

An Updated Guide for Accountants 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. The rules that were published as draft legislation on 6 December 2011 were then amended in the legislation that was published in the Finance Bill 2012 on 29 March 2012.

The amended legislation will have a significant impact on the entitlement to capital allowances of property purchasers. Whilst property sellers will not suffer directly from the new rules, there will be consequences for all businesses incurring expenditure on fixtures within commercial property. In this guide we look at how accountants can ensure that their clients are not adversely affected by these changes and even add value by spotting the opportunities that will arise.

The new rules

In summary, the new rules will require that in order for a purchaser of a property to claim capital allowances for the fixtures within the property, the following requirements must be satisfied:-

- (i) For purchases from April 2012, where any seller has claimed capital allowances and is required to bring a disposal value into account in accordance with Items 1, 5 or 9 of the Table at section 196 of the Capital Allowances Act 2001 (CAA 2001), there must be a joint election under sections 198 or 199. Alternatively, either one or both of the parties to the transaction must have made an application to the Tribunal, to fix the disposal value of the fixtures, within two years of the sale. Together, these requirements are termed "the fixed value requirement" There is one exception to the fixed value requirement, which is detailed below at item 5) of "Acting for a purchaser".
- (ii) For purchases from April 2012, where any seller has claimed capital allowances but a joint election is not possible (i.e. where the disposal event is covered by Item 7 of the Table at section 61 or Items 2 or 3 of the Table at section 196) the seller must have confirmed the disposal value of the fixtures in a written statement within 2 years of the date of the sale. This is termed "the disposal value statement requirement". There are no exceptions to the disposal value statement requirement and no application to the Tribunal is possible.
- (iii) For purchases from April 2014, in addition to the requirements in (A) and (B) above, any seller who could claim capital allowances must have pooled the expenditure on the fixtures or have claimed a 100% first year allowance.. This is referred to in the new legislation as "the pooling requirement". There are no exceptions to the pooling requirement.

Acting for a purchaser

It is the purchaser that will be the most adversely affected by the new rules and therefore the accountant needs to be particularly focused on ensuring that purchasers are properly advised in time. As much information as possible should be obtained about the ownership history of the property and what actions, if any, the seller and previous owners have taken in respect to capital allowances. This should be done before the contract is signed. In addition, the accountant should be aware of the following:-

- 1) 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 section 198 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. This is no longer the case, but the purchaser does have the option of making an application to the Tribunal.

- 2) Whilst an application to the Tribunal in order to establish the apportionment to fixtures should generally be avoided by sellers, there may be circumstances where this option could substantially benefit the purchaser. However, the accountant should be cautious before advising such action as, apart from the costs involved, it will not always result in additional capital allowances. If a referral to the Tribunal is contemplated then specialist capital allowances advice will be essential.
- 3) A full capital allowances analysis of the property may well uncover fixtures that have not been included within a previous claim. However, the accountant should bear in mind that such an analysis needs to be carried out by a specialist who thoroughly understands the legislation in order to avoid repeating the mistakes that were illustrated all too well in the case of Mr & Mrs Tapsell & Mr Lester (in partnership as "The Granleys") v HMRC (2011).
- 4) Where a purchaser is unable to satisfy the requirements for claiming capital allowances immediately after completion, there will still be a window of opportunity to rectify the situation provided that a full capital allowances review is carried out in time.
- 5) There is one exception to the fixed value requirement. Where the purchaser acquires the property from a non-taxpayer who has acquired the property from a capital allowances claimant, the 2 year time limit will not apply. Instead the purchaser must provide the following documentation to support a claim:-
 - (i) A written statement from the non-taxpayer that a joint section was not executed, nor was an application made to the Tribunal within the 2 year time limit.
 - (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.

Whilst there is no time limit for obtaining the written statement of the disposal value in (ii) above, it should form part of the due diligence carried out before exchange so that the effect of the disposal value can be built into the purchaser's investment appraisal.

- 6) Whether the requirements for claiming capital allowances are satisfied on or after completion

(and the former is best practice) the quantum of potential capital allowances will need to be ascertained in order that the purchaser can make informed decisions.

- 7) 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 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.

Acting for a seller

There are certain issues that will be relevant for a seller and which the accountant therefore needs to be aware of, as follows:-

- 1) Sellers still need a section 198 election for tax certainty. The fact that the purchaser will be unable to claim capital allowances without an election will not change the position of the seller. If there is not a correctly executed joint election then the seller is subject to the risk that HMRC will refer the sale to the Valuation Office Agency resulting in an increased disposal value.
- 2) The drafting of the election should be given careful consideration. Currently, many elections just refer to "all the plant and machinery in the building", without any specific details as to what items are covered. Under the new rules, the election will take on more importance and it is possible that an election could fail if it does not adequately describe the fixtures.
- 3) Even though the purchaser will need an election to claim, the seller should be aware that the purchaser also has the option of referring the issue of apportionment to the Tribunal if no election is executed. This applies even when the purchaser is unable to claim capital allowances, i.e. a pension fund or property trader. Therefore, the seller should be very wary of a purchaser who wants the contract to remain silent on capital allowances.
- 4) If the seller has not claimed capital allowances then a section 198 election is not applicable. This remains unchanged under the new rules. However, just because the seller has not

entered into an election with the purchaser does not prevent the seller from making a late claim after completion, subject of course to the terms of the contract. Unless the purchaser decides to make an application to the Tribunal, there will be no way for the purchaser to challenge the disposal value relating to a late claim by the seller. Furthermore, where the seller disposes of the property to a non-taxpayer, it would appear from the new legislation at section 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.

- 5) Value can be added by the seller by highlighting any capital allowances that have not been claimed because the seller did not have an entitlement. For example, certain integral features where the seller had acquired the property before April 2008.

Preparing for the pooling requirement

Whilst there is currently a 2 year reprieve from the pooling requirement, we strongly advise that accountants prepare now for the added due diligence that will become necessary from April 2014, together with safeguards for clients that will purchase commercial property after that date. Some of the issues for accountants arising from the pooling requirement are as follows:-

- 1) The question as to whether or not the seller is able to claim capital allowances can be most easily established by reference to replies to pre-contract enquiries. However, property transactions are often completed without the seller providing replies to enquiries concerning capital allowances, or sometimes such enquiries are not even raised.. This needs to change to avoid purchasers and subsequent owners wasting unnecessary time trying to establish a fact that should be readily straight forward to establish. The accountant can help ensure that this basic information is obtained prior to completion by stressing the importance of the information to their clients.
- 2) The accountant will ideally need advance warning of any acquisition prior to completion in order that the mandatory pooling requirement can be considered in a timely manner. This could be achieved if the client forwards replies to pre-contract enquiries to the accountant as part of a client's standard acquisition policy. This would give the accountant early notice that a property transaction is imminent and therefore allow the

accountant the opportunity to provide (or ascertain) early advice for either a seller or a purchaser.

- 3) Where a seller has not claimed capital allowances (but could), an arrangement should be possible whereby the purchaser incurs all the costs associated with ascertaining the seller's entitlement to capital allowances. The seller then pools the expenditure within the statutory time periods for amending or submitting a return and brings into account an equivalent disposal value in the chargeable period of the sale. It should be noted that whilst the purchaser may be meeting all associated costs, the seller may be concerned that any enquiry into the pooled expenditure could adversely affect the seller's relationship with HMRC.
- 4) At some point after mandatory pooling takes effect, it will be necessary to establish not only whether the seller needs to pool the expenditure, but also whether there is a pooling requirement in respect of a previous owner. Not only will this increase the due diligence required on behalf of the purchaser, but it will also complicate the procedure for potentially satisfying the pooling requirement where it is not already satisfied.
- 5) Relying on the cooperation of the seller (or previous owner) after completion is likely to prove more expensive for the purchaser than if the new rules were fully considered at the pre-contract stage.
- 6) Where the pooling requirement is not satisfied, the capital allowances will be lost to the purchaser and all future owners at the expiry of the earliest of:-
 - (i) two years from the date of sale, or
 - (ii) expiry of the time period in which the seller or previous owner can amend the relevant tax return for the period in which the property was sold.

If the accountant does nothing else, he or she should at least ensure that the time limits for satisfying the new rules are not reached without a capital allowances review. However, we reiterate that it

should become best practice to consider capital allowances at the pre-contract stage of each property transaction.

Dealing with HMRC

It should be noted that these new rules have come about because HMRC have grown increasingly concerned that capital allowances are being claimed in excess of original cost. This is certainly the case under the current rules where there are no previous claims to limit the purchaser's entitlement. HMRC have also mentioned the compliance issue, meaning that they believe that the new rules will make it easier to identify rogue capital allowances claims.

With the above in mind, it is certain that capital allowances claims will come under greater scrutiny by HMRC. The rule of "prove it or lose it" will be applied rigidly and assumptions will not be accepted where the facts cannot be established with written evidence. This will be particularly true for "overage" claims, where some consultants have fallen into the trap of making erroneous assumptions.

Finally, it will be readily acknowledged by accountants that HMRC have limited resources to police these new rules. Therefore, HMRC are likely to target their resources where they believe they will achieve maximum results. Those specialists whose capital allowances claims are often reviewed by HMRC can expect to see a greater level of scrutiny by HMRC to the detriment of their clients.

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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