



Capital allowances consultations May 2011

HM Treasury (Treasury) and HM Revenue & Customs (HMRC) have launched consultations into several areas of the capital allowances regime which were initially announced in Budget 2011. Respondents to the proposals set out in the consultation documentation have until 31 August 2011 to make their comments. The consultation documents are considered here with some initial thoughts on their impact for businesses.

Background

As part of the Government's Tax Consultation Framework, where changes are considered necessary to the tax regime a consultation process is undertaken to enable all parties to set out their views and to try and ensure that the final decisions about tax legislation and policy have been correctly represented.

Budget 2011 contained several proposals for capital allowances measures where this process would be required and the consultations were launched on 27 and 31 May 2011 covering the following areas:

- Abolition of Flat Conversion Allowances;
- Abolition of capital allowances for safety at sports grounds expenditure;
- Feed-in tariffs & the renewable heat incentive;
- Changes to the capital allowances anti-avoidance rules for plant and machinery; and
- Capital allowances for fixtures

The consultation process for all of these areas concludes on 31 August 2011 and the intention is that final decisions on any changes to the legislation will be introduced from Finance Bill 2012 onwards.



Abolition of Flat Conversion Allowances

This relief, one of those introduced in 2001 as part of a package of regeneration measures, was recommended for abolition by the Office of Tax Simplification (OTS) in their final report of March 2011. The rationale for the abolition was that since its introduction, take up had been very low and it had been unsuccessful in achieving the intended policy objectives. The proposal is to introduce legislation in Finance Bill 2012 to withdraw the relief for expenditure incurred on or after 1 April 2013 for corporation tax purposes and on or after 6 April 2013 for income tax purposes.

Abolition of capital allowances for safety at sports grounds expenditure

Again, this was another of the reliefs recommended for abolition in the final report of the OTS back in March 2011. Treasury and HMRC state the rationale for abolition is that its original purpose has been met and, as the relief does not apply to new stadia which are designed to comply with relevant safety legislation, it is no longer needed and should be removed from the statute book as part of the simplification of the tax system.

The proposal is that legislation will be introduced in Finance Bill 2012 to withdraw the relief for expenditure incurred on or after 1 April 2013 for companies and on or after 6 April 2013 for any unincorporated businesses.

However, this is not a view held by Sport generally, which sees the relief as a key element in the development and upgrading of sports facilities across all sports and at all levels and, it is expected that Sport will mount a vigorous campaign to seek the retention of the relief. Dunham Consulting is already working with the Sport & Recreation Alliance to co-ordinate this campaign.



Feed-in tariffs and the renewable heat incentive

Budget 2011 announced that the Government was seeking to enable businesses to claim capital allowances on expenditure incurred on generation equipment with regard to the Feed-in Tariffs (FITs) and Renewable Heat Incentive (RHI) schemes, in order to incentivise low carbon electricity generation and heat generation from renewable sources.

The proposals set out in the consultation document propose that Enhanced Capital Allowances (ECAs) would not be available where equipment could qualify for FITs or RHI tariff payments and that writing-down allowances (WDAs) in respect of the equipment should be given as part of the special rate expenditure provisions which will be 8% from April 2012.

It is intended that these provisions would apply to expenditure incurred on or after 1 April 2012 for corporation tax purposes and on or after 6 April 2012 for income tax purposes.

The issue it seems will be whether investors in these technologies will consider that by obtaining relief over a longer period will still provide an incentive to incur the expenditure.

Changes to the capital allowances anti-avoidance rules for plant and machinery

As part of its on-going desire to tackle tax avoidance, the Government announced in Budget 2011 that it intends to amend the capital allowance legislation to make the rules more effective in preventing perceived avoidance in this area.

As well as the normal written responses, HMRC intends to convene a small working group of interested parties to discuss the detail and impact of the proposed changes and has asked for any interested persons or bodies to contact them.

The intention is that legislation for the proposed changes will be published in the Autumn of 2011 and included in Finance Bill 2012.

It is proposed that four changes will be made to the legislation:

- To replace the 'sole or main benefit test' which determines if a transaction is a 'transaction to obtain allowances' with a new purpose test;

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- To expand the definition of a 'relevant transaction' to include all transactions where the claimant of allowances becomes entitled to benefit from a hire purchase or similar contract and the level of capital allowances after such transactions will be the claimant's capital expenditure under the contract;
- Where the legislation applies, the amount of qualifying expenditure on which allowances can be claimed may be restricted to market value and where arrangements are put in place to reduce the effective value of the asset to the buyer, those arrangements will be considered in determining the market value and any arrangements to increase the perceived value for the buyer would be disregarded; and
- To revoke the exclusion for manufacturers or suppliers of plant and machinery.

The recent case of *HMRC v Tower MCashback* in the Supreme Court has highlighted again the complexities of claiming allowances where complex structures are used and so a change to the anti-avoidance rules in this area was almost inevitable, especially given the importance that the Government and HMRC have placed on their anti-avoidance strategy. While this is clearly not intended to catch out the majority of businesses, it will be important not to catch bona fide commercial transactions within the anti-avoidance net.

Capital allowances for fixtures

By far the most important and far reaching of the consultation documents released is the intention to force businesses to pool their expenditure on fixtures in buildings within a short period of acquiring the building in order to be entitled to capital allowances – this is – the 'mandatory pooling' proposal announced in Budget 2011.

The Government perceives that the current rules for capital allowances for fixtures have defects which undermine the policy purpose of the legislation and allow for the avoidance of tax by obtaining allowances on more than the original cost of the fixtures and through an acceleration of allowances on fixtures.

As suspected, one of the reasons that this has been considered is the emergence over the last couple of years of a number of "specialist capital allowances" firms which has led to a significant increase in the level of second-hand property

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acquisition claims. HMRC do not consider these claims to be valid under the terms of legislation as they perceive in many cases, that little or no due diligence in respect of prior entitlement has been carried out to accurately establish the right to claim for the current owners.

The following proposals are therefore being considered:

- Businesses must pool their expenditure on fixtures within a short period after acquisition in order to qualify for capital allowances;
- The purchaser of a second hand building must agree with the seller the amount of the sale price attributable to the fixtures and that both parties should record and formally notify HMRC of this within the same time period;
- Proposed changes to the rules regarding s198 CAA 2001 where the legislation allows for the retention of allowances by the seller; and
- The effectiveness of the anti-avoidance rule in s197 CAA 2001 in preventing the acceleration of allowances.

The intention is that draft legislation will be produced in response to the consultation process for publication towards the end of 2011 and included in Finance Bill 2012.

With regard to 'mandatory pooling' the proposal is to look at either a one year or two year timeframe from the acquisition date to make a valid claim. Also, the consultation document identifies four types of expenditure on which fixtures can be identified:

- Second hand fixtures – those where the previous owner claimed capital allowances;
- Second hand fixtures – those where the previous owner did not claim capital allowances;
- New fixtures – those purchased by the current owner; and
- 'Historic fixtures' – those where expenditure was incurred before the introduction of any changes to the current regime, where fixtures are still owned but the expenditure has not been pooled.

It is intended that the new proposal should apply to the first three of these types and that for 'historic expenditure', consideration is being given that this expenditure

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should be pooled within one or two years from the date of the new mandatory pooling regime.

For the agreement between seller and purchaser, the proposal should be that a joint note of the mutual agreement be sent to HMRC with their respective tax returns within a similar timescale to that for mandatory pooling. This is seen as a way of removing the perceived difficulties of proof and that the figure used should be a market value of the assets in question and would be similar to a s198 CAA 2001 election.

For s198 CAA 2001 elections the proposal is that the minimum amount to be included in an election would be the tax written-down value for the seller. This deals with the issue that HMRC seem to have regarding the retention of allowances by the disposing party.

Finally, for the effectiveness of s197 CAA 2001, the intention is to prevent the acceleration of allowances in all cases as a result of a scheme or arrangement where the main or one of the main, purposes is the obtaining of a tax advantage.

It is clear that HMRC are very worried about the potential of lost tax revenues as a result of the current legislation and the increase in the number of claims being seen for property acquisitions.

While the current legislation has seemed to be easy to operate and has enabled taxpayers who, through no fault of their own, become entitled to allowances they are still due in later periods, the emergence of some advisors with an obvious lack of technical competence, combined with some dubious sales practices in this area, has given HMRC enough of a fright to propose the changes. It is hoped that through the consultation process, sensible new arrangements can be accepted which will close down the opportunities currently available to these types of advisors, thereby ensuring entitlements are properly researched and established.



Conclusions

These consultation documents represent an important period for capital allowances and all businesses are encouraged to take the time to respond to the issues raised. Dunham Consulting would be happy to assist in the formulation of responses to any of the areas covered and will be sending in its own responses as part of the process.

Copies of the consultation documents can be found on both the Treasury and HMRC websites and for completeness a link to them is shown below:

- http://www.hm-treasury.gov.uk/d/consult_removal_36_tax_reliefs.pdf
- http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageLibrary_ConsultationDocuments&columns=1&id=CURRENTCONSULTATIONS

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