to replace references to finance and operating leases. The consultation suggests that HMRC believes the necessary changes can be made without adding any complexity, although only limited details are provided.
8. The capital allowances regime provides some flexibility on timing because of the possibility of deferring capital allowance claims. For loss making companies this flexibility is useful and the availability of deferral would become more significant for large companies if the proposed restrictions on loss relief go ahead, as set out in the consultation document earlier in 2016.

Is the current system of lease taxation well enough understood to override issues around complexity?

9. The current lease taxation regime is complex, particularly the long funding lease rules. It has also been subject to frequent changes introduced to address avoidance; this has added considerably to the complexity. However, s70H CAA 2001 permits lessees not to use the long funding lease rules in certain circumstances. The regime also has the advantage of familiarity.
10. As discussed below it is unclear whether Options 2 to 4 would in practice result in genuine simplification.

Option 2

An accounts based regime would replace for all leased assets current access to capital allowances with accounting depreciation. What impact would this have on financing decisions and on the availability of finance?

11. Adopting any of options 2 to 4 could restrict the availability of finance because of the adverse consequences for lessors. These options could discourage investment and lead to an unwillingness amongst lessors to deal with medium to long term assets such as aeroplanes and trains.

There may be circumstances where the tax treatment will need to depart from the accounting treatment to prevent abuses. How much of a burden would this present?

What are the relative merits and disadvantages of this option compared to the existing regimes?

12. Option 2 (and options 3 and 4) might provide some benefits for lessees, particularly if they involved genuine simplification. As noted above some aspects of the current regime, particularly the long funding lease rules are complex.
13. A key advantage of option 2 should be that it would represent simplification. However, as noted in paragraph 4.8 of the consultation document, it seems likely that there would have to be anti-avoidance rules to prevent abuse arising out of 'asymmetry of treatment between lessor and lessee and acceptable rates of depreciation'. This would considerably reduce the attractiveness of option 2 – particularly given the potential adverse consequences noted in paragraph 11 above.
14. Option 2 would also require grandfathering provisions for existing leases. It is unlikely to be practical to maintain two sets of records for the duration of long leases so grandfathering would have to be time limited. The transition is likely to require complex legislation and could have an adverse impact on those with affected long leases.

Option 3

If a leasing allowance were considered, would this have an impact on financing decisions?

Would claiming the leasing allowance present any particular difficulties?

Should the leasing allowance be available where assets of low value are leased and no right of use asset is recorded by the lessee?

What do you consider are the advantages and disadvantages of the accounts based incentives option compared to maintaining the existing scheme of legislation (Option 1)?

15. See our comments in paragraphs 11 to 14; these apply to option 3 as to option 2. As option 3 is potentially more expensive for the exchequer than option 2 it is possible that additional anti-avoidance measures might be required, further reducing any simplification benefit.
16. The intention of option 3 is to compensate lessees (but not lessors) for the loss of capital allowances. This would be likely to require more than one rate of allowance to address differences between long life and short life assets. This would add complexity to the regime.
17. The proposal set out in paragraph 4.12 would also involve added complexity. In many cases this is likely to affect smaller companies which are least able to cope with the added burden and therefore most likely to lose out.

Option 4

If capital allowances were made available to the lessee based on the right of use asset would this have an effect on a decision to buy or to lease an asset?

If capital allowances were to be made available to lessees should this extend to cover arrangements where no right of use asset is recorded by the lessee?

Should capital allowances be available where assets of low value are leased and no right of use asset is recorded by the lessee?

What do you consider are the advantages and disadvantages of the accounts based capital allowances option compared to maintaining the existing scheme of legislation (Option 1)?

18. See our comments in paragraphs 11 to 14; these apply to option 4 as to option 2. Option 4, like option 3, is potentially more expensive for the exchequer than option 2 so it is possible that additional anti-avoidance measures might be required, further reducing any simplification benefit.
19. The benefits to lessees are only likely to apply to leased assets where the asset is longer life and the lessee leases it for most of its useful life.
20. See our comments in paragraph 17 above in relation to paragraph 4.16 of the consultation document.