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Insights

UK BUDGET 2021 – THE DATA CENTRE SPIN ON SUPER-DEDUCTIONS

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SUMMARY

In the UK budget on 3 March, Rishi Sunak, the Chancellor, announced a significant improvement in tax relief for a two year period that may make the data centre industry sit up and consider investing in new equipment between 1 April 2021 and 31 March 2023.

When it comes to building data centres, the cost of the land and the shell are a relatively small proportion of the build cost. Fitting the plant and machinery required to operate the data centre is a much bigger cost and that is why data centres are typically constructed in phases as more demand is identified and, where possible, contracted. An empty fitted data hall is not simply a waste of space; it is a massive drain on resource and a truly wasting asset.

A gift to the data centre market?

Data centres have not generally struggled under Covid-19 but, in the UK budget on 3 March, Rishi Sunak, the Chancellor, announced a significant improvement in tax relief that may make the industry sit up and consider whether some speculation may be justified and certainly provide further impetus to the already hot data centre market.

The Chancellor's biggest budget giveaway (projected cost to the exchequer of c. £25bn) will introduce enhanced capital allowances on expenditure on plant and machinery incurred between 1 April 2021 and 31 March 2023. Whilst not aimed specifically at the data centre market it could be a significant beneficiary.

What items?

The enhanced allowances are for "plant & machinery". From the perspective of the data centre industry, this is the main category of expenditure already attracting capital allowances. The other category, structures and building allowances, do not benefit from the budget announcement.

What conditions?

In order to benefit from enhanced allowances, there are a number of conditions, the principal ones being:

- The assets must be unused and not second hand. This may negatively impact on the attempts within the data centre industry to create a market in refurbished data centre kit. However, unlike the 100% enhanced capital allowances available for expenditure incurred in an enterprise zone (which continues in parallel, though of course, both reliefs cannot be claimed in relation to the same item), there is no restriction preventing relief from being available on "replacement expenditure", so the new allowances announced in the budget will be available on upgrading equipment as well as providing new capacity.
- The expenditure must be "incurred" on or after 1 April 2021 but on or before 31 March 2023. "Incurred" has its usual capital allowance meaning, namely generally when the payment obligation becomes unconditional (even if payment is to be in the future) – this is subject to special rules, notably for payments left outstanding for 4 months or more, and for staged payments under long-term contracts. Businesses with substantial capital expenditure on plant and machinery should have regard to these rules, so as to maximise the amount of plant and machinery expenditure that will be incurred within the 1 April 2021 to 31 March 2023 window.
- The expenditure must not be incurred pursuant to a contract entered into prior to 3 March 2021. For the avoidance of doubt, expenditure under a contract entered into before 3 March 2021 but "incurred" in the 1 April 2021 and 31 March 2023 period, will not benefit from the enhanced allowances. How this will apply will need to be considered on a case-by-case basis and the difference in value of a deal signed before versus after the budget could be substantial.
- The expenditure must not be incurred for plant and machinery for leasing. The effect of this would have to be considered on a case by case basis. However, we would expect expenditure incurred by an operator on cooling or electrical equipment to be located outside of any leased areas to be capable of falling outside of this exclusion.
- The expenditure should be incurred by a company, as opposed to a partnership or an LLP.

How much?

For items that currently attract plant and machinery allowances at the regular rate of 18% per year, a one-off first year allowance of 130% is given (called a "super-deduction"). Expenditure of £100 in a year will result in a deemed expense of £130, fully deductible against profits of the business in that year (and to the extent unused, it can be carried forward to be deductible against profits of future years subject to the usual rules). If a business's accounting period straddles 1 April 2023, the rate of super-deduction for expenditure incurred before 1 April 2023 will be between 100% and 130%, depending on what proportion of the accounting period occurs before 1 April 2023. Again, businesses may wish to consider taking care as to which accounting period expenditure falls into.

For items that currently attract allowances at the lower rate of 6% per year (long life assets, integral features), a one-off first year allowance of 50% will be given (called a “special rate deduction”). Expenditure of £100 in a year results in (a) tax deductible expense of £50 fully deductible against profits of the business in that year (and to the extent unused, it can be carried forward to be deductible against profits of future years subject to the usual rules) and (b) capital allowances on the remaining £50 written down at 6% per annum from the following year.

What might this mean for the UK data centre market?

Data centre expenditure generally has a very high proportion of plant and machinery expenditure (sometimes up to 90%) and so businesses constructing or refurbishing data centres in the next two years should be able to benefit materially from this relief. Potential options to leverage the benefits include:

- New builds and expansion space will see a significant tax benefit over the next two years.
- Enterprise CTOs, under pressure to deliver ever-improved services whilst seeing their budgets constrained, now have something to offer their CFOs in return for cash for some upgrades to their facilities.
- The divestment market looks even more attractive as investors in this space will be able to upgrade facilities whilst benefiting from the significant tax break.

But time is short – the window is only open for two years and the clock is already ticking. As that window closes, expect to see the industry making some big decisions on whether the upside of the tax savings outweighs the downside risks of some speculative development.

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