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ENHANCED CAPITAL ALLOWANCES ARE THE FUTURE - THE REASONS WHY

Introduction

Enhanced Capital Allowances are a 100% tax relief against capital expenditure, but the chances are most taxpayers will only be vaguely aware of their existence, if at all.

All this is about to change with the introduction of new rules on Capital Allowances in April 2008. The rules introduced a separate plant and machinery classification, integral features. The effect is to shift a large proportion of plant and machinery into the new 10% writing down allowance (WDA) rate from the old higher rate. This will affect high cost assets such as lifts, central heating systems, air conditioning, electrical lighting and power systems, some of which may partly qualify for ECAs but only if robust pre planning measures are introduced early in the projects' design.

As a result, there is an increased incentive on all taxpayers to try and benefit from ECAs. Although it is possible to tackle ECAs during the later stages of a projects' development, the best outcome will be achieved via an early dialogue with the M&E consultant. This will ensure the correct documentation is available and specifications reflect 'qualifying' equipment and technologies.

What are ECAs

The ECA scheme is split between energy technologies managed by the Carbon Trust (CT) and water efficient technologies managed by the Department for Environment, Food and Rural Affairs (Defra). It has been around since 2001 to encourage taxpayers to invest in energy and water efficient plant and machinery. This is done by boosting the first year Capital Allowances to 100% for investment in qualifying equipment (see ovefleaf). This means the entire cost of these assets can be offset in the year the expenditure is incurred.

ECAs are available on new build expenditure, refurbishment work and even purchases; in all cases the plant must be new and unused.

How taxpayers could be missing out?

Taxpayers claiming ECAs are still an exception, some of the reasons why this may be so are listed below:

- There are few consultants who fully understand the scheme.
- Qualifying equipment is difficult to identify from the ETL.
- A low awareness of the potential cashflow benefits generally.
- The consideration of ECAs is left too late in the design process.
- ECAs must be specified before the mechanical or electrical specifications are finalised, because later changes are often impossible to accommodate.
- ECAs are often an after-thought, at which point, orders for (non ECA) equipment have already been placed.

Reasons why ECAs cannot be ignored

- The recent drop to 10% for integral plant creating a much larger differential between ordinary plant and equipment qualifying for ECAs.
- Incoming tenants are increasingly looking for more efficient accommodation.
- 'Greener' clients and property investors keen to demonstrate more sustainable credentials.
- Building obsolescence - there is a danger that inefficient buildings will at some point become more difficult to let.
- The more energy efficient the building design, the greater the opportunities to reduce running costs. Any savings will only be maximised if the end user optimises their use of the space.
- ECAs are an important and expanding fiscal incentive that simply cannot be ignored when considering investment in commercial property.

To achieve greater tax saving;
Think Early, Think ECAs

What type of equipment qualifies for ECAs?

ENERGY TECHNOLOGIES

- Air-to-air energy recovery.
- Automatic monitoring and targeting.
- Boiler equipment.
- Combined heat and power.
- Compact heat exchangers.
- Compressed air equipment.
- Heat pumps for space heating (revised for 2009).
- Heating ventilation and air conditioning zone controls.
- Lighting.
- Motors and drives.
- Pipework insulation.
- Refrigeration equipment.
- Solar thermal systems.
- Warm air and radiant heaters (new Summer 2009)

WATER TECHNOLOGIES

- Cleaning in place equipment.
- Efficient showers.
- Efficient taps.
- Efficient toilets.
- Efficient washing machines.
- Flow controllers.
- Leakage detection equipment.
- Meters and monitoring equipment.
- Rainwater harvesting equipment.
- Small scale slurry and sludge dewatering equipment.
- Vehicle wash water reclaim units.
- Water efficient industrial cleaning equipment.
- Water management equipment for mechanical seals.
- Efficient membrane filtration systems.

An example showing the cashflow advantages of ECA compliant plant

The table opposite shows clear cash benefits in favour of investing in energy efficient (ECA) plant. It is based on a modest expenditure of just £10,000. Equipment qualifying for ECAs is shown in the left hand column and plant classified as integral features on the right.

Assumptions used - ECAs rate is 100% FYAs and non ECA plant rate is 10% WDAs. The rate of corporation tax is 28%, note higher rate taxpayers would show even greater tax savings.

ECA Qualifying			Non ECA Qualifying		
Year	Incentive 100% ECA	Cashflow Saving - 28%	Unrelieved Balance	Incentive 10% General Rate (Reducing Balance)	Cashflow Saving - 28%
1	£10,000	£2,800	£10,000	£1,000	£280
2	Full capital cost of ECA qualifying equipment is relieved in Year 1.		£9,000	£900	£252
3			£8,100	£810	£227
4			£7,290	£729	£204
5			£6,561	£656	£184
Total	**£10,000**	**£2,800**		**£4,095**	**£1,147**

In addition to the superior cash flow benefits, specifying more energy efficient equipment may produce energy savings for the end user.

Companies who may be loss making and invest in energy efficient assets will receive first year tax credits of 19% of the losses attributable to expenditure on ECA assets in some cases this may have an upper limit of £250,000.

Davis Langdon recommends implementing a FIVE POINT plan so the ECAs are not overlooked:

- Raise ECAs early with the appointed design team members, particularly the consulting engineers
- Adopt an ECA strategy with inherent tax savings which 'fits' comfortably with the client brief and the philosophy and objectives of the design team.
- Prepare an ECA report which considers alternative ECA compliant plant (to 'ordinary' plant) offering greater tax relief's.
- Incorporate recommendations into M&E specifications ensure correct documentation is in place to support later claims.
- Submit claim and hold supporting documentation in case of HMRC queries.

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 www.dlcrosherjames.com.