



## Budget 2011 – Capital allowances commentary

The Chancellor, George Osborne, delivered his second Budget which was promoted as a “Budget for growth”, and contained several measures which will affect capital allowances for businesses:

- The previously announced reductions in the rates of writing-down allowances (WDAs) for expenditure on plant and machinery from 20% to 18% for the main pool and from 10% to 8% for the special rate pool were confirmed and will be included in Finance Bill 2011. The reduction in WDAs will take effect for chargeable periods ending on or after 1 April 2012 for businesses within the charge to corporation tax and on or after 6 April 2012 for businesses within the charge to income tax. Even though the effect is only a timing one, as to achieve 90% of WDAs will now take 12 years for main pool expenditure, up from 11 years and 28 years for special rate pool expenditure, up from 22 years, it will still have a fairly significant impact for businesses, even taking into account the reductions in the mainstream and small companies rates of corporation tax;
- Similarly, Finance Bill 2011 will also provide for the previous announcement of the reduction to the level of expenditure that benefits from the Annual Investment Allowance (AIA) from £100,000 to £25,000 to take effect from April 2012. The announcement in the Office of Tax Simplification’s (OTS) Small business tax review that consideration should be given for small businesses to be able to spread a purchase of a single asset that exceeds £25,000 over two years would, if followed, lessen the impact of this reduction for those businesses;
- A surprise announcement was that Finance Bill 2011 will introduce an extension of the current short-life asset (SLA) regime from four years to eight years as a measure to ensure that the tax system better reflects the economic depreciation of assets with longer useful lives. The measure will have effect for expenditure after 1 April 2011 for corporation tax and after 6 April 2011 for income tax purposes. Elections to treat assets under the SLA system have to be made within two years of the end of the relevant chargeable period in which the expenditure was incurred for corporation tax and twelve months after the 31 January following the end of the tax year in which the end of the relevant chargeable period occurs for income tax. The exclusions under the current system which include most cars, all long-life asset expenditure and integral features, will be retained. While it should be looked at as a positive measure its effect will only be timing in nature, however, it will be attractive to those

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businesses which will exceed the level of expenditure under the AIA, though the level of balancing allowances that could be generated will lessen significantly the nearer to year eight an asset is disposed of;

- As has become the norm over recent Budgets, the customary tinkering to the Enhanced Capital Allowances (ECA) regime was announced. The changes will have effect on and after a date to be appointed by Treasury Order prior to the Summer 2011 Parliamentary recess and will include one new technology, certain energy efficient hand dryers and there will be revisions to the criteria for automatic monitoring and targeting equipment. This is not expected to have a significant impact for businesses but continues the drive for more efficient energy usage and CO2 emissions reductions;
- Continuing the “green” theme, it was announced that the Government are looking to enable businesses to be able to claim capital allowances in respect of expenditure incurred on the generating equipment as part of the feed-in-tariffs (FIT) and renewable heat incentive (RHI) schemes to incentivise low carbon electricity generation and heat generation from renewable sources. A consultation document will be published in May 2011 with the hope that legislation will be introduced in Finance Bill 2012. The problem to date has been the apparent confusion over the rate of allowances that can be claimed and it is hoped that the highest rate is selected to as part of the drive to ensure the UK meets its commitment to reduce carbon levels up to 2050;
- The Governments intention to create a new raft of Enterprise Zones was widely reported in advance of the Budget and so the announcement in the Budget that these zones would be created was expected, though the overall number, 21, was more than had been anticipated. Ten zones will be created within the following Local Economic Partnership (LEP) areas:
  - Birmingham and Solihull;
  - Leeds City Region;
  - Sheffield City Region;
  - Liverpool City Region;
  - Greater Manchester;
  - West of England;
  - Tees Valley;
  - North Eastern;
  - The Black Country; and



- Derby, Derbyshire, Nottingham and Nottinghamshire

There will also be one area created in London which will be able to choose its site and, in addition, the Government will also launch a competitive process for LEPs that are interested to establish the remaining ten Enterprise Zones. From a capital allowances perspective, the Government will work with the LEPs to look at introducing enhanced capital allowances to support Enterprise Zones in the assisted areas where there is a strong focus on high value manufacturing. While this will obviously provide an immediate advantage for those businesses which qualify for the relief, it is a much more restrictive system than that of previous Enterprise Zones where a 100% relief on all capital expenditure construction costs was available;

- Despite the OTS recommending that Business Premises Renovation Allowance (BPRA) be abolished once its five year period comes to an end in April 2012, the Government confirmed that it should be extended for another five years, subject to state aid approval. It is intended that the measure will be included in Finance Bill 2012. Even though HM Revenue & Customs (HMRC) has estimated its fiscal value at only £20million, the Government has included it as part of its wider strategy of encouraging investment to create a more balanced economy;
- An interesting announcement, and one that will affect a very large number of businesses, was the announcement that the Government intends to consult on introducing a time limit for the notification of the intention to pool expenditure incurred on fixtures within a building in order to qualify for capital allowances. Currently, businesses are able to introduce this expenditure into the relevant pool at any time after the expenditure has been incurred, subject to the business still owning the asset in a later period, and benefit from the allowances. This enables those businesses which have either failed to claim in the period in which the expenditure was incurred or which were not in a position to do so if the project is particularly complex, to still be able to benefit from the relief they are entitled to. This provision, if enacted, would prohibit such relief. This proposition has been included under the anti-avoidance measures of the Budget, though it is difficult to see how the establishment of expenditure to which allowances should be due, even if not identified until after the period to which the expenditure relates, can be classed as "tax avoidance", particularly given the restrictions that exist in the capital allowances legislation in respect of fixtures in buildings. The consultation document is expected at the end of May 2011 with any necessary legislation to be introduced in Finance Bill 2012;



- Another measure included in the anti avoidance section, is the proposal to consult over changes to the specific provisions within the Capital Allowances Act 2001 (CAA 2001) for anti-avoidance. The Government proposes to make the current anti-avoidance provisions within CAA 2001 more effective and more in line with anti-avoidance tests elsewhere in the Taxes Acts by replacing the current 'sole or main benefit' test. The consultation process will commence in May 2011 with a view to introducing legislation in Finance Bill 2012. While greater certainty for businesses around whether transactions are caught by anti-avoidance provisions are welcomed, the legislation should not look to catch bona fide commercial transactions within the anti-avoidance net;
- On 9 March 2011, via a Written Ministerial Statement, it was announced that legislation would be introduced in Finance Bill 2011 to counter a disclosed avoidance scheme for the leasing of plant and machinery under a long funding finance lease where tax relief is given on more than the actual expenditure. The new legislation will confirm that lessees involved in these arrangements, which have the effect of guaranteeing the value of a lease asset at the end of a lease but, which also enable the amount guaranteed to be taken into account for tax relief a second time when paid, will only be entitled to tax relief up to the actual amount of their expenditure. The legislation will apply to arrangements entered into on or after 9 March 2011 or to payments made on or after that date, irrespective of when the arrangement was entered into;
- The Government has accepted the OTS recommendation to abolish the specific provisions in the capital allowances legislation (s30-32 CAA 2001) providing for plant and machinery allowances to be claimed on capital expenditure incurred in respect of taking required safety precautions at certain sports grounds and, intends to abolish the relief some time after 2012 following a period of consultation. The OTS does not appear to have fully understood how both the safety provision system works and the wider application of the relief across a variety of sports. Sport is expected to mount a vigorous campaign against the proposed abolition of this relief as it is likely to harm the continued development of sports venues in the UK;
- Another one of the reliefs the OTS proposed for abolition was flat conversion allowances which currently give 100% relief for expenditure incurred in converting empty or underused space over shops and commercial premises for residential use. The detailed nature and number of conditions that need to be met to fall within the



scheme makes it complex and given its limited impact since its introduction in 2001 (less than £3million per annum) confirmation of the abolition was not surprising. Again, following a period of consultation, abolition is expected some time after 2012;

- Confirmation was provided that the new rules for Furnished Holiday Lettings (FHL) will take effect from April 2011, so that loss relief may only be offset against income from the same FHL business and the letting and availability thresholds will increase from April 2012; and
- An announcement was made to further amend the legislation for the sale of lessor companies to prevent avoidance with effect from 23 March 2011 and to ensure the legislation continues to have the intended effect. The rules are intended to impose a charge, at the time of sale, on profits of a lessor company that have been earned but not recognised for tax purposes before it changes ownership. The changes ensure that all plant and machinery leasing is taken into account in determining whether the company falls within the rules and will also make sure that the calculation of the charge fully reflects the deferred taxable profits. The changes also withdraw the option to elect out of the charge when the lessor company is sold and further changes will ensure that a company that has previously elected out of the charge will bring into account for tax purposes, the full value to the company of any asset later sold. The changes target a range of planning ideas intended to enable a group to avoid the effect of the legislation and will only impact those companies carrying on a business of leasing plant and machinery alone or in partnership.

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