

DATA SHEET

CAPITAL ALLOWANCES ON CONSTRUCTION PROJECTS

The vast majority of businesses incurring capital expenditure for construction work on commercial property can benefit from tax relief in the form of Capital Allowances. The allowances are available to anyone who retains property as a fixed asset in the business, including; property investment vehicles, those who occupy their own buildings and those who lease property and adapt it for their own use. In certain circumstances, a lessee can even claim Capital Allowances on machinery or plant installed by a lessor.

Who can benefit?

Taxpayers who can benefit from Capital Allowances include companies, individuals and partnerships in any of the categories listed below:

- Constructing buildings to hold as investments.
- Constructing or renovating buildings for their own use.
- Fitting out leased property for their own use.
- Taxpayers making contributions towards costs incurred by others.
- Lessees who have leased machinery or plant on a long funding lease (refer to our long funding leases data sheet).

Non-resident landlords can also claim Capital Allowances. Developers who intend to trade-on their property will not directly benefit from allowances, but the value to a potential purchaser can be computed and included in the agent's particulars as a 'sales aid'.

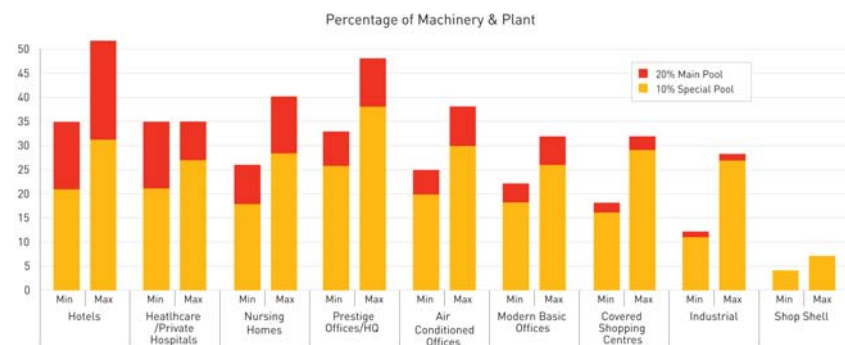
Typical values

The main allowances available on commercial property are those relating to plant and machinery fixtures. Qualifying items include; most of the mechanical and electrical services, sanitary fittings, external solar shading, carpets, lifts and other fittings and equipment. The potential list is huge and will vary from building to building. Whether or not certain items may be allowable will be influenced by factors such as the use of the building in the taxpayers business and the building design. How the tax efficiency of a building can be influenced through alternative design solutions is covered in the planning section.

Other allowances

Capital Allowances are generally given in the form of writing down allowances at the rate of 20% each year on a reducing balance basis. A lower rate of 10%, also on a reducing balance basis, applies to expenditure on machinery or plant categorised as long life assets or integral features. An Annual Investment Allowance (AIA) on the first £50,000 of qualifying expenditure from either pool, or a mixture of both, is given at 100% before the writing down allowances are calculated. Subject to certain exceptions, only one AIA is available to a group of companies.

Typical upper and lower ranges for different building types are given below (please note: this also shows the different rates of allowances attracted by the different pools; ie. 20% main pool and special 10% pool items):



Enhanced Capital Allowances in the form of a 100% first year allowance is available on certain energy saving, water saving and environmentally beneficial machinery or plant. Other allowances that may be available include; industrial building allowances, hotel allowances and research and development allowances, all of which are dependent on the actual use of the building. Enterprise zone allowances may be available if the building is, or was, located in a designated zone. However, from April 2011, industrial building allowances, hotel allowances and enterprise zone allowances will no longer be available.

Refurbishment

It is often said that property refurbishment is more tax efficient than new build. The basis of this statement is that the legislation allows the cost of incidental alteration works to be included within Capital Allowances' claims, relating to the provision of plant and machinery within an existing building. Allowances can also be claimed on the demolition costs of old plant and machinery and the addition of thermal insulation to commercial buildings. In addition, 100% first year allowances may be available for expenditure incurred on bringing back into use previous residential space for letting specified, or for the renovation or conversion of disused commercial property located in a disadvantaged area.

Capital Allowances planning

The amount of allowances available is based upon the actual cost of the plant and machinery shown in the construction contract documentation, plus additions for associated builder's work, profit and overheads and other on-costs like professional fees. All these numbers add up to a significant value against which tax relief can be obtained, maximising project returns or enhancing viability. Problems are often experienced when trying to identify the true cost of an item; this is because the building contract documentation or procurement method is not designed to capture information to substantiate a Capital Allowances claim. Any analysis should also reconcile with the statutory accounts. Consideration of various design issues at an early stage

can be beneficial to any claim for Capital Allowances. Claims made retrospectively will typically require a large degree of forensic investigation to ascertain the reasons for design decisions that may influence claim values. It is estimated that by planning a Capital Allowances claim, increases of up to 20% can be achieved when compared to purely retrospective claims. The benefits of early consideration include:

- Minor design changes that do not impact on building function can sometimes increase claim values with no extra construction cost.
- The correct wording of design and other documentation can help in substantiating claims for specific items.
- Changes in the format of contract documentation and the inclusion of obligations relating to the provision of information, facilitate the identification of the true cost of items qualifying for Capital Allowances.
- Consideration of items that may not be 'background machinery or plant' and where restructuring the basis of expenditure may prevent loss of allowances to a lessor under Capital Allowances Act 2001, Section 34A.
- Timely collection of supporting information and monitoring of works in progress will assist in agreeing a claim at the maximum value.
- Items for which claims are likely to be challenged by HM Revenue & Customs can be identified early, leaving more time to compile documentary evidence and increase the chances of a successful outcome. The value of the tax allowances can be factored into financial appraisals and can assist funding applications for projects that may otherwise be marginal.
- Documentary evidence is compiled at a time when decisions are being made, rather than many years after a building's completion, when an enquiry is likely to arise under self assessment.

Please refer to our tax planning data sheet for further information about the principles of Capital Allowances planning.

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