

An Updated Guide for Property Investors to Capital Allowances for Fixtures

Background

Much has already been written about the new rules for capital allowances on fixtures forming part of a property, such as lifts, heating, ventilation and toilets. The government announced in last year's Budget on 23 March 2011 that it was looking to make changes to the existing regime and that was followed by a consultation and subsequently draft legislation. To add to the potential confusion of the property investor, the rules that were published as draft legislation on 6 December 2011 were amended in the legislation that was published in the Finance Bill 2012 on 29 March 2012. This guide is an attempt to simplify the capital allowances legislation that now applies to both buyers and sellers, assuming that the Finance Bill 2012 receives Royal Assent without any amendment to the new rules.

Significance of the new rules

Before we look at the changes and their effect, it should first be made clear that it is the purchaser of a property that stands to lose the most from the new rules rather than the seller. The seller can destroy value, preserve value, or even add value for the purchaser but, apart from one unlikely scenario, there is nothing in the new rules that should directly impact on the capital allowances position of the seller. The purchaser, on the other hand, can only lose out from not understanding the impact of the changes. There is no upside.

It is important to understand that whilst the commencement date of the new legislation is April 2012 (1st April for corporation tax and 6th April for income tax), not all of the rules immediately apply. There is a two year transitional period between April 2012 and April 2014 when the purchaser does not have quite so many hurdles to clear in order to benefit from capital allowances on fixtures acquired with a property. From April 2014 the full effect of the rules will be felt by the purchaser. That is why the new rules need to be considered from two separate time frames.

The new rules do not have any effect until there is a change of ownership. Therefore, capital allowances for expenditure incurred on constructing or

refurbishing property will not be affected. In addition, there is no impact on the transfer of capital allowances that have been claimed as a result of a capital contribution. It should also be appreciated that the restrictions on the level of capital allowances that can be claimed by a purchaser, due to claims made by previous owners and the necessity to prove to HM Revenue & Customs (HMRC) that no such claims exist, remain in place together with the new rules.

1. Property transactions from April 2012

(a) The purchaser's position

Where a seller has claimed capital allowances on fixtures, it will now be necessary for the seller to fix the disposal value of the fixtures by entering into a joint election with the purchaser under the Capital Allowances Act 2001 (CAA 2001), section 198 or section 199, in order for the purchaser to be able to establish an entitlement to capital allowances. It has always been best practice for the seller to do this but up until April 2012 the purchaser would usually have been in an advantageous position if the seller omitted to do so.

A section 199 election would only apply where the seller has created a new lease. In practice, it is unlikely that an election under section 199 will be relevant very often because the purchaser would first need to have obtained a joint election under section 183 making the new lease the relevant interest for capital allowances. Any seller who wanted to retain the capital allowances on the sale of the new lease would simply not enter into a section 183 election.

The need for a section 198 or 199 election is referred to in the new legislation as "the fixed value requirement". Where the elected value is nominal, the existence of a joint election will obviously be of no real benefit to the purchaser. However, there is an alternative to a joint election.

If the seller does not insist on a section 198 election as a term of the sale, the purchaser can apply to the Tribunal to fix the disposal value of the fixtures within 2 years of the transaction date. The amount fixed by the Tribunal will then be treated as fulfilling the fixed

value requirement even though the decision of the Tribunal is reached outside of the 2 year time limit. Alternatively, provided the application to the Tribunal is made within the 2 year time limit, a section 198 election can be executed at any time up until the Tribunal reaches its decision or the application is withdrawn. An application cannot be made to the Tribunal unless the purchaser could enter into a joint election with the seller, i.e. the purchaser must have acquired the relevant interest.

If the purchaser acquires a property from a non-taxpayer (i.e. a charity or pension fund) who had previously acquired the property from a capital allowances claimant and the non-taxpayer had not entered into a s198 election, or made an application to the Tribunal within 2 years of the date that the non-taxpayer acquired the property, the purchaser is still able to meet the fixed value requirement by obtaining the following documents:-

- (i) A written statement from the non-taxpayer that a s198 election was not executed nor was an application made to the Tribunal within the 2 year time limit for doing so.
- (ii) A written statement from the capital allowances claimant as to the disposal value that was brought into account on the sale of the property to the non-taxpayer.

Occasionally, there will be situations where the seller has claimed capital allowances but is not able to enter into an election because of the type of disposal event. These disposal events are set out at item 7 of the Table at section 61 and items 2 and 3 of the Table at section 196. Instead of the parties to the transaction being able to fix the disposal value of the fixtures by mutual consent, the capital allowances legislation requires that the disposal value is computed on the assumption that the property is sold at market value. For example, where the seller disposes of the property as a dividend in specie - that would be a disposal event where a joint election is not possible. In such cases, the purchaser will need to obtain from the seller a statement of what disposal value the seller brought into account. This is referred to within the new legislation as "the disposal value statement requirement". The purchaser must obtain this statement from the seller within 2 years of the date that the seller ceased to own the fixtures.

Where the purchaser is not satisfied that the disposal value of the seller, as stated on the disposal value statement, has been brought into account in accordance with the existing capital allowances

legislation (i.e. item 7 of the Table at section 61 or items 2 or 3 of the Table at section 196), the matter cannot be referred to the Tribunal in accordance with sections 562, 563 and 564. This is because under the new legislation, specifically section 187B (2) (b), the disposal value statement is treated as if it was a section 198 election.

So far we have been referring to the "fixed value requirement" and "the disposal value statement requirement" in the context of the seller and purchaser. However, the new rules also apply to previous owners and subsequent purchasers where the relevant transaction occurs after the commencement date.

For example, if a previous owner claims capital allowances on fixtures and sells after the commencement date to the next owner who could but does not make a claim, a subsequent purchaser will not be able to claim capital allowances unless the fixed value requirement or the disposal value statement requirement is satisfied. Therefore, if the previous owner did not enter into a joint election when the property was sold and the purchaser from the previous owner did not apply to the Tribunal to fix the disposal value of the fixtures within the 2 year time limit, no subsequent purchaser will be able to claim capital allowances. The entitlement to capital allowances for the existing fixtures within the property will have been lost permanently.

(b) The seller's position

If the seller has not claimed capital allowances then a section 198 election is not applicable. This remains unchanged for sales made after the commencement date of the new rules. Where the seller decides to claim capital allowances after the sale of the property, by making the claim for a chargeable period when the property was still owned, the success of the seller in retaining sufficient capital allowances to make the exercise worthwhile will depend on the actions of HM Revenue and Customs (HMRC) and/or the purchaser.

In theory, the seller is required to bring a disposal value for the fixtures into account, within the tax return covering the chargeable period in which the sale of the property takes place, in accordance with either section 61 or section 196. This is confirmed in the new legislation at section 187B (3). But it is far from certain that HMRC will scrutinise the seller's disposal value (even if it is, or should have been, brought into account in the same chargeable period in which the claim is made) because HMRC, in our experience,

tend to be concerned much more with claims made by purchasers.

The above contention, concerning the approach of HMRC, was certainly supported by the facts in the case *Mr & Mrs Tapsell & Mr Lester (in partnership as "The Granleys") v HMRC (2011)*. There is however a risk, albeit small, that HMRC do decide to question the seller's disposal value, which could result in the seller having to bring into account a full disposal value leaving no benefit from making the late claim.

The real risk to the seller of not being able to retain capital allowances made in a late claim, is probably where the purchaser wants to make a claim. The purchaser will seek confirmation from the seller that no claim has been made. If the seller refuses to provide such confirmation, the purchaser will suspect that the seller could be planning to make a late claim and therefore be alerted to the need to refer the matter to the Tribunal within 2 years of the purchase date.

It is unlikely, where the purchaser is not able to claim capital allowances, that the purchaser would refer the seller's disposal value to the Tribunal. Furthermore, where the seller disposes of the property to a non-taxpayer, it would appear from the new legislation at 187B (2) (b) that after 2 years of the sale date the seller's disposal value cannot be challenged by HMRC irrespective of the fact that an enquiry would still be possible under the self-assessment rules.

Where the seller has claimed capital allowances before the sale of the property, the seller should agree the disposal value of the fixtures with the purchaser via a section 198 election as part of the terms of the sale. This will provide the seller with tax certainty. If the seller does not insist on an election as part of the terms of the sale, then the seller will be in the same position as if a late claim was made with all the same consequences as set out above.

2. Property transactions from April 2014

(a) The purchaser's position

In addition to the "fixed value requirement" or "the disposal value statement requirement", purchasers that acquire property after the end of the 2 year transitional period (31st March 2014 for corporation tax and 5th April 2014 for income tax) will also have to comply with the "pooling requirement". The pooling requirement is that any seller who could have claimed capital allowances must have pooled the expenditure

or claimed a 100% first year allowance in order that the purchaser can claim capital allowances.

The pooling requirement also applies to previous owners, other than the seller, where the previous owner has sold the property after the transitional period. Therefore, if the purchaser is a non-taxpayer or property trader that is not able to claim capital allowances and the seller or a previous owner, who could claim but did not make a claim, has sold the property after the end of the transitional period, no future owner of the property will be able to claim capital allowances in respect of the existing fixtures.

(b) The seller's position

The seller will only be indirectly affected by the pooling requirement. If the seller could claim but does not make a claim and sells the property after the end of the transitional period, the seller will have destroyed value because neither the purchaser nor any subsequent owner can claim capital allowances. This may well be reflected in the price that can be obtained for the property from April 2014 onwards.

A seller that wishes to maintain the value of the inherent capital allowances for a future owner should make a claim within the tax return covering the chargeable period in which the disposal took place or an earlier chargeable period. The seller should then enter into a section 198 election with the purchaser within 2 years of the date of sale at the full value of the capital allowances pooled on the respective tax return.

Conclusions and recommendations

Whilst the pooling requirement will not apply until April 2014, purchasers must be mindful of the fact that where the seller has claimed capital allowances, either the fixed value requirement or the disposal value statement requirement will need to be met for property acquisitions made from April 2012.

Alternatively, the disposal value could be fixed by the Tribunal, but only where an election under section 198 or 199 is possible and has not been made. However, a note of caution is appropriate for any purchaser who agrees a figure for fixtures in the Sale & Purchase contract and then seeks to improve his position after completion by making an application to the Tribunal.

In the Granleys case, the Tribunal decided that it had insufficient evidence to supersede a contract apportionment and the purchaser's claim for additional capital allowances was rejected.

Where the purchaser has not entered into a section 198 election with the seller, time will be of the essence. This is because the seller will still have time to make a late claim and therefore a failure to apply to the Tribunal within 2 years of the purchase date will still have time to make a late claim and therefore a failure to apply to the Tribunal within 2 years of the purchase date will result in the permanent loss of capital allowances for the purchaser and future owners of the property. It is now dangerous for a purchaser, who can claim capital allowances, not to make a claim in the chargeable period in which the property was acquired.

We recommend that due diligence is carried out by the purchaser at the time of acquisition and not when the tax return for the relevant chargeable period is being prepared. Early consideration of these new rules is essential to avoid the potential loss of capital allowances. If the fixed value requirement is not met when the property is acquired there may still be time to remedy the omission for the purchaser provided a capital allowances review of the property is carried out in time. Likewise, in circumstances where it is relevant, the disposal value statement requirement can be satisfied after the purchase of the property if the facts are discovered in time.

From April 2014, the purchaser will need to consider whether the seller or any relevant previous owner could have claimed capital allowances but did not do so. Again, early consideration of the facts could provide the purchaser with the opportunity of satisfying the pooling requirement where the requirement was not previously satisfied at the purchase date. Alternatively, if it is already too late for the pooling requirement to be satisfied then at least the purchaser can build that fact into the investment appraisal.

As far as the seller is concerned, not much changes under the new rules. Probably the main change for the seller, who has claimed capital allowances, is that a purchaser that is not able to claim capital allowances can now apply to the Tribunal to fix the seller's disposal value. This is one more reason why a seller, who wants to retain capital allowances, should always seek tax certainty by entering into a section 198 election as a condition of the sale.

In addition, the seller will have the opportunity to destroy, maintain or add value for a purchaser or subsequent owner. The seller will destroy value by being able to claim capital allowances, not making a claim and then selling the property after the transitional period. The seller can maintain value by making a claim when the seller would not previously have done so and then passing the full benefit of the capital allowances to the purchaser. The seller can add value by making an application to the Tribunal to fix the disposal value of the previous owner, even though the seller is unable to claim capital allowances.

Finally, it should be noted that these new rules have come about because HMRC have grown increasingly concerned about overly aggressive capital allowances claims. Therefore, it can be assumed that there will be no concessions by HMRC concerning ownership history. Also, claims prepared by consultants that have been particularly aggressive in making claims on historic expenditure for high percentage fees could well see an increase in enquiries by HMRC.

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

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