

3 June 2010

The Rt Hon George Osborne Esq MP
Chancellor of the Exchequer
HM Treasury
1 Horseguards Road
London SW1A 2HQ

Agricultural Engineers Association
British Automation and Robot Association
British Paper Machinery Suppliers Association
British Plastics Federation
British Turned Part Manufacturers Association
Confederation of British Metalforming
Gauge and Toolmakers Association
Manufacturing Technologies Association
Printing Industry Confederation
Processing and Packaging Machinery Association
UK Industrial Vision Association

Dear Chancellor

Engineering and Machinery Alliance Budget Submission

First, may I congratulate you on behalf of EAMA's eleven trade associations and their 1,600 member companies on your appointment as Chancellor of the Exchequer. I very much hope that together we will help you to achieve the economic rebalancing you have set as a priority for the country.

In that regard I believe that there is common ground between us.

But rebalancing isn't only about growing UK manufacturing output for its wealth creation and employment potential. There's the yawning trade deficit to consider too.

UK manufacturers earn three times as much overseas as the City of London. So expanding manufactured exports is one of the simpler ways to tackle the UK's growing trade deficit, which on its current trajectory will reach an unsustainable 5% in 2020 (see Cambridge University's Coutts and Rowthorn (Civitas March 2010) *Prospects for the UK balance of payments*).

At £194 billion in 2008, a 13% increase in manufactured exports alone would have eliminated the current account trade deficit that year. Typically our sector, mechanical engineering, exports 70% of production.

Our recommendations were framed by our business experience and in particular the following factors:

- Affordability – obviously the public finances.
- Perceived waste -- Manufacturers are edged about with far too much vitality-sapping bureaucracy and regulation when a simplified approach would produce more cost effective results e.g. applying for most types of support is so complex that consultants routinely charge/skim off 20-25% of the support sum as their fee for the paperwork they handle for the applicant firms.
- The increasing speed of technological change – manufacturing machinery may well have a useful life after seven or eight years but it will probably have been surpassed in terms of operating efficiency.
- Competitiveness -- most western economies facing similar problems to the UK's are coming to very similar conclusions about exporting as a priority, witness the USA where the administration aims to double exports in five years. Measures there include an Export Cabinet, reporting directly to president Obama, and a 50% increase in the Ex-Im Bank's budget (to \$6 billion) for SMEs that want to export.
- In addition, newly industrialising countries are emerging as powerhouses producing and trading manufactured goods.

- Government's past commitment to manufacturing – Government has only shown a real interest in manufacturing fairly recently. For the previous 40 years, service sectors and particularly finance dominated enterprise and economic policy, so that basically manufacturing survived in the UK despite government policy.
- Now government needs to attempt something it hasn't done before -- introduce a sector-shifting, coherent pro-manufacturing policy strand across all Whitehall departments. It will be vital to have an open mind on policy and excellent feedback loops from trusted sources to monitor progress.

We applaud your commitments to simplify the corporate tax structure and reduce the rate, and cancel the previous administration's 2011 increase in employer NICs.

In the attached submission we show how the previous government's policies have affected manufacturing investment and its knock-on impact all but reducing the size of the sector in real (gross value added) terms.

Amongst the proposals we recommend are five crucial actions on tax/investment, skills/education, on SME access to credit and exporter support in line with your commitments for reform while protecting manufacturing industries.

To develop and maintain an internationally competitive, longer term manufacturing investment friendly tax environment. Our main proposals are to:

- Reduce Corporation Tax as soon as is prudent.
- Maintain the Annual Investment Allowance at £100,000 and indicate your intention to increase this steadily each year up to £500,000.
- To raise the quality and number of UK students with science and engineering qualifications by benchmarking UK attainment levels against competitor nations.
- To reform SMEs' access to credit by pressing the banks to deliver on their promise to fund an extra £41 billion to SMEs on reasonable terms.
- To ensure that UK manufacturing exporters are supported by world competitive trade financing services by creating a significant bond support scheme that works to the benefit of exporters in their relationship with their financial partners.

With best wishes

Yours sincerely



(signed electronically 3 June 2010)

Martin Walder
Chairman

cc Dr Vincent Cable MP – Secretary of State, BIS
Mark Prisk MP – Minister of State, BIS
Catherine Green, Jaya Choria – HMT
Marie-Anne Mackenzie, Brian Greenwood, Sandy Grom – BIS
Member associations

Budget Briefing

from the

Engineering and Machinery Alliance

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1 June 2010

1 Background to the Alliance

The Engineering and Machinery Alliance (EAMA) represents the following trade associations:

- Agricultural Engineers Association
- British Automation and Robot Association
- British Paper Machinery Suppliers Association
- British Plastics Federation
- British Turned Part Manufacturers Association
- Confederation of British Metalforming
- Gauge and Toolmakers Association
- Manufacturing Technologies Association
- Printing, Papermaking and Converting Suppliers Association
- Processing and Packaging Machinery Association
- UK Industrial Vision Association

They represent 1,600 firms in the mechanical engineering sector with sales of £8 billion.

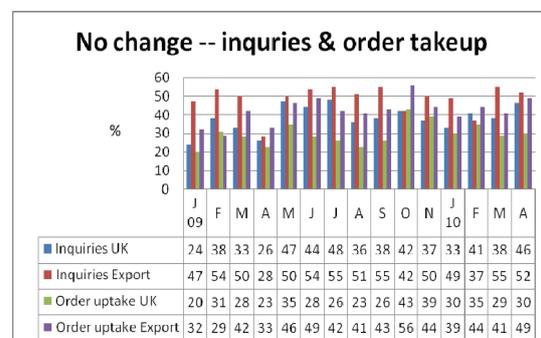
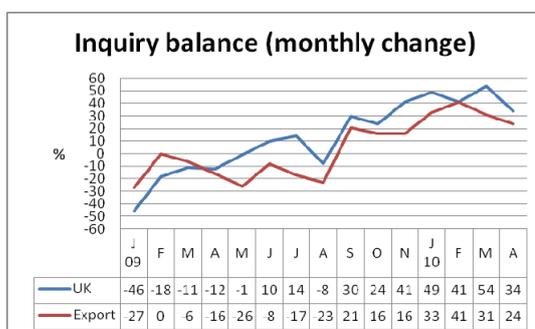
- Based on the Office of National Statistics (ONS) new criteria for the sector they represent a third of the UK's mechanical engineering output.
- Using HM Customs' data, sector exports account for about 70% of sector sales.
- And again according to ONS comparisons, mechanical engineering is one of only two manufacturing sectors to regularly contribute a positive trade balance to the UK economy -- over £3 billion in 2008.

Typically our companies supply 'enabling technologies' to other sectors (e.g. automotive, aerospace, medical, power and food industries) in the form of machinery or packages combining services and products.

This is the preserve of small and medium sized niche or specialist companies (SMEs). Important, large companies are also involved, as are many innovative entrepreneurial SMEs, all pushing the boundaries of factory performance, extending the envelope of the physically feasible to new levels in terms of speed, precision and migration into novel technologies and materials.

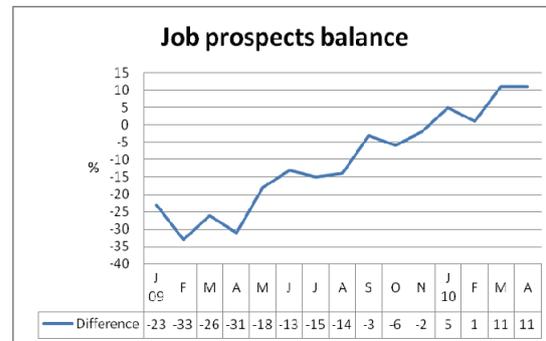
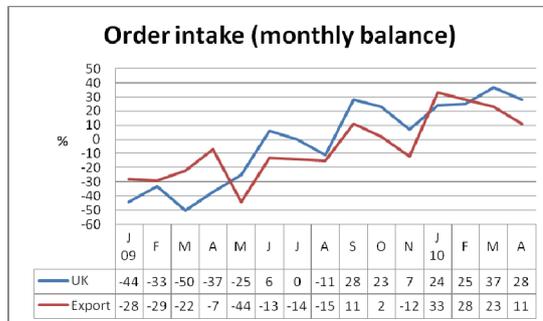
2 Current business environment – EAMA Business Monitor¹

- On inquiries the balance, between firms recording increases and those reporting falls, turned positive last September.
- A larger proportion of export companies has consistently reported no monthly change when it comes to inquiries and order uptake, indicating that export related business has been more resilient through the recession.

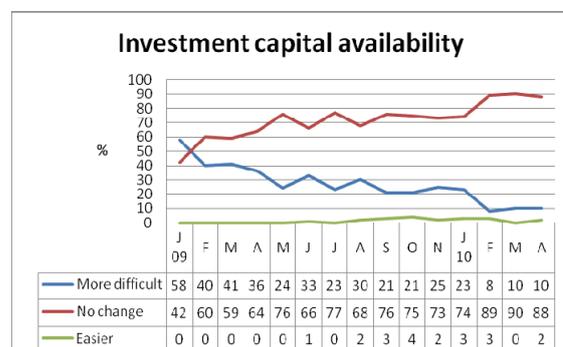
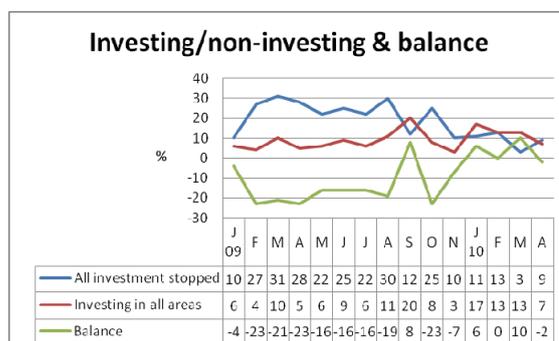


¹ The EAMA Business Monitor is a snapshot survey recording month on month changes in performance (up, down, the same). Participation fluctuates between 70-130 firms. (Note: there was no December survey due to seasonal closures.)

- However, UK orders picked up before exports (as early as June).
- Since January this year order intake has performed well for UK and export business. After a very positive first quarter, the balance slipped back in April. Although good business continues, we estimate it's still 20-30% down on 'normal' trading.
- Job prospects have also improved with just under a fifth of firms positive and less than one in ten saying that they are reducing numbers.



- However, on investment there is little improvement to report so far.
- The Monitor tracks investment intentions through a bank of six questions. Between a fifth and a quarter of companies have kept on investing in training since October, but capital investment performance is more erratic as shown in the graph below tracking responses to the questions "All investment stopped" and "Investing in all areas".
- We haven't seen any real improvement in the availability of investment finance.



3 Impact of previous policies

UK manufacturing investment performance

According to the Office of National Statistics, UK manufacturing investment declined 40% while gross value added (GVA) increased by 5.3% and numbers employed in the sector fell by nearly 30% in the ten years 1998 to 2007.

Table 1 UK manufacturing performance 1998-2007

Year	GVA basic prices £ billions	Average numbers employed (millions)	Net investment £ billions	No of companies
1998	150	4.4	20.4	169,376
1999	150	4.3	18.1	170,196
2000	149	4.1	17.0	167,289
2001	145	4.0	16.3	164,718
2002	144	3.8	13.2	162,212
2003	142	3.5	12.7	157,894
2004	149	3.4	11.7	154,967
2005	147	3.3	11.3	153,262
2006	152	3.2	11.4	151,365
2007	158	3.1	12.0	149,101

Annual Business Inquiry June 2009

Using the EU's AMECO ECFIN database we can compare French, German and Spanish performance on a similar basis.²

Thus, over the same 1998 to 2007 period, French, German and Spanish manufacturers grew their GVA in 'constant' 2000 Euros by three to five times the UK rate and in doing so kept their manufacturing employment levels significantly higher than the UK.

As a result France, Germany and Spain have all benefitted from an additional 15-25% rise in national wealth which has flowed through their economies, creating extra demand for other sectors as well as of course making an extra contribution to government coffers.

Table 2 Manufacturing gross value added comparison constant 2000 Euros 1998 to 2007

Country	1998			2007			% change 1998 - 2007		
	Sector € billion	Nos employed millions	Per employee € '000	Sector € billion	Nos employed million	Per employee € '000	Sector GVA	Nos employed	GVA per employee
Germany	395	8.1	54.6	494	7.5	76.4	25	-7.4	40
Spain	98.5	2.7	38.8	115.1	3.1	42.7	17	+14.8	10
France	188	3.6	54	216.8	3.2	70.7	15	-11.0	31

Source: AMECO ECFIN

Productivity versus value added

For historic reasons, and as a comparatively open economy, UK policy mainly focused on productivity and competitiveness. GVA has only come into focus more recently.

And the policy had some success. Government initiatives such as the Manufacturing Advisory Service pushing lean manufacturing techniques have vastly improved UK productivity growth and at over 50% (GVA per employee) outperformed increases in France, Germany and Spain (10-40%) over the period in question.

But basically this improvement has been achieved by paring back and cutting employment numbers by a third (32%), whereas Spain actually increased manufacturing employment and France and Germany reduced their proportions (-7/-11%) by a fraction of the UK drop (-30%) and invested for the future.

Indeed, perhaps more worrying even than the overall fall in UK manufacturing investment is the fact that according to the government's own statistics UK companies have been investing less per employee than in the past while our competitors were investing in the latest technology.

Table 3 UK GVA and investment performance 1998-2007 per employee and per company

Year	GVA per employee £000	Investment per company £000	Investment per employee £000	Ratio £GVA to £investment
1998	34	120.4	4.6	7.35
2007	51	80.5	3.9	13.17
Change %	+50	-33	-15%	+79

Source: workings based on Table 1

There are no readily available sources that compare different countries' use of high tech machinery or automation per se. But industrial robots are useful proxies because of the added-value they bring to the manufacturing process and also because their installation

² Unfortunately UK data on this database is only available up to 2005, hence the need to use data sets from two different sources. Although it's not ideal this approach does provide useful indicators as we observe changes in performance within the data sets.

is recorded on an international database, which enables us to compare the UK's performance with other countries.

This shows the UK in a weak position over the period 1998-2007. And that weakness goes well beyond the use of industrial robots in welding applications in the car industry where the UK is understandably less well represented than Germany, France, Spain and China.

It's simply that UK manufacturing has been slower to adopt automation and the latest high tech manufacturing machinery.

Table 4 Estimated numbers of industrial robots per 10,000 persons employed in manufacturing

Country	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Germany	117	130	146	158	172	186	2003	216	228	234
Spain	34	40	49	60	67	74	71	76	79	77
France	39	43	48	52	57	62	67	74	79	82
UK	26	29	32	36	39	42	45	50	52	53

Sources: World Robotics (UNECE, International Federation of Robotics, national robot associations and the OECD STAN database)

Table 5 Shipments of industrial robots by major application area 2007

Application	Germany	France	Spain	China	India	UK
Welding	3,631	687	585	2,462	292	313
Handling operations/ machine tending	8,159	1,571	1,211	3,023	522	559
Dispensing	603	200	140	420	92	95
Processing	446	96	26	54	10	18
Assembly	791	98	126	97	1	37
Cleanroom	100			448		2
All others non classified	1,172	84	101	77	11	26
Total	14,902	2,736	2,189	6,581	928	1,050

Sources: World Robotics (International Federation of Robotics and national associations)

Taxation, capital allowances and investment

Manufacturers working on improving their performance know that improvement usually means having to do something that they have never done before. Often that means investing in new skills, new procedures and new equipment and of course risk.

In the UK, businesses' Corporation Tax liability is assessed before they write down any machinery unless there is a special allowance for the type of investment they make. Other countries treat this depreciation differently.

The UK's capital allowances have varied quite considerably over the last 13 years making investment planning more complex and in essence encouraging a short-term approach. (For a description of changes in UK capital allowances please see Annex A.)

In an interesting paper *Tax Reform – A manifesto for a balanced economy* EEF shows UK manufacturers using the 20% capital allowance will take 30 years to fully depreciate their investment against tax on the reducing balance basis that applies in the UK. This 30 year tax depreciation period for manufacturing machinery in the UK compares with radically shorter periods in competitor countries e.g. USA 3-10 years; France 10-20 years, Germany 10-16 years. Note: if the capital allowance is reduced to 12½%, the tax related write down extends out to 53 years.

Conclusions

1. Bounded on the one hand by a relatively unfavourable and oft-changing investment tax regime and on the other by banks that require entrepreneurs to put their own homes up as security, SME manufacturers in particular have preferred in part to manage improvement through their ability to change the size and configuration of

- their workforce, training for specific workshop needs or, where that's not been possible, by taking on foreign workers.
2. Meanwhile the challenge to increase the UK's productive capacity grows.
 3. The typical replacement cycle for modern manufacturing machinery has now shrunk to seven or eight years. But the UK tax system is still working as if it were on 30 years.
 4. The UK has invested less in high technology manufacturing machinery with knock-on, lower demand for school leavers and graduates with STEM skills to design, maintain and operate such machines.
 5. As a result UK factories are underinvested compared with the high value adding automated producers in Europe, USA and Japan.
 6. Increasingly they face a threat from newly automating countries such as India and China where businesses are also recognising that automation:
 - Reduces operating costs and increases production output.
 - Improves product quality and consistency and reduces waste.
 - Raises quality of work for employees and improves safety.

In the current economic environment the step change in approach requires government leadership to ensure awareness and a coherent pan-Whitehall longer term manufacturing investment friendly policy framework. The battle for lean manufacturing must continue but now it must be yoked to strategies for manufacturing growth and expansion, as well as competitive survival.

In line with the benefits that will flow from such an improvement, this step change will need to involve all manufacturing stakeholders from finance and customers to future employees and local government, all of whom will find their own challenges in the new technologies involved.

4 Recommendations

Tax policy

In the recent past SME manufacturers have had to face a series of tax increases (Corporation Tax up from 18 to 21 per cent, withdrawal of Industrial Buildings Allowance, cuts in Empty Buildings Allowance and a cap on investment allowances) all of which have reduced cash flow. And that's not all. It is well established that SMEs carry a disproportionate share of the tax admin burden, so they have suffered a 'double cost whammy'.

We therefore recommend that tax policy should:

- Reduce corporation tax levels as soon as this is prudent so that they are more competitive with others in the OECD and restore the UK as the country of choice to do business in.
- Continue to encourage private investment as a source of funding in SMEs (particularly when the banks are being so difficult) by maintaining the current benevolent regime available under Entrepreneur's Relief.
- Reinforce long term investment with reasonable offsets (e.g. against Capital Gains) for the 'losses' that occur over time due to inflation (even at 2%, inflation over ten years reduces the value of the original investment by nearly a third).

Cash flow

Manufacturers' cash flow is still being squeezed. The withdrawal of trade credit insurance, customer imposed extended payment terms and the higher hurdles set by banks mean manufacturers have had to self-insure and find their own working capital or pay exorbitant rates.

Conditions are no longer as extreme as they were but many companies remain wary of a double-dip and are taking action not to be caught/exploited again by so-called business partners.

- A technical amendment to accounting standard FRS 5 so that firms servicing Just-in-Time contracts aren't subject to the huge increase in Corporation Tax liability when work in progress and stocks are grossed up and added to sales.
- Maintain pressure on the banks to fulfil the undertakings they gave as part of the rescue package they received, e.g. RBS and Lloyds to lend an extra £41 billion to SMEs.

Investment allowances

For too long capital intensive companies have been forced to operate on the same terms as the 'lightweight' economy of the service industries. As a result many firms have moved manufacturing, or at least some of it, offshore. Venture capitalists thinking about investing in a UK manufacturer expect that company to have at least some of its productive capacity offshore and a strategy to exploit that trend.

If this bias is to be broken one of the most important signals government can give will be on investment.

- Maintain the Annual Investment Allowance currently capped at £100,000 (available to all sizes of company).
- Announce your intention to increase it in £100,000 tranches over the next four years to £500,000 and then to ensure that it will be indexed to maintain its real value.
- Maintain 20% capital allowance for general pool items.

Reluctantly we have come to the conclusion that UK banks are not going support UK manufacturing SMEs in the sort of partnership similar sized firms enjoy in Germany and France or the USA.

- We therefore support the idea of investigating broad support for an Infrastructure and Industrial Investment Bank, which would change perceptions about the UK as a place to run a manufacturing business.

Research and Development

According to the government's latest R&D Scorecard (March 2010) the UK's top 1000 R&D companies invested an extra 9.2% in 2008 compared with a 7% increase amongst the world's top 1000 corporate R&D investors.

Just 100 companies accounted for 81% of the £27 billion spent in the UK on R&D. The three leading UK sectors were pharmaceuticals, aerospace and banking (£12.9 billion).

Many UK mechanical engineering SMEs supply 'one-off' products tailored to resolve problems in a unique manner. The sale may even be dependent on the firm coming up with a novel solution, which itself has to be tested.

We therefore share the views expressed in the Dyson report on the need to:

- Focus R&D tax credits on high tech companies, small businesses and new start-ups
- Increase the rate to 200% when the public finances allow
- Simplify the claims procedure.

To grow its manufacturing base, the UK needs to improve its ability to test and commercialise innovation, not only from the larger companies but also for SMEs.

- Make it easier (less expensive) for SMEs to take part in leading innovation-focused organisations such as the Technology Strategy Board (TSB) and the Manufacturing Technologies Centre.

- Extend TSB funded projects to cover the pre-production phase so that a proportion of the customers' costs associated with testing and evaluating prototypes or demonstrators supplied by SMEs can be covered (e.g. agricultural machinery for a low carbon future).
- The total budget for this would be limited (say to £30 million). Projects would be approved in a twice yearly competition.

Exporting – finding and developing new customers

This is the area where there should be major potential to rebalance the economy.

Practical measures

- The UK needs a national agency that champions UK exports and exporters.
- To match the best in the world this agency should be totally separate from inward investment activities and staff.
- The regime should be far simpler, run with a national focus, not subservient to regional priorities.
- Companies should be supported when they show commitment and proper preparation, not on the basis of their exporting 'virginity'.
- The Export Credit Guarantee Department's cover needs to be remodelled to be competitive across a far wider range of business.

Trade Credit Insurance

Manufacturers have been forced to self insure following the withdrawal of trade credit insurance.

For exporters it has been even worse though and especially for those using invoice discount houses or factors, as they won't cover export sales unless there's trade credit insurance in place.

Guaranteeing the customer's deposit

In mechanical engineering it is standard practice for a customer to pay a 30% deposit to confirm their order. It happens all over Europe and in the USA. In return for the deposit, the customer expects to receive a guarantee, normally from a bank, that they will receive the machine they have ordered or their money back.

If the company making the machine is any good, this is all very low risk, for which the banks make a charge.

Whereas French, German and US banks provide the guarantee for a small (sometimes no) charge, UK banks often deduct the deposit from the company's overdraft at the bank. So, while there's no benefit to company cash flow, the bank manages to strengthen its books.

Some banks have doubled the interest they charge (to 3½%) and increased their administration charges associated with the service. Others have placed ceilings on the total amount they will guarantee for any one manufacturer, effectively slapping a cap on the size of the firm's order book, or forcing them to forego the benefit of the deposit, which opens them up to increased risk.

Companies facing these problems on UK contracts have been able to access the Enterprise Finance Guarantee Scheme, which was conceived to help improve the availability of working capital for SMEs.

However, the terms specifically exclude support for 'individual export orders'. If a firm is 100% export, all their activity is excluded. In mechanical engineering it is quite common to find firms that are 90% export, which in practice means they too are excluded.

Apparently such difficulties do not arise in other countries, because they run a 'Bond Support Scheme' with government backing, so that any orders where the deposit may be too big to be handled by the usual channels, can be covered competitively.

- Exporters' problems with Trade Credit Insurance and guaranteeing their customers' deposits could both be satisfied by an appropriately designed bond guarantee scheme. But the support should be structured to help exporters in their relationship with their finance partner, rather than to strengthen the partner's position.

Skills

Skills development is the second most important issue for most companies in the sector (after finding new customers). We therefore applaud the Coalition's recent decisions to increase apprenticeship funding for 16-19 year-olds and the commitment to attract more top STEM graduates as teachers.

In our sector the common view is that educational standards have slipped in the last 20 years and that the school leavers they see tend to lack the commitment and work ethic found in immigrants from eastern Europe. (Witness the recent Sheffield University study (March 2010) that showed 22% of English 16-18 year-olds are functionally innumerate and 17% illiterate.)

- Government should benchmark the UK's educational attainment levels in STEM subjects against our competitor nations.

After several different initiatives over the last five years, many firms have come to the conclusion, despite all the claims, that the training arena is controlled by educationalists - not employers. They consider the system overly complex leading to waste and unnecessary expense. And at the extreme find themselves having to undertake basic educational tasks (numeracy and communication skills) that should have been attended to in the classroom.

Government has been loath to give companies the money to undertake the training they need and has therefore set up a very complex (for which read expensive) structure to handle the money.

- The system should be simplified to deliver direct to companies.
- This could be in the form of a loan, which the firm undertakes to repay out of the 6:1 benefits it will accrue once, course completed, the trainee is back at work delivering on those newly acquired skills.

Regulation

We estimate the average SME spends over £33,000 a year complying with various regulations.

We were pleased to learn of the recent announcement from BIS that there is to be a Star Chamber to oversee the implementation of the one-in-one-out reforms and the immediate review of the £19+ billions a year worth of regulation the new government has inherited.

But we believe that culture change could and should go further.

It is readily accepted that UK manufacturers operate in a globalised market. But regulators must be more alive to the fact that they do too. The norms they set affect the

UK's position in that globalised market. If the UK is to enjoy the benefits of manufacturing goods, the parameters for operating here must not be economically out of kilter with the requirements set offshore, otherwise companies will continue to migrate. Responsible regulation strikes an effective balance between the two.

Actions to reduce wasteful regulation:

- Draft regulations with business so that implementation is practical and clear
- Simplify compliance by using fewer, simpler forms and fewer regulatory bodies
- To ensure fair competition in a global market it is important the UK maintains the ability to verify that goods entering the UK conform to the standards nominally specified.
- For preference imported manufactures will be produced in factories meeting similar social and environmental standards as those required of UK companies.

Annex A

Investment allowances (from the HMRC website)

An "investment allowance" was introduced in 1954 to encourage investment in new plant and machinery, mining works, industrial and agricultural buildings, and buildings and plant used for scientific research. Investment allowances were given in addition to initial and annual allowances. This meant that businesses could receive allowances over the period of ownership of more than the asset had actually cost.

The investment allowance was set at a rate of 10% for agricultural and industrial buildings and 20% for other qualifying assets. Investment allowances continued on and off at various rates until 1966. Then they were replaced by direct grants administered by the Board of Trade.

The method of making claims for plant and machinery by reference to a wide range of different rates of writing-down allowance set out in published lists continued until 1962. In a move to reduce the burden on business and simplify the process of claiming capital allowances, the number of rates was then reduced to three (15%, 20% and 25%) and taxpayers were allowed to pool expenditure within each category for the purposes of calculating writing-down allowances. This was a considerable simplification, but difficulties still remained where assets were sold or scrapped, as the pool had to be unscrambled to calculate the balancing allowance or charge.

The 1971 system

There was a further major simplification in 1971. The number of rates of writing-down allowance for plant and machinery were reduced to just one at 25%. The rules for pooling were extended so as largely to eliminate the need for balancing allowances and charges. This was a considerable simplification and greatly reduced the record-keeping requirements and the number of computations needed for tax purposes.

1984 reforms

In 1984 the then Chancellor of the Exchequer, Nigel Lawson, started a series of reforms to create a more neutral, broader based tax system. Initial allowances and first year allowances were phased out over three years. The 1984 business tax reforms brought capital allowances closer into line with actual rates of commercial depreciation. Allowances were set at 25% for plant and machinery, 4% for industrial and agricultural buildings.

Developments after 1984

Short-life assets: For assets with lives of less than 4 years, the 25% rate for plant and machinery was recognised as representing less than economic depreciation. To adjust for this, from 1985 taxpayers have been able to elect to keep specific assets out of the general pool. If the asset is then sold or scrapped within 4 years a balancing allowance or charge is made, bringing the allowances given into line with the actual economic depreciation of the asset.

Long-life assets: In 1996 the then Government introduced a new 6% rate of allowance for plant and machinery with an expected life of more than 25 years when new. This was a further step towards greater neutrality of the tax system, bringing allowances more closely into line with rates of economic depreciation. The rules only apply to businesses which spend more than £100,000 a year on long-life assets.

Return of incentive allowances

First-year allowance for plant and machinery and initial allowances for industrial and agricultural buildings were reintroduced on a temporary basis for expenditure incurred in the year ended 31 October 1993.

First-year allowances (FYAs) were introduced again for expenditure incurred by small and medium sized enterprises from 2 July 1998 to April 2008; the rate varied over this period, but was either 40% or 50%. 100% FYAs were introduced for assets purchased by small and medium-sized businesses in the period 12 May 1998 to 11 May 2002 for use primarily in Northern Ireland. Subsequently, other 100% FYAs targeted to encourage particular types of socially desirable investment were introduced for expenditure on:

- ICT by small businesses, between 1 April 2000 and 31 March 2004;
- energy-saving plant and machinery, from 1 April 2001;
- cars with low carbon dioxide emissions, from 17 April 2002;
- plant or machinery for gas refuelling stations, from 17 April 2002;
- plant or machinery for use wholly in a ring fence trade, from 17 April 2002;
- environmentally beneficial plant and machinery, from 1 April 2003

Other new allowances

Two new codes of allowances (not restricted solely to expenditure on plant or machinery) were introduced in the early years of the 21st century: Flat conversion allowances (FCAs) were introduced by FA2001. Business premises renovation allowances (BPRA) were introduced by FA2004, but the scheme did not come into effect until 11 April 2007.

The FA2008 reforms

The capital allowances changes introduced in FA2008 represented the biggest reform of the capital allowances system since the 1980s. The changes were part of a wider 'Business Tax Reform' package, which included a 2% cut in the main rate of corporation tax. The reforms had three main objectives: (1) to promote investment and growth; (2) to reduce distortions and complexity and (3) to maintain fairness and refocus the tax system for smaller businesses. The main capital allowances changes were:

- The introduction of a new Annual Investment Allowance (AIA), which is effectively a 100% allowance for business expenditure on plant and machinery (apart from cars) up to £50,000 a year. The AIA applies to businesses regardless of size, and replaced the previous 40% or 50% FYAS for small and medium-sized businesses only.
- A new small pools allowance, allowing historic and future pools of plant and machinery expenditure of £1,000 or less to be written-off immediately.
- New payable tax credits for businesses that make losses attributable to investment in environmentally beneficial plant and machinery.
- The phased withdrawal of industrial and agricultural buildings allowances by 2011.
- Changes to the rates of capital allowances on plant & machinery: from 25% to 20% for the main pool, and from 6% to 10% for long-life assets in the new special rate pool.
- The introduction of a new classification of "integral features" of a building or structure to apply to new and replacement expenditure and which will attract 10% allowances in the special rate pool.

Consolidation

The capital allowance legislation was consolidated in 1990 in CAA90 apart from the legislation on patents and know-how, which stayed in ICTA88. The legislation was rewritten in 2000 and all of the capital allowance legislation is now in CAA2001. You can find CAA2001 and the explanatory notes that go with it on the Intranet or on the Internet at www.hmso.gov.uk/acts/acts 2001.