Capital allowances for business properties

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Ray Chidell and *Jake Iles*: what all tax practitioners need to know

Whilst capital allowances in general are familiar to nearly all accountants dealing with business tax computations, allowances for fixtures in commercial property have increasingly become a specialised topic. Important changes came into effect in 2008, 2012 and again in 2014, and as the rules become ever more complex, it is not feasible for every business tax adviser to have a safe grasp of all of the specialist issues.

Help is available in various guises, but there are certain key aspects that all accountants and tax advisers need to understand if they have clients who own (or are thinking of buying) commercial properties of any kind. In this article, the authors summarise the essential principles that all such practitioners should understand to protect their clients' interests.

Value

The starting point is simply to appreciate the fact that capital allowances for commercial properties are potentially very valuable. There are many variables here, but tax relief may typically be available for between 15% and 45% of the cost of a property. A simple warehouse will be at the lower end, whereas a care home or upmarket hotel may be around the top of that range.

For a company paying corporation tax at 19%, therefore, a £1 million property might yield potential tax savings of between £28,500 (£1 million x 15% x 19%) and £85,500 (£1 million x 45% x 19%). For individuals paying income tax at 45%, the potential savings could be as much as £200,000. There will be exceptions outside both ends of that spectrum of savings.

These are significant sums for any client, so the clear duty of the tax adviser is to ensure that the tax relief is not lost through negligence or an incomplete understanding of the relevant statutory rules.

Fixtures

The value of the allowances comes from fixtures in the property.

The key point here is to recognise that the term “fixture” has a technical meaning for capital allowances purposes (CAA 2001, s. 173). Crucially, the meaning is different from the concept of “fixtures and fittings” as used for accounting purposes.

The technical capital allowances definition is that a fixture is “plant or machinery that is so installed or otherwise fixed in or to a building ... as to become, in law, part of that building ...”.

So the term “plant or machinery” includes tables and chairs and computers and cars and much more besides, but none of these items are fixtures. The latter term only encompasses plant or machinery that is fixed to the property in some way, such as toilets, lifts and general lighting.

This distinction has all sorts of practical implications. The key one, however, is to recognise that capital allowances claims cannot simply be based on the figures in the accounts for “fixtures and fittings”.

Suppose, for example, that a care home has an extension. The costs of the beds and tables will be categorised in the accounts as “fixtures and fittings” but the toilets, lifts and lights will all be included as “additions to property” or under some such heading. If the capital allowances claim only picks up the items categorised as fixtures and fittings, the claim will be far smaller than it should be.

Sale and purchase agreement

The same principle applies when a property is bought. The sale and purchase agreement may distinguish between various categories, for example £800,000 to property, £200,000 to goodwill and £30,000 to fixtures and fittings. The buyer will no doubt hope to claim plant and machinery allowances for the £30,000 cost of the fixtures and fittings. That is fine as far as it goes but must not be the end of the story! The main capital allowances claim will lie within the £800,000: not all of this

amount will qualify, but a substantial percentage will do so. (As discussed below, however, particular steps will be needed to ensure that these more valuable allowances can be claimed.)

Time limits

Time limits work differently for capital allowances.

If a property was bought (say) 15 years ago, and allowances were not claimed at the time, it is not possible to go back now and re-open the computations for the year in question. What is possible, however, is to bring any qualifying expenditure into account in the current year (or into any year that is still open under normal self-assessment principles).

This principle is subject to various caveats, however.

First, a condition of doing this is that the person must still own the items in question at some time in the chargeable period for which the claim is first made (see section 58(4) CAA 2001). So no claim can be made for a period after that in which the property is sold.

Care must also be taken if a property is refurbished. Suppose, for example, that a property bought in 2003 included a boiler that was replaced in 2010. No claim may now be made for the original boiler, so that tax relief has been permanently lost. It will be necessary to check whether the cost of the new boiler was capitalised (in which case allowances may now be claimed) or was written off as revenue expenditure (in which case, of course, no claim may be made).

Another restriction is that no claim for either annual investment allowances (AIAs) or first-year allowances (FYAs) will be possible for delayed claims, i.e. where the expenditure is first brought into the capital allowances computations in a later year than that in which it was actually incurred. This is because of restrictions imposed by s. 51A(2) CAA 2001 (for AIAs) and s. 52(2) CAA 2001 (for FYAs). The claim will therefore be for writing-down allowances only.

Capital gains tax

The fact of claiming allowances for fixtures in a property does not mean that a higher capital gain will arise on sale (TCGA 1992, s. 41). So, if a property is bought

for £600,000 and sold for £800,000, the gain will (in simple terms) be £200,000, whether or not allowances are claimed, and whether or not the value of those allowances is retained at the point of sale. (The position is more complex if the property is sold at a capital loss.)

Changing rules – 2008

2008 saw several important changes to the rules for claiming plant and machinery allowances, some of which continue to raise important practical issues today.

The introduction of AIAs meant that most businesses can claim accelerated allowances for most types of qualifying expenditure. The annual limit for such AIAs is now set at £200,000, after some eye-wateringly complex transitional rules in past years. AIAs are subject to various restrictions (e.g. they are not given for cars), and the £200,000 must be shared between various entities as specified in the legislation (e.g. group companies).

The concept of “integral features” was also introduced from 2008. This broadened the range of assets qualifying for capital allowances. In particular, it meant that cold water systems, general lighting and general electrical wiring all started to qualify for capital allowances on pretty much a routine basis. This cut-off date (expenditure incurred from 1 or 6 April 2008 for corporation tax and income tax respectively) remains significant today, as the buyer of a commercial property needs to know whether or not the vendor has been able to claim allowances for any given fixture. If the person who is today selling an office block bought it in 2007, the current buyer can be reasonably certain that the outgoing owner was not able to claim for the general lighting and wiring costs, for example. This can have a big impact on the claim that may be made today.

Changing rules – 2012 and 2014

Finance Act 2012 (FA 2012) introduced some important new legislation, now at s. 187A and 187B of CAA 2001. These changes – applying from April 2012, but to some extent deferred to April 2014 – again have critical implications for the buyer of a property.

In brief, a buyer normally has to jump through two hoops before claiming capital allowances for fixtures in the property. As these hoops necessarily involve action by

the vendor, it is vital to consider them before the sale and purchase agreement is signed off.

Pooling requirement

The first of these is the so-called “pooling requirement” (s. 187A(4) CAA 2001). Essentially, this says that the vendor has to pass the value of the fixtures in the property through his (or her or its) capital allowances computations before transferring any such value to the buyer. This is best illustrated with an example:

> **Example**
>
> Jack bought a restaurant in 2010 for £450,000 and is selling the property to Jill in 2018 for £480,000. The business has not been a success, so Jack generated no taxable profits and has not worried about capital allowances.
>
> A review makes it clear that Jack could have claimed £160,000 for fixtures in the property. Although he does not need the allowances, Jack must add the full £160,000 to his capital allowances computations, and must then agree a transfer to Jill, if Jill is to have any chance of claiming the valuable tax relief.
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> If Jill only becomes aware of this after the purchase agreement has been signed, Jack will have no interest in cooperating and may refuse to pool the qualifying expenditure. Jill will then have no legal hold over Jack, so will miss out on the tax relief.

Fixed Value requirement

The second requirement introduced by FA 2012 (the “fixed value requirement” at s. 187A(5) CAA 2001) is that the parties must sign a fixtures election (under s. 198 or sometimes s. 199 of CAA 2001) to determine a value at which the fixtures will pass for capital allowances purposes from one party to the other. More on this below, but in the example just given the parties may therefore agree to transfer the fixtures at £160,000, the maximum amount allowed.

However

As a further complication, the FA 2012 rules are not imposed for fixtures for which the vendor was unable to claim (e.g. general lighting costs incurred before April 2008). The buyer can nevertheless claim for these, over and above any figures in the fixtures elections.

The FA 2012 rules also contain a trap for the unwary vendor. This is a seemingly innocuous comment at s. 187B(6) CAA 2001, which says that the pooling and fixed value requirements do not have any bearing on the vendor's disposal value. What this means in practice is that we can very easily end up with the position where any capital allowances formerly given to the vendor are clawed back at the time of the sale, even as allowances are denied to the buyer.

> **Example**
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> Romeo ran a restaurant, and is selling it to Juliet. The facts are as for Jack and Jill above but in this case Romeo has had a profitable business and has claimed full relief (by way of annual investment allowances) for the qualifying expenditure of £160,000.
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> If no fixtures election is signed, or if the election proves to be invalid for any reason, Juliet will be unable to claim for the cost of the fixtures. Nevertheless, Romeo will face a balancing charge of up to the full amount of £160,000 – a disastrous outcome for both parties! With a valid election, one of the parties would have enjoyed the full amount of tax relief or (more probably) they would have agreed to share it in some way.

The fixtures election

Care is needed to get the s. 198 (or s. 199) election right, to avoid the scenario in the second example above, and detailed conditions for the election are given at s. 201 CAA 2001. A common error is to forget that the election can only cover fixtures in the sense described above. If the election purports to include tables and chairs, for example, it may well be invalid, with dire consequences as just illustrated.

The election determines an amount that will be treated *for capital allowances purposes only* as the transfer value of the fixtures to which it relates. There are two important points here. First, this does not (in itself) affect the commercial apportionment between the "fixtures and fittings" and the property. Second, the

figure in the election does not have to be in any sense “reasonable”; within certain parameters, the parties can negotiate the figure as they wish, and it will be binding on HMRC. Understanding what negotiations are possible is critical to defending the interests of the client, whether buying or selling.

Commercial property standard enquiries (CPSEs)

The solicitors acting for the buyer will normally raise CPSEs, the last section of which is concerned with capital allowances. Most solicitors, however, will make it clear in their engagement terms that they do not wish to be responsible for capital allowances matters, so the buck may well stop with the accountant or tax adviser.

The CPSEs are problematic in various ways, not least because they include an ambiguous question about former claims by the vendor. Furthermore, the CPSE replies rarely provide sufficient information to determine the best way forward, and often need to be challenged. Given the amounts at stake (even, and indeed especially, if the CPSE replies purport to say that no or few allowances are due) it may well be worth getting specialists involved in reviewing the replies received from the vendor’s side (and indeed in formulating the replies if acting for the vendor).

Valuation

In some circumstances, it will be essential to have a valuation of the property and of the fixtures it contains. This is not something that most accountants are professionally qualified to do, so specialist valuers will need to be engaged as appropriate.

A valuation will generally be necessary, for example, if the vendor owned the property before 2008 and/or if the vendor has not yet made a full capital allowances claim.

In conclusion

This article only scratches the surface of the practicalities of claiming capital allowances for fixtures, and there are many potential complications.

The capital allowances history of previous owners is one key factor that may determine whether or not a claim is possible (s. 185 and s. 562(3) CAA 2001). This may involve digging up Land Registry records and/or Companies House accounts,

and understanding the implications of both.

Different issues also arise, for example, where leases are granted (s. 183, 184 CAA 2001), where there are connected parties (s. 214 CAA 2001) or where the property is a dwelling-house, albeit perhaps with communal elements for which a claim may be possible (s. 35 CAA 2001).

Dealing with capital allowances without a detailed understanding of the underlying complexities is, of course, unlikely to lead to the best outcome for the client. But ignoring the potential claim (a much more common scenario in practice) is equally unacceptable for the client and risky for the adviser. The professional adviser who does not want to grapple with all the technicalities should, at the least, become familiar with the risks and opportunities, so that specialist support can be used where necessary.