

Property Embedded Capital Allowances: Technical Summary Notes

What is a capital allowance?

A capital allowance is a taxable benefit against expenditure on plant and machinery used for the purpose of a trade. It is an allowance that replaces depreciation for the objective of claiming tax allowances.

Who is entitled to claim?

A company or individual that carries out a 'qualifying activity' and incurs 'qualifying expenditure'. These are two very simple prefaces set out in the Capital Allowance Act 2001 s11. A qualifying activity can be a trade, profession, or property investment. Qualifying expenditure is simply capital expenditure for the provision of plant and machinery, but that is where the simple questions end.

The more difficult question to answer is 'what is plant and machinery'?

In this respect, the statute we are given has no definition and the HMRC inspector's manuals confirm this vagueness (CA21100).

The only guidelines the statute does provide is to designate items that do not qualify under sections 21 (buildings being walls, floors, windows, etc.) and 22 (structures being hard standings, roads, fixed structures, etc.). All is then subject to exceptions under s23, and can also be subject to the period in which the expenditure occurred.

There has been some small statutory definition provided under the 2008 Integral features pool under section 33a but this is limited to a short list of items designed to be taxed over a longer period rather than providing us with clearer guidance.

In light of definitive statutory guidance, we are left to find our way with case law precedents, the first of which dates back to 1887. *Yarmouth v France* 'whatever apparatus is used by a businessman for carrying on his business... All goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business.



Although the clearest guidance of cases is notably over the last twenty years, the courts have set out certain 'tests' as guidance in the classification of plant and machinery. The most notable are the premises test or setting test set out in the Cole Bros case (1982) and Wimpy International Ltd v Warland (1989).

The premises do not qualify for plant, the definition of premises is solely to house the business. If an item does something more than housing the business then it has functionality and therefore may qualify as plant and machinery.

This concept is further reaffirmed in the 'business use test' in the inspectors manual CA21140 and the 'functionality test' in CA21100 most notably set out in Benson v The Yard Arm Club Ltd. What this provides us with is a broad classification of 'functionality vs setting'. Does an item provide a function to the business used in its trade rather than simply the setting of the business?

The area that we consider specifically relates to where items cease to become solely setting and provide a function but are part of the property so are commonly missed or overlooked due to their very nature.

For example, a suspended ceiling is setting on a building, but if that same suspended ceiling houses part of the air conditioning units or ducting, forming an integral part of the ventilation system, it takes on functionality and therefore qualifies as plant and machinery.

Similarly, a floor is structural and quite clearly the setting of a property, specifically excluded under CAA2001 S21 Table A, but in the case of a mezzanine used for storage purposes in a warehouse this may qualify for allowances.

What we do

Our remit is to identify these items that are overlooked due to lack of a paper trail or lack of detailed knowledge of the legislation.

These items are identified by an onsite detailed professional survey. A technical review then confirms this, case law precedents cross-referenced to the historical legislative changes before being independently professionally valued at the date of the expenditure.

This provides us with a full detailed report to submit to HMRC to support our claim for additional capital allowances to be offset against taxation paid and due.

There is no historical time bar on a claim being established i.e. identifying relevant expenditure, this is set out in the Statute.

Nothing in CAA2001 s58 requires a person who would like to claim capital allowances to allocate their expenditure to a pool in a chargeable period in which the expenditure occurred. The taxpayer is allowed to allocate expenditure to the pool for a later period, CAA 2001 rewrote explanatory notes (Annex 1, Change 8).

Other Changes

The Finance Act 2012 Schedule 10 enacted as 'Transitional Rules' between 2012 and 2014 and in full in April 2014 has been the most significant change since July 1996.

These statutory changes apply to property transactions occurring post-April 2012, they mean whilst these capital allowance claims are still available where a property transaction occurs, unless it is dealt with correctly, the capital allowances can be lost forever to any future owner.

CAA2001, s187A, and s187B created three new requirements:

- A 'fixed value requirement'
- A 'pooling requirement'
- A 'disposal value statement'

The fixed value requirement is that the part of the price apportioned to fixtures in the building must be fixed by:

- The seller and buyer agreeing and entering into an election under CAA2001 s198 at the time of purchase or within two years or
- Applying for a determination by the First-tier tribunal within two years of the purchase.

The pooling requirement only affected transactions since April 2014 and stipulates that the seller should have pooled expenditure on fixtures before a property is sold. The seller should either:

- Claim capital allowances or
- Notify HMRC of the amount of their qualifying expenditure and add it to their pool without making any claim.

The disposal value requirement applies where a seller who has made a claim is disposing of the property at a price below market value or involves the sale of more than one interest in the land being merged.

These new changes mean that any parties entering into a property transaction should take professional advice on the position of the capital allowances at the earliest opportunity.