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# CLAIMING CAPITAL ALLOWANCES ON A GROUND RENT INVESTMENT

## Introduction

When an investor purchases the freehold of a block of flats, Capital Allowances (allowances) are probably about the last thing that is factored into the appraisal, if at all. The investor will be focusing on the ground rent due from the flat owners, as well as any additional value that can be derived from granting lease extensions and commissions from insurance brokers. It is unlikely the investor will realise that, in addition to purchasing an income stream, he or she has also purchased plant and machinery leading to a potential claim for allowances. However, as the allowances will reduce the tax liability of the investor, they effectively represent hidden value, which can be easily overlooked.

## Common plant and machinery

The purchaser of the freehold interest in a block of flats will be able to claim allowances for the part of the capital sum paid for the freehold that can be attributed to the common plant and machinery, such as the lifts or fire alarm system. The owners of the individual flats, the leaseholders, will usually only have incurred capital expenditure on items within the four walls of their individual flats. As no other person will have been able to claim allowances on the common plant and machinery, the right to these will rest with the freeholder.

## Apportionment

The level of the qualifying expenditure will not be immediately evident as the purchaser is likely to have paid one lump sum for the freehold. In order to establish the capital expenditure incurred on the common plant and machinery a 'just and reasonable' apportionment is necessary in accordance with the Capital Allowances Act 2001, Section 562.

A just and reasonable apportionment, as far as HM Revenue & Customs is concerned, is an apportionment that is acceptable to the District Valuer. The District Valuer will generally use a formula method to apportion the purchase price of the freehold to the qualifying plant and machinery. An apportionment that is not based on the approved formula method is unlikely to be agreed by the District Valuer and will not, therefore, be acceptable to HM Revenue & Customs.

### The benefit

The purchaser of the freehold interest in a block of flats could be entitled to allowances of somewhere between 5% and 10% of the price paid for the investment; therefore, every £100,000 of expenditure on ground rent investments will save a 40% tax payer up to £4,000 ( $£100,000 \times 10\% \times 40\%$ ). From 6 April 2010, the tax rate for income in excess of £150,000 is 50% and therefore, the tax saving to the ground rent investor could increase to £5,000 for every £100,000 of expenditure.

### Summary

Purchasers of ground rent investments are likely to incur expenditure on common plant and machinery that will qualify for allowances. The level of the available allowances must be established by apportioning the price paid for the property investment in accordance with Capital Allowances Act 2001, Section 562. The apportionment should be 'just and reasonable' and must be agreed with the District Valuer. It is, therefore, essential that the investor understands the correct basis of valuation to be adopted, otherwise the claim will be unacceptable to HM Revenue & Customs.

Owners of ground rent investments are entitled to an annual investment allowance of up to £50,000 in respect of expenditure on plant and machinery. This means that the first £50,000 of Capital Allowances in any year are allowable in full, against tax in that year. Any allowances that cannot be utilised against property income will be available for sideways set-off against the investor's other income. For expenditure on ground rent investments incurred after 5 April 2010, the level of tax savings will significantly increase for investors subject to the new 50% tax rate on income over £150,000. The allowances available to ground rent investors will, therefore, provide valuable tax savings, but specialist advice is recommended to reduce 'risk,' correctly ascertain eligibility and prepare the subsequent apportionment valuation.

For further advice concerning any of the issues raised in this briefing, please contact one of our key individuals detailed overpage, or alternatively call our helpline on 0800 526262. Information on other property tax related topics can also be found on our website at <http://bankingtaxfinance.davislangdon.com>.

