Office for Budget Responsibility

17 February 2022

Supplementary forecast information release

Capital allowances super-deduction costing

1.1 The OBR is releasing this information following a request for further detail on the information presented in our March and October 2021 *Economic and fiscal outlooks* (*EFO*) in respect of the '*capital allowances: 130% super-deduction for main rate assets and 50% first year allowance for special rate assets for two years*' measure that was announced at Spring Budget 2021. We will, as far as possible, meet any requests to release supplementary forecast information where this will improve the quality of public debate on the public finances. Our full release policy is available on our website.

1.2 The enhanced super-deduction rates apply to unlimited new expenditure on qualifying plant and machinery within the two-year period from 1 April 2021 to 31 March 2023. The rates are several times more generous than the 18 and 6 per cent capital allowance rates that would otherwise have applied to expenditure on main and special rate assets respectively. Specifically, the request relates to the behavioural effects that were included in the costing, and how it captured the interaction with the existing annual investment allowance (AIA).

Behavioural effects included in the costing

1.3 The main behavioural response in the costing relates to the impact on investment in qualifying assets, particularly the incentive to bring investment forward so that it falls within the super-deduction eligibility window (see Chapter 2 and Annex A of our March 2021 *EFO* for more detail). By making projects more profitable, we also expect it to raise capital spending during the period the super-deduction is in place. At its peak, we assumed that business investment would be around 10 per cent higher than would otherwise have been the case, due overwhelmingly to investment brought forward from future periods. Once the incentive is withdrawn, investment is assumed to be lower than would otherwise have been the case as the impact of the brought-forward investment unwinds. As a temporary measure, it will not affect the long-run cost of capital and therefore we did not assume that it would affect the level of investment and the capital stock in the longer term.

1.4 Table 1.1 shows the time-shifting nature of the measure. The original costing totalled £29 billion between 2020-21 and 2023-24, with a single-year peak cost of £12.7 billion in 2022-23. The measure then recoups £4.9 billion of this cost in total over the final two years of the forecast, an effect that would be expected to continue beyond the forecast horizon. This reflects not only the subsequent drop in investment but also that super-deduction claims affect receipts in a single year whereas under the pre-measures system they are spread out over several years. In our October 2021 *EFO* we reported that the early evidence suggested that claims were building up more slowly than assumed in the original costing, which, along with other smaller factors (one of which is discussed below) led us to reduce the overall costing by £4.8 billion between 2020-21 and 2023-24. The slower take-up also pushed some of the yield in later years beyond 2025-26.

1.5 A second, smaller, behavioural effect is included to account for an increase in tax avoidance. The generosity of the super-deduction means that businesses have an incentive to rebadge non-qualifying expenditure as being eligible. The costing includes a rise in this type of 'boundary-pushing' that equates to a 5 per cent addition to the cost in 2021-22 and a 10 per cent addition in 2022-23. This assumption was informed by HMRC's published estimate of the corporation tax gap, the most recent of which is 7.6 per cent for 2019-20.

Table 1.1: Super-deduction: original and revised costing

	£ billion					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
March 2021	-1.7	-12.3	-12.7	-2.4	2.1	2.8
October 2021	-1.0	-9.4	-10.6	-3.2	0.8	2.1

Interaction with the annual investment allowance

1.6 The AIA is a 100 per cent capital allowance for qualifying expenditure on plant and machinery, up to a specified annual limit. At the time the super-deduction was announced, the AIA limit was £1 million between 1 January 2019 and 31 December 2021, before dropping to £200,000 thereafter. These are the parameters used in the costing.[1]

1.7 The costing assumes that 90 per cent of expenditure eligible for both the AIA and the super-deduction shifts to using the latter since it is more generous. It does not assume 100 per cent will shift since there is likely to be a degree of inertia for some companies that are familiar with using the AIA. Some companies will also be able to gain by replenishing their AIA pool with qualifying expenditure that is ineligible for the super-deduction, and that would have previously exceeded the AIA limit. The original costing assumed that 80 per cent of the expenditure that shifted from the AIA to the super-deduction in 2021-22 would be replaced, rising to 85 per cent in 2022-23 and 2023-24. In October, we revised these assumptions down – to 25 per cent and 30 per cent respectively – to reflect new information from further company-level analysis carried out by HMRC. This change reduced the overall costing by around £1.7 billion across the forecast period.

[1] Our forecasts are prepared on an iterative basis and we include the impacts of policy and other developments sequentially as they arise. This means that the costing for the subsequent Autumn Budget 2021 extension of the £1 million AIA limit to 31 March 2023 was costed against a baseline forecast that included the effect of the super-deduction (rather than the super-deduction measure being recosted to reflect the impact of the AIA remaining at £1 million throughout the period it is in place).