UK Capital Allowances – the new opportunities!

Over the last twelve months, a number of changes to the capital allowances regime have been introduced and with these changes come opportunities for the taxpayer.

Indeed there are a number of tax saving opportunities out there which coincide with the release of many commercial properties into the market place, many at a discount from the original cost, so there can be a ‘double win’ for the canny investor.

The key is spotting these opportunities at the right time and throughout this article we will look at some of the most beneficial.

Property transactions and the ‘mandatory pooling’ requirement

The availability of capital allowances on a property transaction can make a property more attractive to a potential purchaser and increase the speed of sale. It may even result in the purchaser being willing to pay more for the property. Let’s take a look at how a seller can avail of the opportunity which stems from the newly introduced ‘mandatory pooling’ requirement.

So where is the opportunity?

The ‘mandatory pooling’ requirement has to be met within 2 years of the sale of the property so all is not lost. If no capital allowances have previously been claimed on the fixtures element of the property, then it may be possible to complete an unrestricted claim to allocate capital allowances to qualifying expenditure and in doing so meet with the mandatory pooling requirement.

There are often situations where, say, a property is bought but there is no mention in the Sale & Purchase Agreement of how much of the purchase price is to be allocated to fixtures and fittings. This does not however mean that your client cannot claim capital allowances on the qualifying aspects of the purchase, as long as they had not already been claimed by the vendor and they are within the time limit for the mandatory pooling requirement.

There are two bases for a capital allowances review, depending on whether the expenditure on the property was incurred by the vendor and so there is, for example a Bill of Quantities available, or, where
the vendor purchased the property from another party, a ‘just and reasonable’ apportionment method can be used.

The ‘just and reasonable’ apportionment method is in accordance with the Valuation Office Agency and HMRC’s guidance. It involves using the most appropriate cost model for the building under review and allocates the expenditure on the building between the different costs e.g. the substructure, the external walls etc. Through using the model you are then able to allocate the amount of the total spend that qualifies for capital allowances.

The ‘just and reasonable’ approach is based on the purchase price of the property when it was acquired by the vendor, which in itself may unlock an additional tax saving. For example, take a property that has been purchased for £400k but which had originally cost the vendor £2m (yes we have seen cases such as these recently). If a ‘just and reasonable’ exercise was completed and even a fifth of the £2m qualified for capital allowances, the new purchaser may be able to claim capital allowances on the total £400k spend, resulting in a tax saving of £80k, reducing the cost of the building to £320k.

A further opportunity, and indeed one that is available even if a s198 election has been signed, is that, where a property is being sold and the fixtures held as part of the property were acquired prior to April 2008 (the date of introduction of the integral features allowances). The introduction of this allowance meant that some items that previously did not qualify for capital allowances now did, these items being:

1. an electrical system (including a lighting system),
2. a cold water system,
3. a space or water heating system, a powered system of ventilation, air cooling or air purification, and any floor or ceiling comprised in such a system,
4. a lift, an escalator or a moving walkway,
5. external solar shading

In this instance the purchaser may be able to claim more than is agreed in the election by claiming capital allowances on those assets that did not previously qualify. In order to do this, a just and reasonable allocation of the expenditure can be made via a detailed capital allowances review.

So what is the benefit of making the claim to capital allowances within a property transaction?

If there are capital allowances available to the purchaser then it makes sense that the purchaser is more likely to cooperate for the transaction to complete quicker. There is also the possibility that they will pay more for the property as there is the potential for them to get an up-front tax deduction in the form of capital allowances.

Say a property is on the market for £2m and has capital allowances attaching of £500k, which is an additional tax saving for the purchaser of £100k (at 20%) on the acquisition. Whether the purchaser is willing to negotiate a higher price for the property or whether the tax saving speeds up the transaction as a whole depends on the parties involved – but either way it is a win for the seller!

Who commissions the capital allowances review will often depend on who will benefit from the identification of the capital allowances and it may be the case that the purchaser bears the cost in order to determine the expenditure that should be included in the capital allowances pool of the seller.

**Business Premises Renovation Allowances (“BPRA”)**

The BPRA scheme is intended to give an incentive to bring derelict or unused properties back into use but can result in a real tax saving for a taxpayer whose property purchase and renovation falls within the scheme.

BPRA gives an initial allowance of 100% for qualifying expenditure on converting or renovating unused (for a period of at least a year) business premises in a disadvantaged area provided certain other conditions are met. The whole of Northern Ireland, as well as other areas in the UK, is considered to be a “disadvantaged area” for the purposes of BPRA and so this relief could apply to more situations than people realise!

Buy a site and build v buy a derelict building and renovate

If an investor has, say, £1m to spend on developing a commercial
building, there are big opportunities to save tax by purchasing a derelict property and developing it.

Take, for example, a business which buys land for £200k and on that land constructs a property for £800k. As a result of a Capital Allowances review, it is determined that £400k of this expenditure qualifies for capital allowances, that is an £80k tax saving (at 20%) on £1m of spend, leaving the effective cost of the project £920k.

On the other hand, if a derelict property qualifying for BPRA was purchased for £100k and a further £900k used to renovate it, this £900k will qualify for 100% Capital Allowances, subjection to certain conditions. Here you are getting a 100% initial allowance on, for example, walls and floors, where, if you had constructed the building yourself they would not have qualified for any capital allowances. In this case there would be a tax saving of £180k (at 20%) on £1m of spend which is really expenditure of £1m costing only £820k!

One condition for BPRA is that the renovation has to take place between the existing walls of the derelict building; anything outside of this will not qualify but there is no limit to the work that can be done as part of the renovation. Therefore, by buying a qualifying building and carrying out renovation works there could be a real tax saving compared to buying the land and paying for the full construction of the building.

**Research & Development allowances (RDA’s)**

Research and Development Allowances (RDA’s) give tax relief at a rate of 100% of capital spend on assets that are used for the purposes of Research & Development (R&D). So if you have an asset that is used in an R&D project, 100% allowances can be claimed on the asset, and even when the project is finished there will be no claw back on the relief.

In order for a business to qualify for RDA’s, there needs to have been expenditure on a project that answers yes to the following three questions:

- Was there a scientific or technological advance?
- Were there scientific or technological uncertainties involved in the project?
- Was the knowledge being sought not readily deductible by a competent professional?

If the answer is ‘yes’ to the above questions then RDA’s tax relief should be available on qualifying asset expenditure.

**It covers more than you might think!**

The relief reaches beyond the plant etc used for R&D and even applies to the premises used! For example, if a new property is constructed and is to be used, even partly, for R&D activities then a proportion of the spend can be allocated to the RDA capital allowances pool and a 100% tax deduction taken on the same.

In this way, RDA’s can be further reaching that the more commonly valued annual investment allowance (AIA), in that more expenditure qualifies. You cannot claim AIA on walls, but if a portion of a building construction is in relation to an area occupied by R&D staff then RDA’s can be claimed! Also, unlike the AIA there is no cap on the amount of spend that can qualify for RDA’s. Therefore, if there is a building being purchased or constructed then a bit of thought about whether any areas are to be used for R&D is worth the time!

**Annual Investment Allowance (AIA)**

This is one of the most commonly considered capital allowance reliefs but is enough being done to extract the maximum benefit from it?

**The timing is key!**

Since April 2014 the AIA has been set at £500k per annum so at present, if £500k of assets that qualify are purchased, a 100% deduction can be taken at the time of the spend. However this is only the case if the accounting period started after the increase to £500k and ends before the expected reduction to £25k after 31 December 2015.

Therefore, if a taxpayer has plans to carry out any substantial capital spend then this should be carried out before 31 December 2015 so that the maximum AIA available can be claimed on the qualifying aspects of the spend – otherwise the opportunity will be missed!
THE MORAL OF THE STORY
As more and more commercial properties are now being sold at discount prices, the cost to the canny investor can be reduced even further by realising the tax savings available from using capital allowances opportunities.

Even if there is no property transaction at play, only basic capital expenditure, opportunities in capital allowances exist but we need to make sure they are not missed! Professional advice should be sought at the earliest opportunity to ensure that all options are considered and the deadlines for availing of the opportunities are met.

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