

Giving another tax break to big business is not the way...

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The [Telegraph has reported](#), in what is no doubt an article placed by the Treasury seeking to 'fly a kite' to gauge reaction to an idea, that:

"Rishi Sunak is considering a multi-billion pound tax cut to encourage big companies to invest in machinery and factories as part of his bid to jump-start the economy after the damage wrought by Covid-19.

The Chancellor is understood to be studying plans to give firms a full tax break on capital investment, such as technology, machinery and industrial premises, allowing them to immediately deduct the costs from their bills.

Senior Tories believe such a move could encourage investment among firms otherwise reluctant to do so as a result of the financial hit from coronavirus and rising debt."

This idea makes quite literally no sense right now. This needs explanation because I am well aware that many people find this issue confusing.

What we are talking about is what is called the capital allowance system. This works in both corporation tax and for the self-employed who pay income tax. The system provides tax relief on the cost of the equipment a business buys, from IT, to cars, to planes, to generating equipment for use in the Green New Deal.

In a company's accounts a charge for the use of such equipment is included to represent the cost of the wearing out of that equipment in use over time. It is called depreciation. There is nothing inappropriate about this, although there are guidelines that govern how such charges are made. However, the results can be so variable that around the world depreciation is replaced for tax purposes by capital allowances. So, let me stress, unless you think businesses should not have tax relief on the equipment that they buy then claiming capital allowances is nothing to do, at least superficially, with tax avoidance. That situation can, admittedly, be confused by things like leasing, where tax avoidance has definitely been commonplace. But let's instead take things at face value for this analysis.

What is now planned is that all capital allowances be given in the year equipment is bought. To give a simple example, suppose I bought a computer for £2,000 and claim it as a business expense. If I get a 20% allowance in the first year I can offset £400 against my income in the first year of ownership. If my tax rate is 40% then my tax bill is reduced by £160.

Now suppose the capital allowance rate increased to 100% in the year of acquisition. Now I can offset the full £2,000 against my income, and so reduce my tax bill by £800 in the first year of ownership. I don't get a tax subsidy: the computer is used for business purposes and so is a legitimate charge against income. But I do get the tax relief earlier than with the 20% rate. In fact, I get it well before the useful life of the computer is over. But it does match with my outward cash flow, however financed (unless I lease it, and again, let's ignore that).

What does change does is, in that case, bring forward the tax relief on the purchase of equipment. In theory it does not change the total amount of tax relief, but it does quite significantly change the cash flow surrounding tax payment.

In practice small businesses, like mine, already get 100% capital allowances in the year that equipment is bought. So, I might, if I bought that computer, get a one-off reduction in my tax bill of £800 this year, assuming I was a 40% taxpayer.

Right now, businesses spending up to £1 million a year get 100% allowances. Then, broadly speaking (and there are nuances to this that do not require explanation here), they get 20% allowances, so the cash flow subsidy falls dramatically. What the government is now planning is to scrap that £1 million limit and to give 100% allowances to all businesses.

This will, of course, almost only impact companies. Very few self-employed people will be spending £1 million a year on equipment. And it's also right to remember that companies only pay tax at a rate of 19%. So that computer would give its owning company £380 at most, in one go now when previously the maximum allowance for the company was £78 in a year. The question is whether this will deliver economic benefit to justify the cost?

I suggest it won't. First, with our corporation tax rates so low now the amount of tax relief available from capital allowances provides little incentive to spend. Prima facie, there's simply not enough in this to change decision making, especially in the face of the overwhelming shortage of demand that there will be in the economy. That's because, it must be remembered, that the tax relief is given either way, in the end: all that the change does is bring forward the time when relief is given. And for large businesses this has little impact.

Firstly that's because for them money is available to borrow almost cost-free right now: if they have an investment project at present funding it is simply not an issue and as

such tax relief will have very little bearing on the overall decision-making process. The proposal simply indicates that the Treasury is not aware of this, which is worrying.

Secondly, this is also because the benefit is not reflected in the accounts of these companies: the up from tax relief they get cannot be claimed against profit because what is called a deferred tax provision has to be made to counter it in any event, and since (given the previous point) the timing of tax relief is at present of little consequence to them and the inability to show the gain for tax adds no value to the reported result for the year because of the deferred tax provision that must be made the overall economic impact of the change on large companies will be minuscule.

Third, there is little evidence that such schemes do work.

But as important from the macroeconomic perspective is whether all investment is worth having. There is no reason to think that all investment is of equal value, because it isn't, and yet this rule does not in any way differentiate good and bad investment. Right now we need investment in a green transition more than anything else. I see very little reason for giving additional tax relief on gambling equipment, for example. I am sure I am not alone. In that case, a blanket provision of the sort proposed makes no sense.

My suggestion, in that case, is simple. It is very unlikely that this measure will increase useful investment. It will instead give tax relief to the sector of the economy that least needs it, which is the large corporate sector. Some of the funding will definitely support the financial services sector, unnecessarily. And, crucially, there are very simply many better uses of the money. People need support. Smaller businesses need support. Track and trace needs support. A vaccine needs support. Support is needed for Brexit chaos. And tax relief needs to go to those who will spend, and not necessarily to those who invest where the benefit is by definition delayed unless there is clear social reason for that investment. This is, then, inappropriate use of funds.

The issue is then that this policy makes no sense when there are so many more pressing demands. So the question is, why is Rishi Sunak making another ill-informed decision? Is that he has simply succumbed to lobbying, yet again?