SQUIRE SANDERS

CAPITAL ALLOWANCES – NEGLECT THEM AT YOUR PERIL

From 1 April 2014, the capital allowances regime that applies to property transactions is set to change. While the changes are no surprise (they have after all been in place since 2012), their significance may have slipped under the radar.

What are Capital Allowances?

Capital allowances give tax relief for capital expenditure on a wide range of plant and machinery installed in buildings. This includes basic items such as electrical and cold water systems, space and water heating, as well as bigger items such as lifts and escalators and, more generally, other plant and machinery.

Plant and machinery is allocated to one of two "pools" – a general pool which qualifies for an annual writing down allowance of 18% and a special pool at 8%.

Capital Allowances on Property Transactions

Capital allowances can have significant value but this is often overlooked when deal terms are agreed. Buyers can lose out on a potentially valuable asset; sellers may give away value.

The basic rule is that the person who incurs the expenditure can claim the allowances. But if that person sells the plant and machinery, the buyer can take over the right to claim allowances in the future. The buyer's claim will be based on an apportionment of the price – this needs to be agreed by the parties and should be reflected in the purchase agreement.

Special rules apply where the plant and machinery has become a fixture – that is, part of the land. Since 2012, it has been a requirement that the buyer and seller fix the part of the price that is attributed to plant and machinery fixtures. This is usually done by the parties making a section 198 election. Where an election is not made, the buyer can apply to the tax tribunal to fix the value.

New "Pooling" Requirement

From 1 April 2014 there will be an additional requirement: in order to allow the buyer to claim allowances, the seller must include the plant and machinery in its tax computations, even if it does not claim the allowances. This will not have any real impact where the seller has been claiming allowances, given that the plant and machinery will already be "pooled". But where the seller has not claimed allowances, it will now have to "pool" the plant and machinery. Time will tell how easy it will be for buyers to persuade sellers in this situation to agree to carry out this extra step.

The change means that buyers will need to undertake additional due diligence before exchanging contracts and cannot rely on standard responses to enquires. It will no longer be enough simply to rely on a section 198 election and extra provisions should be included in contracts to ensure that the expected capital allowances outcome is achieved.

If the pooling requirement is not met, the buyer will not be able to claim allowances, even if a section 198 election is made. Moreover, when the buyer comes to sell, it will not be able to offer any allowances for historic expenditure as part of its sale.

Developers and Pension Funds

The new rules only bite where the seller (or any owner since April 2014) is entitled to claim capital allowances. Developers and tax exempt sellers, such as pension funds, cannot claim allowances so are not required to pool expenditure. Buyers can continue to claim allowances on a just and reasonable part of the price they pay for the land. However, if a previous owner was able to claim capital allowances it must have pooled its expenditure. This results in the need for due diligence when tax exempt buyers purchase properties, even though they themselves cannot claim the relief.

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