Capital Allowances
General Application of CA’s Commercial Real-estate

Compiled for: XYZ Bank

INTRODUCTION

Capital allowances afford businesses tax relief for expenditure on plant and machinery (P&M), fixtures & fittings and integral features that are used within the business. This can include items such as trade related machinery, vehicles and fixtures.

Tax relief is given by a ‘Writing Down Allowance’ (WDA). This is given as a percentage of the expenditure incurred on a reducing balance basis. WDAs are given at either 8% or 18% depending on the classification of the expenditure.

For example if you spent £100k on qualifying P&M (18%) your taxable profits would be reduced by the following amounts:

<table>
<thead>
<tr>
<th>Year</th>
<th>Calculation</th>
<th>Reduction in taxable profits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>18% of £100k</td>
<td>£18k</td>
</tr>
<tr>
<td>Year 2</td>
<td>18% of £82k i.e. 100k - 18k</td>
<td>£14,760</td>
</tr>
<tr>
<td>Year 3</td>
<td>18% of £67,240 i.e. 82k – 14.76k</td>
<td>£12,103</td>
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So the amount that you are taxed on would be less, therefore reducing the tax bill.
CAPITAL ALLOWANCES IN COMMERCIAL REAL ESTATE:

Allowances on systems endemic to a building are often overlooked. Whereas a good accountant should pick up the obvious items like computers or actual machines, many miss out on the less obvious items of plant. This means that most property owners are only claiming the tip of the iceberg while most of the value remains hidden from them.

What can be claimed will vary from building to building and between different industries. These typically included systems like heating, security, general power, fire alarms and even the carpets! The purchase price paid for a property is deemed to have contained an amount for the plant & machinery and integral features present in the building at that time.

Combining a fusion of tax and surveying expertise STax is able to quantify and process historic claims on the funds already expended, in a fully compliant manner accepted by HMRC and advocated by the Office of Valuation.

These claims can often equate to a substantial percentage of the value of a freehold. Claims sometimes amount to as much as 35% of the value of a freehold i.e. £350k of tax relief waiting to be released for a property bought for £1m.

ELIGIBILITY FOR CAPITAL ALLOWANCES:

To claim capital allowances the items in question need to be used in a business, this covers trades and property letting business (as long as they are run on a commercial basis). Do bear in mind that capital allowances are used to reduce taxable profits i.e. they are generally only ever as much benefit as the business in question is profitable!

CAPITAL ALLOWANCES AT THE POINT OF SALE:

When a commercial building changes hands the parties should enter into a joint election to fix the transfer value of these allowances at the point of sale. For freehold transactions these are referred to as section 198 elections after the relevant part of the Capital Allowances Act (CAA2001) that empowers them.

These elections are often not put in place or are implemented badly. Because of this the Treasury felt there was a risk that businesses were double claiming allowances and brought in new legislation to effectively enforce the use of these elections.

FA2012 contained amendments to S187 (S187A & S187B) of the CAA2001. Broadly speaking these mean that unless the transference of allowance is handled correctly then both parties (purchaser and vendor) lose and the Treasury has a net gain.

Post April 2014 pooling (employing a firm like STax to calculate the amount of allowances available) of allowances prior to sale becomes mandatory. This works in conjunction with the transfer value requirement detailed above. This means that anything not quantified, claimed and then transferred in a 100% correct manner will be lost.

ANNUAL INVESTMENT ALLOWANCE (AIA):

The AIA allows businesses (including property rental businesses) to claim a 100% deduction against taxable profits on a proportion of their expenditure in a year.

From 1st January 2016 the AIA is set at £200,000.

The AIA can be allocated as the tax payer wishes. For larger projects it is normally best utilised against expenditure that qualifies for the lower 8% WDA. This offers a fantastic opportunity for tax relief to be accelerated on new expenditure.
RELEVANCE TO LENDERS:

“Good bank”

Capital allowances represent significant opportunities and risks to your clients. In even the smallest of buildings we could be talking about hundreds of thousands of pounds of tax relief. The implications for the businesses who own these properties are self-evident and if realised could assist them to grow and thrive during this age of austerity.

If your clients are buying or selling and they ignore capital allowances they are running substantial risks. These include:

• Potentially missing out on significant amounts of unused tax relief on the property they are buying/selling.

• By failing to comply with the new legislation the full market value of previously given allowances could be clawed back by HMRC. This can result in a tax charge being issued to the vendor whilst the buyer loses all ability to claim capital allowances.

• Not putting in place a robust and thorough S198 election will leave vendors open to a myriad of manoeuvres by a tax savvy purchaser, which could cost them dearly.

• Tax savvy vendors often seek to impose nominal transfer values and therefore retain the tax benefit of your clients’ expenditure!

“Bad bank”

In a recovery position being able to claim a tax rebate on previously paid tax (up to two years) can often help a business fight its way back to health.

If receivers have had to be appointed then capital allowances can be a great tool to help reduce the loss to the bank.

Capital allowances have an easily quantifiable benefit in the hands of a tax paying buyer. For example a £10m property with £3m of transferable allowances, for a purchaser paying corporation tax at the main rate, has a total value over time of 23% x £3m = £690k in saved tax for the new owner. This can deliver the following benefits to the vendor:

• A higher sale price should be achievable

• Putting these details into the marketing material should attract more interest and potentially facilitate a quicker sale

For example, an office worth £1m with £250k of transferable allowances is clearly more attractive than an identical office with no transferable allowances.
FURTHER INFORMATION

Every taxpayer’s situation is unique and what applies to one may not apply to another.

We would strongly advise that circumstances are looked at by us here at STax, before any decisions are made based on the availability of allowances.

Please feel free to contact us on the details below to discuss these points further.

Yours sincerely,

Andrew Stanley
Managing director