Tax relief for expenditure on property

April 2014

Many business owners are aware of the tax allowances available for items of plant and machinery acquired to use in the course of their trade, but not so many understand how tax relief can be obtained for expenditure on their business property; whether that be an office, a factory, or a room at home.

**Expenditure incurred on fitting-out a property**

Should you incur costs in fitting-out a property, tax relief may be available.

This document summarises the tax reliefs available under five possible headings.

Expenditure that does not fall within one of these categories will be treated as ineligible and no relief will be available for income tax or corporation tax purposes.

**Revenue expenditure**

Expenditure such as repairs and maintenance are treated as revenue expenditure and are allowable for a 100% deduction in arriving at the tax-adjusted profit, provided that the costs have been charged immediately to the profit and loss account. Examples of revenue expenditure are painting and replacing guttering. Repairs are allowable against income as long as they do not constitute any element of improvement.

Particular care has to be taken when repairs are undertaken on a new building, as HM Revenue & Customs will argue that this expense can be capital in nature.

**100% first year allowances (“ECAs”)**

Certain types of expenditure will attract first year allowances at 100% and therefore receive a full write off for tax purposes in the year in which the expenditure is incurred. In some circumstances a repayable tax credit may be claimed equal to 19% of the expenditure.

Enhanced capital allowances are available for certain expenditure incurred on green technologies – energy-saving plant and machinery and environmentally beneficial plant. To qualify, the assets on which the expenditure is incurred must be of a description specified by Treasury order or have a certificate of energy efficiency.

The classes of energy-efficient and water-saving assets are specified on the Government’s energy and water technology lists. The assets must be unused and not second-hand.

Establishing entitlement to enhanced capital allowances can be problematic and time consuming. There are many different items of energy efficient or environmentally beneficial plant in existence. It is essential, therefore, to review proposed expenditure at a very early stage in order to ensure that enhanced capital allowances are maximised.

Examples of items of plant and machinery eligible for 100% first year allowances are energy saving boilers and energy saving air conditioning units.

Expenditure on plant which qualifies for ECAs can be more costly than equivalent items which are not energy efficient. However, this additional upfront cost must be viewed in terms of the additional time period of which capital allowances can be obtained. An equivalent air-conditioning unit which does not qualify as efficient would only obtain allowances as an integral feature and enjoy vastly less generous allowances (see below).

**Main pool expenditure**

Capital allowances are a tax relief designed to allow the cost of certain of your business’ assets to be written off against its taxable profits. They take the place of the depreciation shown in the financial accounts, which is not allowable for corporation tax purposes.

General items of “plant and machinery” will be allocated to the “main pool” for capital allowances purposes and be written down for tax purposes at the rate of 18%, on a reducing balance basis. An item will qualify as plant where it fulfils a “function” in the trade, or is specifically treated as plant in the legislation.

Examples would include furniture (such as cupboards, racking, shelving), fire safety and security equipment, moveable office partitioning that you intend to move in the course of the trade, and electrical installations that are specific to the trade (for example specialist lighting).

Many of the fixtures and fittings of a building fit-out are likely to qualify for allowances under this category, provided they are not a permanent addition to the building itself. For example, carpet tiles may qualify for allowances, but it would be more difficult to show that hardwood flooring was not an improvement to the building.

In addition, the annual investment allowance provides a 100% first year allowance for investment in plant and machinery (excluding cars) up to the AIA limit. The current AIA limit is £250,000 per year, increasing to £500,000 per year from 1 April 2014 to 31 December 2015. Only one AIA is available per group of companies/associated businesses, so it may be the case that the AIA is not available for capital expenditure within the new building, as it is already being used against other eligible expenditure.

As the annual investment allowance may be allocated flexibly, it should be allocated in the first instance to expenditure that would otherwise qualify for the lowest rates of relief, for example integral features (see below).

**Integral features**

Allowances are available in respect of expenditure incurred on the provision of an ‘integral feature’ of a building. These assets should be put into a separate special rate capital allowances pool where the writing down allowance of 8% is applied.

Examples of integral features are electrical systems (including wiring and ordinary lighting), cold water and air cooling.
systems, passenger lifts, space or water heating systems and external solar shading.

It will take approximately twenty years to claim relief for 80% of this category of expenditure. If the AIA allowance is still available it should be allocated in preference to integral features, as they qualify for the lowest rates of relief. The speed at which relief can be obtained will be significantly increased by ensuring as much of this type of “integral” expenditure as possible can qualify for the 100% enhanced allowances outlined above.

Business premises renovation allowances (BPRA)

Business premises renovation allowances are intended to give an incentive to bring derelict or unused qualifying buildings back into use. A qualifying building is a commercial building or structure situated in a disadvantaged area.

The government has announced that it will make changes to simplify the scheme, make it more certain in its application and to reduce the risk of exploitation with effect from April 2014.

BPRA give an initial allowance of 100% for expenditure on converting or renovating unused business premises in disadvantaged areas.

Expenditure only qualifies for BPRA if the building is situated in a disadvantaged area and has been unused for a year immediately before the conversion or renovation begins. The last use must not have been as a dwelling.

To check whether or not a property is in a disadvantaged area for BPRA purposes you can enter its post code on the following website: http://www.bis.gov.uk/analysis/statistics/sub-national-statistics/assisted-area-look-up

Making the capital allowances claim

Capital allowances should be claimed through a company or self assessment tax return and it is necessary to ensure the claim is properly supported to confidently meet your self-assessment obligations.

Expenditure incurred must be analysed between the categories and entered onto the relevant tax return accordingly. Expenditure that does not fit in any category will be treated as ineligible and no tax relief will be due.

Fixtures

Fixtures are items which qualify as plant and machinery for capital allowances purposes but are legally part of a building. Examples might include air conditioning systems or lifts. The costs of these items will generally be included in the cost of a building and it is possible to undertake a survey of a building to identify fixtures within the building and, based on that survey, make a claim for capital allowances in respect of a part of the cost of the building.

Sale or purchase of a property that includes fixtures

Previously, a capital allowance claim on fixtures could be made at any time after the acquisition of the building (provided the building was still held). It was also possible for a vendor and purchaser to agree the figure at which fixtures within a building could be transferred for tax purposes.

The interaction of the capital allowance rules and the rules relating to the calculation of capital gains on the sale of property meant that in some circumstances it was possible to obtain a double deduction for the cost of fixtures.

HMRC considered that these rules could be used to obtain an unfair tax advantage. Consequently, since 1 April 2012 HMRC have introduced significant changes.

In the past, a property purchaser could claim capital allowances irrespective of whether the seller had ever made a claim. However, from April 2014, a buyer will only be able to claim if the seller has “pooled” the qualifying expenditure. The pooling can happen at any time after the seller has built or bought the property, but must be done before the property is subsequently sold on, otherwise no capital allowances will ever be available to the buyer or any future owner of the property.

Previously, when a property was transferred, the buyer’s capital allowances claim was generally calculated using a “just and reasonable” apportionment of the purchase price (although the amount could be restricted by past claims made by the previous owners of the property). Alternatively, within two years of the transaction, the parties had the option of negotiating an amount for the capital allowances and confirming this by a formal “section 198” tax election.

Since April 2012 in almost all cases, the seller and buyer are required to enter into a s198 CAA 2001 agreement within two years of the sale in order for the buyer to be entitled to allowances on fixtures.

For property sales, the costs allocated to fixtures are intended to be a market value “just and reasonable” apportionment of the sale price, capped at the seller’s original cost of the fixtures. It may be for a lower amount as the parties agree. If the parties cannot agree, then the matter can be referred to the First Tier Tribunal for a determination.

The agreed price will be included in the tax computation as a disposal value for the seller and will be included in the purchaser’s tax computation as an acquisition value.

Between April 2012 and April 2014 an opportunity to look back at the history of the building and value expenditure on which further allowances are due in addition to the agreement of a S198 election. From April 2014 the additional claims will no longer be available as the pooling requirements will become effective.

New buildings

If you are constructing a new building it is important to involve your tax adviser at the planning stage to ensure that the information that is provided by the building contractor or a quantity surveyor correctly identifies expenditure on which allowances are available.

The above provides a brief summary of the major factors to consider when incurring expenditure on property. This should not be relied upon without taking further advice. Please get in touch with our team if you would like to discuss this in greater depth.

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