

CASE STUDY

UTILISATION OF CAPITAL ALLOWANCES BY A PROPERTY PARTNERSHIP

It is not uncommon for the running costs of a property partnership to exceed gross rental income, resulting in a net loss for the year. In such circumstances, it is tempting to view Capital Allowances as having little value, which would be a mistake. This case study sets out how individual partners of a property partnership can utilise Capital Allowances from qualifying plant and machinery, other than by carrying them forward against future profits of the partnership.

Background

ABC Properties LLP acquired a fully let office building for a consideration of £7.2 million in October 2008. The property was three years old and had been owned since new by a pension fund. The qualifying expenditure for Capital Allowances in respect of the tax year ending 5 April 2009 was as follows:

| | Total Expenditure £ | Total Allowances £ |
|-------------------|------------------------|-----------------------|
| Integral features | 1,007,697 | 145,770 |
| General plant | 408,888 | 81,778 |
| | 1,416,585 | 227,548 |

The qualifying expenditure was calculated in accordance with the Capital Allowances Act 2001, Section 562 as an apportionment of the price paid for the property. The methodology of the apportionment was approved by HM Revenue & Customs. The annual allowance for integral features includes £50,000 annual investment allowance.

The partnership was highly geared and due mainly to the interest on the mortgage, the net result for the tax year ended 5 April 2009 was a small loss before any claim for Capital Allowances.

Sideways set-off

In accordance with the Capital Allowances Act 2001, Section 2; Capital Allowances are treated as an expense of the property business and can be used to create a loss in the current year, or they can be disclaimed in full or part and carried forward to a later tax year.

If the Capital Allowances are used to create a loss in the current year, then that part of the loss created by the Capital Allowances can be set-off against other income of the partners in accordance with the Income Tax Act 2007, Section 120.

The tax savings

ABC Properties LLP consisted of four individual partners, all of whom were higher rate tax payers and each holding a 25% share in the partnership. Two of the partners were self-employed with income from a separate professional partnership, one was a well paid employee and one was a wealthy retiree.

The share of each partner's Capital Allowances for the year ended 5 April 2009 was £56,887, which provided each partner with a tax saving of £22,755 on their other income. It should be stressed that this tax saving relates to just one year and there is no reason why the Capital Allowances cannot be similarly utilised in future years. Indeed, the property partnership might never actually make a profit, but the partners will eventually have benefited from total tax savings of £566,634 at the current top rate of 40% for income tax payers.

As all partnerships are tax transparent, the ability to set-off Capital Allowances against the other income of individual tax payers would not be affected by the type of property partnership. If ABC Properties had been an unlimited partnership or a limited partnership, rather than a LLP, the result would have been the same.

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