

A QUESTION OF FIXTURES

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EXAMINES
HMRC'S PLAN
FOR CAPITAL
ALLOWANCES
AND ASSESSES
THE TAX
LIABILITY FOR
PROPERTY
OWNERS

HM Revenue & Customs has released a consultation on Capital Allowances for Fixtures, which will have a wide-reaching and punitive impact on all taxpayers owning property assets.

Capital allowances are a form of valuable tax relief available primarily to those investing in fixtures, and so-called plant and machinery, for business use. Within commercial properties, capital allowances available on fixed items within the building can be significant. Fixtures will include items such as lifts, water installations, air-conditioning units and sanitary fittings as well as general mechanical and electrical installations.

Existing rules allow property owners and investors to claim capital allowances for historically purchased fixtures as long as the item is still owned and used in the business. Therefore, even if a property was purchased 20 years ago and the owners had not previously claimed capital allowances, they could still submit a claim in the earliest open tax period.

The ability to make these so-called 'late claims' not only benefits those who may have missed the original opportunity but also those who may not have sufficient profits to utilise the allowances and, therefore, choose to analyse the expenditure at a later date.

THE PROPOSALS

It is unlikely that any other government consultation will have such a significant effect on so many taxpayers. The document highlights the appropriate statistics and arguments, but one feels that the Treasury has already made up its mind and that these measures are solely designed to secure tax revenues.

Mandatory pooling

As with most things described as 'mandatory', these rules will be far from pleasant if introduced in their current guise.

HMRC has been faced with many late claims for capital allowances on fixtures and is worried that many claims are being made without the technical analysis and historical checks. As time passes, the quality of records deteriorates, property ownership changes and, therefore, it can be difficult to establish whether capital allowances had been claimed and if so, at what value.

The mandatory pooling proposals suggest that a

property owner must make a capital allowances claim and pool the items within a specified time period (either one or two years) after purchase. If a purchaser does not pool the qualifying expenditure within this period, the taxation relief will be lost forever under a 'use it or lose it' principle.

The proposals will also apply to historical expenditure, which will affect potential claimants who have not yet pooled prior period expenditure. These property owners will have to do so within an allotted time period (either one or two years) after introduction of the measures.

Some may argue that these proposals eliminate an anomaly for claiming tax relief long after the appropriate period has closed, in comparison to other reliefs such as R&D tax credits. However, as capital allowances claims are specifically prohibited within the new 'Overpayment Relief' provisions (which allow a taxpayer to amend up to four years of tax returns if tax has been overpaid), the consultation does appear to continue what has recently been seen as an assault on property owners.

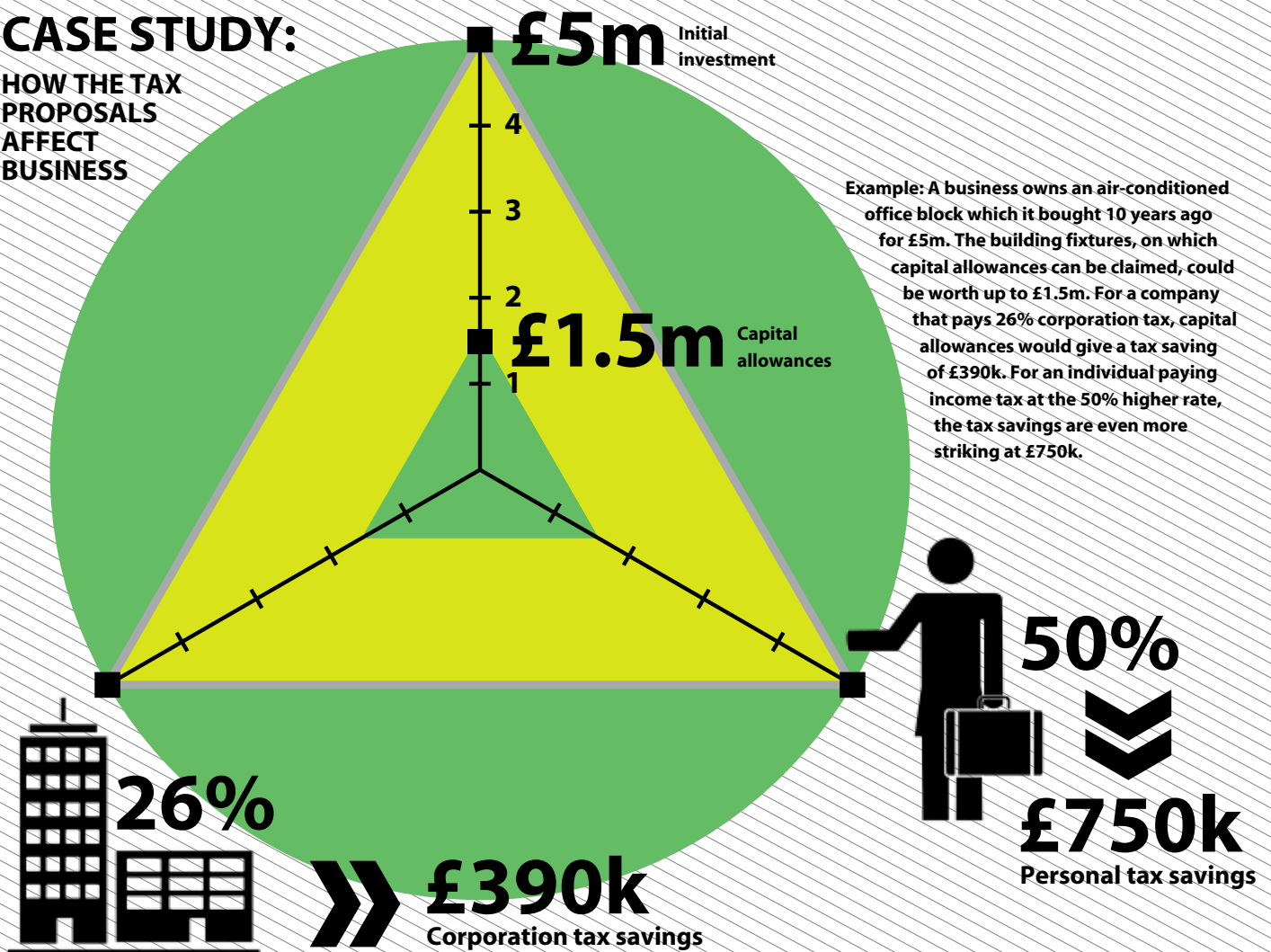
Record of agreement

The second proposal is designed to provide certainty to property vendors, purchasers and, of course, HMRC with respect to a property's capital allowances history. A formal record of agreement would prevent erroneous claims on items that have already been claimed in full.

This record of agreement would also affix a value to fixtures within the property qualifying for capital allowances on a market-value basis upon disposal. At present, a vendor may utilise a section 198 election to affix a value to the capital allowances within a property. Most transfers occur at nominal value (to enable the vendor to retain the allowances) or at tax written down value (for simplicity).

It will be interesting to analyse the final rules for this proposal because the market value for fixtures in a property would be difficult to ascertain. It is not feasible to rip out an air-conditioning unit from a building and sell it to a third party at arm's length.

Regardless of the final details, these proposals will affect every commercial property transaction within the UK and will ensure that further expense is incurred by the purchasers, vendors and their respective advisers.

CASE STUDY:**HOW THE TAX PROPOSALS AFFECT BUSINESS****End of section 198 election**

The government believes the affixation of nominal values by a vendor is not fair to property purchasers and has suggested a removal of the s198 election altogether. Ministers are concerned that a seller may retain allowances and accelerate taxation relief, even though they no longer own the asset.

It is proposed that a minimum amount (probably the tax written down value) must be used when completing a transaction, though how these proposals would dovetail with the aforementioned 'market value' provisions remains to be detailed.

The s198 election regime has become a mainstay within the commercial property sector and although disparity may occur, those involved with transactions understand the regime and the administrative requirements. These elections are particularly useful in situations where a vendor sells a property to a non-taxpayer such as a pension fund, charity or public body.

As these organisations do not pay tax and, therefore, could not use allowances, the vendor would often assign an amount of £1 to fixtures in the property, meaning their capital allowances pool would remain all but intact. Under the new proposals, the vendor must

assign at least tax written down value to the vendor, regardless of whether the relief could be utilised.

CONCLUSION

This consultation may have been released during the quiet summer period, but these proposals will cause more than just a ripple. Commercial property owners, whether investors or owner-occupiers, and their advisers, will experience a more restrictive regime with increased time input and associated expenditure.

While it is not possible to estimate the value of capital allowances that will be lost as a result of the mandatory pooling proposals, fixed asset registers and capital accounts may be analysed prior to commencement of the provisions.

If the unexpected panic experienced when the Industrial Buildings Allowances were abolished resonates at all, it would be preferable to act now or risk clients missing out on capital allowances for ever more.

The consultation closes on 2 September 2011.

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