Sector Focus

Hotels

The 26 March 2007 was a hugely significant day for hotel-owning companies and individuals. On that day, the then Chancellor, Gordon Brown, announced not only the abolition of industrial buildings allowances (IBAs) but also a proposed reduction in the rate of plant and machinery (P&M) writing-down allowances from 25% to 10% for many plant and machinery fixtures.

While this will have a significant effect for all businesses, the measures will hit the hotel sector particularly hard. Capital investment in hotel construction represents huge sums of money and hotels contain relatively high proportions of assets that qualify for plant and machinery allowances - between 40% and 60% of spend is not uncommon. Furthermore, expenditure not qualifying for P&M allowances was likely to qualify for IBAs on a qualifying hotel. So in one fell swoop, the Chancellor slashed the hotel sector's ability to mitigate their tax liabilities by significantly altering the capital allowances regime.

Cash flow forecasts for business models based on the assumption of the availability of 25% WDA for P&M and 4% for IBAs have needed to be dramatically adjusted based on what the future tax liabilities will now be.
The following example illustrates the point:

	Pre-Abolition of IBAs with P&M of 25% WDA	Post-Abolition of IBAs with P&M at 10%WDA**
Total Construction Expenditure	£50,000,000	£50,000,000
P&M Allowances	£32,500,000	£32,500,000
IBAs	£17,500,000	NIL
Total Tax Saving*	£14,000,000	£9,100,000
NPV*** of Total Tax Saving after 25 Years	£9,842,961	£5,592,366
NPV of Total Tax Saving after 5 Years	£7,472,196	£3,515,605

* Assumes a tax rate of 28% for comparative purposes
** Assumes that P&M will all fall into 10% integral fixtures category
*** Using a discount rate of 6%

So what can be done?

We believe that there are a number of key areas that hotel owners and operators should focus on.

1. **Timing of claims**

   For any companies currently engaged in the construction of a hotel, it is important to make claims for plant & machinery allowances as soon as possible and before the new 10% integral fixtures rules kick in on 1 April 2008. It is our view that P&M added to the general pool will attract the new 20% rate if claimed prior to this date.

2. **"When" is expenditure incurred**

   Consideration should also be given to the dates "when" expenditure is deemed to have been incurred. We can advise on the implications of this and how dealing with this point can give rise to significant cash flow advantages.

3. Expenditure on energy & water-efficient technologies

It is clear that the Government are switching tax incentives towards companies and individuals who incur expenditure on energy and water-efficient technologies. A 100% first-year allowance is available to such companies who incur expenditure on appropriate measures. Furthermore, they are extending the scheme to give tax credits to companies with losses arising directly from such expenditure. However, in practice, it is very difficult to actually obtain this relief due to the requirements for providing documentary evidence of the expenditure combined with the way in which construction projects are procured. Capitus provides a service aimed at addressing these issues and ensuring that this valuable relief is claimed.

4. Transitional arrangements until the abolition of IBAs

IBAs are due to be abolished in 2011, but until then relief is still available over the next four years at the rates of 4%, 3%, 2% and 1% of qualifying expenditure. It is important therefore to ensure that where claims can be made they are in order that the maximum level of IBAs can be obtained. During this timescale it may be possible to undertake additional group planning to further mitigate the effects of losing IBAs. Please contact us for further information.

5. Classification of integral fixtures

What will be deemed to be an integral fixture is currently the subject of a consultation process. However assets falling within the 10% category are likely to include lifts and escalators, air conditioning systems and central heating systems.

This leaves scope for continuing to claim other assets at the new 20% plant and machinery rate where a 100% first-year allowance is not possible. For hotel companies, this will include items such as sanitary ware, kitchen equipment, carpets, bars, furniture and other general equipment and can amount to a substantial proportion of the total expenditure. It is important then to ensure that construction expenditure is properly analysed by professionals who understand and can distinguish which expenditure should be allocated to which pool.

6. Electrical installations and hot and cold water systems

Whilst the proposed 10% plant and machinery rate for integral fixtures is generally punitive, the consultation process is suggesting the possibility of allowing electrical lighting and power systems together with hot and cold water systems as an integral fixture, if hotel operators were having these assets disallowed before.

In some instances entire electrical installations were already being allowed as claimable but this measure would take away the uncertainty. Furthermore, if energy efficient lighting was specified a 100% first-year allowance would be given for such expenditure.

7. Maximisation of other tax relief for expenditure on property

Land Remediation Relief (LRR)

Where hotels are being refurbished there may be considerable expenditure on the removal of asbestos or other contaminating substances. This may qualify for Land Remediation Relief (LRR), which is given as a 150% deduction for qualifying expenditure.

Hotels in Disadvantaged Areas

A 100% first-year allowance is available for bringing disused commercial premises back into use in specifically designated areas. The building must have been previously used as a commercial premises, been unoccupied for a period of at least a year and be in a so-called “Disadvantaged Area”.
So an old mill, which was converted into a hotel, could potentially qualify for the relief.

Sector Focus
Hotels

Summary

Whilst the new capital allowances rules introduced in the March 2007 budget will undoubtedly have an impact on the hotel industry, it is possible to take actions that will help alleviate this impact.
Capitus recommends that all hotels owners and operators act quickly and pro-actively to ensure tax relief is maximised and captured.