CIOT/ATT East Midlands Branch

"The New Capital Allowances Regime"

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A46 Fosse Way, Upper Broughton
Leicestershire

Timetable:
4pm – Refreshments and registration*
4.30pm – Lecture begins
6pm – Break for refreshments*
6.30pm – Lecture begins
7.45pm - Questions
8pm – Close

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THE NEW CAPITAL ALLOWANCES REGIME

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CAPITAL ALLOWANCES

1. **FYAs discontinued**

(a) The main purpose of the FYA legislation was to bring forward the time when tax relief was available for capital expenditure on plant or machinery and to allow a greater proportion of the cost of such investment to qualify for relief against a business' taxable profits of the period in which the expenditure was incurred.

(b) Under S44 CAA 2001, small and medium-sized enterprises were allowed to claim a 40% FYA on most acquisitions of new and second-hand plant or machinery. The rate of FYA for small businesses and companies was temporarily raised to 50% by FA 2007 – there were similar short-term increases included in FA 2004 and FA 2006.

(c) S75 FA 2008 repeals FYAs for small and medium-sized enterprises. With effect from 1 April 2008 (in the case of companies) and 6 April 2008 (in the case of unincorporated businesses), they have been replaced by the new annual investment allowance (AIA) which provides a 100% relief.

2. **A new capital allowance**

(a) On 21 March 2007, the Government announced a wide-ranging package of business tax reforms which included a number of unexpected changes to the capital allowances regime. In the words of HMRC:

'A main objective of the package was to promote investment and growth . . . by refocusing the tax system for smaller businesses through generous and better targeted incentives for investment.'

(b) One result of this reform was the introduction of the AIA (referred to in paragraph 1(c) above).

(c) The Government sought opinions about the design and technical detail of the new allowance through the publication of consultation documents in July and December 2007. Respondents to this consultation process were generally in favour of the AIA and agreed that it would be of particular benefit to smaller businesses.

(d) The provisions dealing with the new AIA are found in S74 and Sch 24 FA 2008. They introduce an annual 100% allowance for the first £50,000 of capital expenditure on plant or machinery (other than motor cars), regardless of the business' size. It is available to:

(i) any individual carrying on a qualifying activity (this includes trades, professions, vocations and property businesses);

(ii) any partnership consisting solely of individuals; and

(iii) any company (subject to certain restrictions which are considered in (h) – (l) below).

(e) The starting date for the allowance is set out in new S38A CAA 2001 (as inserted by Para 2 Sch 24 FA 2008). S38B CAA 2001 then lists a number of exclusions where expenditure will not be regarded as AIA qualifying expenditure. For example, an AIA will not be due in the

chargeable period in which the trade or other activity is permanently discontinued and, as mentioned in (d) above, expenditure on the provision of motor cars is specifically excluded from relief.

(f) Para 3 Sch 24 FA 2008 inserts new Ss51A – 51N CAA 2001. These sections set out the basic entitlement to AIA, introduce a number of restrictions for the relief and provide definitions for certain expressions used in the new legislation.

(g) The £50,000 allowance

S51A CAA 2001 provides the main rules for entitlement to an AIA. The normal capital allowances requirements for claiming an FYA are also in point here:

(i) the expenditure must be incurred in a chargeable period to which the legislation applies; and

(ii) the person incurring the expenditure must own the plant or machinery at some point during the chargeable period.

As mentioned in (d) above, the maximum allowance is £50,000, but this amount is proportionately increased or reduced where the chargeable period is more or less than 12 months. Thus, if the chargeable period is 15 months in length, the relevant AIA for that period is 15/12 x £50,000 = £62,500. Given that companies can never have an accounting period which is longer than 12 months, it is therefore only unincorporated businesses which can have an AIA of more than £50,000 on an appropriate change of accounting date. Taxpayers have the right to claim all or any part of their AIA entitlement, as they wish. If a business incurs qualifying AIA expenditure of, say, £80,000 in the year ended 30 June 2009, it will be able to claim an AIA of £50,000, with the additional £30,000 being dealt with under the normal WDA rules for plant or machinery. Where a business has a chargeable period which spans the AIA commencement date, the maximum allowance is calculated as if the chargeable period began on 1 or 6 April 2008 (as the case may be) and ended on the relevant accounting date. Thus a company with a 30 September 2008 year end is only eligible for a maximum AIA claim of 6/12 x £50,000 = £25,000.

(h) AIA restrictions

Ss51B – 51G CAA 2001 detail four restrictions which can apply to AIA claims for companies and groups. They are as follows:

(i) A company can only have a single AIA, regardless of how many qualifying activities it carries on (S51B CAA 2001). How that AIA is allocated is entirely a matter of choice for the company.

(ii) Where there is a group of companies (this is a 51% test), only one AIA is available to be shared by the whole group (S51C CAA 2001). The AIA can be allocated between the companies, as they see fit, to the extent that they have incurred qualifying AIA expenditure.

(iii) The third restriction, which is found in S51D CAA 2001, applies where two or more groups of companies:

- are controlled by the same person (see S51F CAA 2001); and

- are 'related' to one another (see S51G CAA 2001).

All the companies involved are entitled to a single AIA, split between them as they see fit. The rationale for this restriction is to stop someone who owns a group of, say, four companies from breaking it up into two separate groups of two companies in order to double the annual AIA entitlement. The meaning of 'related' for companies and groups is considered in (i) below.

(iv) The final corporate restriction is set out in S51E CAA 2001. The section is headed 'Fourth restriction: other companies under common control'. It applies to companies which:

- are controlled by the same person; and

- are 'related' to one another,

but neither the restriction in S51C CAA 2001 nor the restriction in S51D CAA 2001 is in point. In other words, this restriction is relevant for non-group companies, ie. two companies which are owned by the same individual. S51E CAA 2001 follows the model in Ss51C and 51D CAA 2001 in that the 'related' companies are only entitled to a single AIA between them, leaving the allocation of the allowance to be decided by the companies (in effect, by the individual who controls the companies).

(i) S51G CAA 2001 provides the meaning of 'related' for companies and groups. When reflecting on whether one company is related to any other where the control test is met, it is necessary to look at two separate conditions, either or both of which must be satisfied. They are:

(i) the 'shared premises condition'; and

(ii) the 'similar activities condition'.

(j) The 'shared premises condition' is satisfied if two companies under common control share the same business premises at the end of an accounting period. The 'similar activities condition' is satisfied if:

(i) there are two companies under common control; and

(ii) more than 50% of the turnover of one company in an accounting period is derived from qualifying activities within a particular NACE classification and more than 50% of the turnover of the other company in the same accounting period is derived from qualifying activities within the same NACE classification.

NACE stands for 'Nomenclature générale des activités économiques dans les communautés européennes' – there are some 21 different

sections in the first level of the NACE common statistical classification of business activities to which S51G CAA 2001 makes reference (eg. manufacturing, construction, real estate activities and so on).

(k) The Treasury explain the significance of these rules as follows:

‘Whether commonly controlled businesses are engaged in a similar qualifying activity is determined by reference to the well-established international NACE classification system – this divides industries into 21 main classifications and will provide the degree of certainty that businesses and HMRC require, in order to avoid doubts and disputed cases. Information on the classifications is readily available on the website of the Office of National Statistics and will, of course, be included in the relevant HMRC guidance. Similarly, where there is common control, the “shared premises condition” is a very simple and pared down test of economic interdependence which it should be straightforward for taxpayers to understand.

These minimal rules to deter businesses from easy fragmentation are needed to protect the Exchequer. But it should be borne in mind that most people do not control such a multiplicity of related businesses and so will have no need to trouble themselves with the rules. In general, separate businesses engaged in separate business activities (even where they are controlled by the same person(s)) will be entitled to one AIA each.’

(l) A fifth restriction can be found in S51H CAA 2001. This applies to businesses other than companies where there are two or more qualifying activities which in a tax year:

(i) are carried on by an individual or a partnership of individuals;

(ii) are controlled by the same person (see S51I CAA 2001); and

(iii) are ‘related’ to each other (see S51J CAA 2001).

The words ‘control’ and ‘related’ in the context of unincorporated businesses are given very similar meanings to their corporate equivalents. Thus, if two estate agency partnerships are both controlled by one individual who also runs a comparable business in his own name, there will be only one AIA available to be shared between the two partnerships and the sole trader business, given that all three qualifying activities are controlled by the same person and all fall within the same NACE classification.

(m) There are special rules dealing with the situation where a non-corporate taxpayer controls two or more related businesses and one or more of the qualifying activities has a chargeable period of longer than 12 months (Ss51M and 51N CAA 2001). The purpose of these rules is to ensure that the amount of the taxpayer’s AIA entitlement is not unfairly restricted.

(n) it should be emphasised that, unlike the position with groups, where an individual runs two or more separate businesses, each one will qualify for a full AIA of £50,000.

3. **Low CO_2 emission cars and refuelling equipment**

(a) The 100% FYAs available in respect of expenditure incurred on new cars with CO_2 emissions of 120g/km or less, which was due to end on 31 March 2008, has been extended for a further five years for cars which meet a more stringent test of 110g/km or lower (S77 FA 2008).

(b) Allied to this is a transitional rule designed to ensure that leased cars which previously qualified as low CO_2 emission cars but would no longer do so under the new criteria do not fall foul of the expensive car leasing disallowance provisions for cars costing more than £12,000.

(c) The 100% FYA rules for expenditure incurred on the provision of refuelling equipment for natural gas and hydrogen powered vehicles are also to be continued for a further five years until 31 March 2013 and are now available, on or after 1 April 2008, for biogas refuelling equipment (S78 FA 2008).

4. **Enhanced capital allowances for energy-efficient and water saving technologies**

(a) The Chancellor has announced further amendments to the existing 100% regime by introducing an additional technology on the ‘Water Technology Criteria’ list to include assets relating to waste water recovery and reuse systems, as well as four additional sub-technologies on the ‘Energy Technology Criteria’ list, namely:

  (i) compressed air master controllers;

  (ii) compressed airflow controllers;

  (iii) heat pump dehumidifiers; and

  (iv) white LED lighting.

(b) Housekeeping changes will be made to some of existing criteria and the lists will fully be updated later this year.

5. **Introduction of first year tax credits**

(a) In accordance with the Technical Note published on 17 December 2007, the Chancellor has confirmed the introduction of first year tax credits for loss-making companies investing on or after 1 April 2008 in energy-efficient and water saving assets appearing on the lists referred to in paragraph 4 above and hence eligible for 100% enhanced capital allowances (S79 and Sch 25 FA 2008). The company can claim a first year tax credit of 19% of the losses attributable to such expenditure, subject to an upper limit of the greater of:

  (i) the company’s PAYE and NIC liabilities for the period; and

  (ii) £250,000.

(b) The claim must include a description of the qualifying plant or machinery, the amount of expenditure on this plant or machinery and the date on

which the expenditure was incurred. Anti-avoidance provisions have been made to claw back any tax credits given should the assets in question be sold or otherwise disposed of within a four-year period.

6. **WDA rate change**

(a) As announced in the 2007 Budget, the Government have decided to press ahead with reducing the WDA rate for plant or machinery pools from 25% to 20% (S80 FA 2008).

(b) This change took effect from 1 April 2008 (for companies) and 6 April 2008 (for unincorporated businesses).

(c) For all businesses where the chargeable period spans the date of this change, a special hybrid WDA rate applies for the whole of that period. This hybrid rate is found by applying 25% to the proportion of the period falling before the change date and adding it to 20% of the proportion of the corresponding period falling on or after the change date. Strictly speaking, the counting should be done in days rather than months and, if necessary, the percentage calculation should be rounded up to the nearest second decimal place.

(d) Illustration 1

Temperley Enterprises Ltd has a 30 June year end.

As at 1 July 2007, the balance brought forward on the company's plant or machinery pool was £8,600.

On the assumption that there were no acquisitions or disposals during the year ended 30 June 2008, the WDA for that year is calculated as follows:

No. of days up to 31 March 2008	275
No. of days from 1 April 2008	91

The hybrid rate is therefore (25% x 275/366) + (20% x 91/366) = 23.76%.

Thus:

	Pool £
b/f	8,600
WDA (23.76%)	2,044
c/f	£6,556

7. **Small plant or machinery pools**

(a) During the consultation process on the concept of the AIA, a number of respondents suggested that small balances in the main plant or machinery pool should be able to be written off in full. This idea was

seen as a simplification measure, given that, following the introduction of the AIA, small historic pools of expenditure were unlikely to grow and that there would be a significant administrative saving if small businesses, in particular, were no longer required to track and write off this expenditure over a number of years.

(b) It has now been decided that, for chargeable periods beginning on or after 1 (or 6) April 2008, businesses should be able to claim a WDA of up to £1,000 where the unrelieved expenditure in their plant or machinery pool is £1,000 or less (S56A CAA 2001 as inserted by S81(3) FA 2008).

(c) Note that the small pool limit of £1,000 is proportionately increased or reduced if the chargeable period is more or less than 12 months in length.

(d) A taxpayer is not forced to take the whole of his entitlement in a chargeable period, if he does not wish to do so. Any remaining balance can always be written off in a later year.

(e) This provision applies to general plant or machinery pools and also to the new special rate pool (see paragraph 9 below). However, it will not have effect for expenditure in single asset pools (presumably because they already have rules which can bring them to an end at a specified time, eg. when the motor car is sold).

8. **Some examples**

(a) Illustration 2

Crowe Garages Ltd is a small company and draws up its accounts to 30 September each year. In the year ended 30 September 2008, the company incurred the following items of capital expenditure:

		£
1 November 2007	Pressure washer	10,000
1 June 2008	Hydraulic car lift	40,000

The brought forward balance on the company's pool of plant or machinery as at 1 October 2007 was £12,000.

On the assumption that all calculations are done to the nearest month, Crowe Garages Ltd's capital allowances for the year ended 30 September 2008 are as follows:

	FYA	*AIA*	*Pool*	*Allowances given*
	£	£	£	£
b/f			12,000	
Additions:				
Pressure washer	10,000			
Hydraulic car lift		25,000	15,000	
	10,000	25,000	27,000	
FYA (50%)	(5,000)			5,000
AIA (100%)		(25,000)		25,000
WDA (22.5%)			(6,075)	6,075
	5,000	–	20,925	
Transfer to pool	(5,000)		5,000	
	£Nil	£Nil	£25,925	
				£36,075

Note: Expenditure before 1 April 2008 qualifies for a 50% FYA. Expenditure on or after 1 April 2008 qualifies for 100% relief up to the AIA limit which, for the year ended 30 September 2008, is 6/12 x £50,000 = £25,000. The hybrid WDA rate for expenditure in the pool is (6/12 x 25%) + (6/12 x 20%) = 22.5%.

(b) Illustration 3

Mrs Appleby is a full-time mother, but for two evenings each week she runs a fitness class at her local community centre.

Her only capital assets are a computer and some fitness equipment bought two years ago for £2,400.

She draws up accounts annually to 30 June and the tax written down value of her plant or machinery pool as at 1 July 2007 was £900.

Mrs Appleby's capital allowances computations for the next two years are as follows:

	Pool £	*Allowances given* £
Year ended 30 June 2008		
b/f	900	
WDA (23.75%)	(214)	214
	686	
Year ended 30 June 2009		
WDA (100%)	(686)	686
	£Nil	

Note: The hybrid WDA rate for the year ended 30 June 2008 is (9/12 x 25%) + (3/12 x 20%) = 23.75%. The balance of £900 cannot be written off in full in that period because it started before 6 April 2008 (see S81(5)(b) FA 2008).

9. **Integral features, thermal insulation and long-life assets**

(a) Integral features

In the 2007 Budget, the Government announced that they planned to introduce a new classification of a building's 'integral features' into the capital allowances system and that expenditure on such items would be allocated to a 10% 'special rate pool' with effect from 1 (or 6) April 2008 (S73 FA 2008). The relevant assets are contained in a list which can be found in new S33A CAA 2001 (as inserted by S73(2) FA 2008) and comprise:

(i) electrical systems (including lighting systems);

(ii) cold water systems;

(iii) space or water heating systems, powered systems of ventilation, air cooling or air purification, together with any floor or ceiling comprised in such systems;

(iv) lifts, escalators and moving walkways; and

(v) external solar shading.

(b) Following their consultation exercise last year, the Treasury have said:

'The majority of respondents to the consultation shared the Government's preference for a simple list approach over a trade-specific or "purposive" approach. The Government's preference was based on the greater certainty and consistency that a short list provides, coupled with the fact that the longer economic life of the listed integral features compared with the generality of other plant or machinery means that, in most instances, a 10% rate is an appropriate rate of WDA.'

(c) However, a well-known capital allowances expert has made the following (somewhat critical) comments on the list:

'Surprisingly, this list does not include "active facades"; instead, the explanatory notes state that part of an active facade has always qualified for capital allowances and, therefore, there was no need to add this item to the list of features. That will be news to many taxpayers who previously tried to include active facades in their capital allowances claims.

The explanatory notes go on to state that the external skin of an active facade does not qualify for capital allowances as it is effectively a window; however, the inner skin of the active facade does qualify as part of the air-conditioning system. The external skin will actually be the two skins of glass forming the double-glazed cladding, whereas the inner skin is added to the facade purely for the purpose of blowing air between it and the inner face of the external skin. It is, therefore, tempting to conclude that the Treasury realised how much tax was at stake if the whole cost of the facade was deemed to qualify.

It is disappointing to note that the more modern active facade system, where an additional external skin is added to the double-glazed cladding so that natural ventilation can take place between the additional skin and the main cladding, is unlikely to qualify for allowances as it will not directly be part of an air-conditioning system. Nevertheless, this system is designed to cut energy consumption by reducing the load on the services installation and, therefore, achieves the same result as external solar shading. The item of external solar shading is included in the list of integral features.

It is also interesting to note that the Treasury felt it necessary to include floors and ceilings comprised within an air-conditioning system on the list of integral features, but makes no mention of walls that are comprised within an air-conditioning system. This might support the contention that the claimable part of an active facade is not an integral feature. However, taking such a stance could lead to problems over eligibility, because, if the item is not part of the air-conditioning system, then it is likely to be considered as part of the building.'

(d) The inclusion of electrical and cold water systems in the list of integral features is a welcome step. It means that assets which were previously treated by HMRC as part of the building (and so did not generally qualify for any plant or machinery allowances) will at least attract an annual 10% relief. Indeed, because these systems have been officially classified as plant or machinery, a number of businesses may now be able to claim 100% enhanced capital allowances if their expenditure on such systems includes specific items from the 'green technology' lists under Ss45A and 45H CAA 2001.

(e) There is, however, a new sting in the tail for these rules as provisions have been put forward to prevent a revenue deduction being claimed where 50% or more of an integral feature is replaced within a 12-month period (S33B CAA 2001 as inserted by S73(2) FA 2008). Such expenditure will instead be added to the 10% pool. This will particularly impact on businesses which regularly refurbish or renovate their

premises such as those in the retail or leisure sectors – they will be prejudiced by initially receiving a rate of tax depreciation which is likely to be far lower than the economic depreciation of the assets in question and they will then be prevented from securing a revenue deduction for their repairs, given that they will only be able to make a further claim via the 10% special rate pool.

(f) Thermal insulation

With effect from 1 (or 6) April 2008, the legislation for expenditure on thermal insulation is extended to cover all existing buildings other than residential properties, with the WDA rate being 10% (S71 FA 2008). Previously, this relief was only available for expenditure on industrial buildings.

(g) Such expenditure will go into the new special rate pool.

(h) Long-life assets

Prior to 1 April 2008 (for corporation tax) or 6 April 2008 (for income tax), the WDA rate for expenditure on long-life assets was 6% per annum, calculated on the reducing balance basis. Long-life assets are defined in S91 CAA 2001 as plant or machinery with an expected useful economic life (when new) of 25 years or more.

(i) With effect from the operative dates mentioned in (h) above, the rate of WDA for expenditure on such assets has been increased to 10% per annum (S83 FA 2008).

(j) Where the chargeable period of a business begins on 1 (or 6) April 2008, any unrelieved expenditure in the long-life asset pool at the end of the previous period is transferred to the special rate pool and will thereafter qualify for a 10% WDA.

(k) However, where the chargeable period of a business spans 1 (or 6) April 2008, the following transitional provisions take effect:

(i) No new expenditure incurred on or after 1 (or 6) April 2008 can be allocated to the long-life asset pool. It must go directly into the special rate pool.

(ii) A hybrid rate of WDA needs to be calculated for this transitional chargeable period. The principles of the calculation match exactly those used for the plant or machinery pool when the rate comes down from 25% to 20% – see paragraph 6(c) above.

(iii) At the start of the next chargeable period, any unrelieved expenditure is transferred to the special rate pool.

(l) The special rate pool – further details

S82 and Sch 26 FA 2008 set out the detailed rules for the special rate pool and the expenditure which goes into it. These can be found in new Ss104A – 104E CAA 2001 (as inserted by Para 2 Sch 26 FA 2008). One point which is worth noting is that S104E CAA 2001 replicates an existing

anti-avoidance provision in relation to the disposal value of long-life assets (S104 CAA 2001) by a similar piece of legislation which looks at the disposal value of special rate assets – in practice, these are most likely to be integral features. In view of the greatly reduced WDA rate for post-March 2008 expenditure on integral features, it would not be surprising to have seen schemes being marketed which created a balancing allowance in order to accelerate the taxpayer's relief. However, where such a disposal event occurs as part of a tax avoidance arrangement, the minimum disposal value will be the asset's notional tax written down value, and not the lower (sale proceeds) figure.

(m) Para 15 Sch 26 FA 2008, which deals with sales between connected persons, is designed to prevent the purchaser of an integral feature from obtaining WDAs on that asset in cases where the seller had not been entitled to any relief. Without this provision, historic expenditure incurred before 1 (or 6) April 2008 on assets such as electrical and cold water systems, which would not previously have qualified as plant or machinery, could have been transferred between connected parties such as group companies specifically in order to access WDAs.

(n) Finally, the provisions in Paras 16 and 17 Sch 26 FA 2008 relating to intra-group transfers are intended to enable companies which are members of the same group to transfer on or after 1 April 2008 property containing what FA 2008 calls a 'pre-commencement integral feature' between themselves:

(i) without giving rise to a balancing adjustment for the seller; and

(ii) without causing the buyer's expenditure on that integral feature to be treated as special rate expenditure.

However, this treatment will only apply where both parties jointly so elect within two years from the date on which the sale takes place. Note that the buying company will then allocate the expenditure to its main plant or machinery pool and 20% WDAs should be available.

10. **A comprehensive example**

(a) Illustration 4

Palmer Industries Ltd is a small company which manufacturers aquaria and garden fish-ponds from a factory near Colchester. The company started up on 1 January 2008 and, during its first year of trading, the following capital expenditure was incurred:

		£
1 January	Factory	300,000
1 January	New electrical writing for factory	25,000
1 January	Machinery	50,000
1 May	Energy-efficient motors	40,000
1 June	Delivery van	30,000
1 June	Air-conditioning unit for factory	12,000
1 July	New roof for staff canteen	25,000
1 November	Computer equipment	16,000

Palmer Industries Ltd's plant or machinery allowances for the year ended 31 December 2008 are as follows:

	FYA	*ECA/ AIA*	*Main pool*	*10% pool*	*Allowances given*
	£	£	£	£	£
Additions:					
Machinery	50,000				
Motors		40,000			
Air-conditioning unit		12,000			
Delivery van		25,500	4,500		
Computer equipment			16,000		
	50,000	77,500	20,500		
FYA (50%)	(25,000)				25,000
ECA/AIA (100%)		(77,500)			77,500
WDA (21.25%)			(4,357)		4,357
	25,000	–	16,143		
Transfer to pool	(25,000)		25,000		
	£Nil	£Nil	£41,143		
					£106,857

(b) There are various points about the computation in (a) above:

(i) There are no plant or machinery allowances for the expenditure on the factory.

(ii) Expenditure before 1 April 2008 on general wiring does not qualify (S21 CAA 2001).

(iii) Expenditure on plant or machinery before 1 April 2008 qualifies for a 50% FYA for a small company.

(iv) Expenditure on energy-efficient equipment qualifies for 100% relief – this is unaffected by the new AIA.

(v) Expenditure on plant or machinery on or after 1 April 2008 qualifies for 100% relief up to the AIA limit which, for the year ended 31 December 2008, is 9/12 x £50,000 = £37,500.

(vi) Expenditure on integral features on or after 1 April 2008 (ie. the air-conditioning unit) would normally go into the special rate pool and qualify for WDAs at 10%. However, given that taxpayers are entitled to choose what items of plant or machinery should qualify for the new AIA, it makes sense to allocate the allowance to the 10% items first.

(vii) The new roof is not an integral feature – it is part of the building and so does not qualify for plant or machinery allowances.

(viii) The hybrid WDA rate for the year ended 31 December 2008 is (3/12 x 25%) + (9/12 x 20%) = 21.25%.

11. Phasing out of industrial and agricultural buildings allowances

(a) Industrial buildings allowances and agricultural buildings allowances were introduced over 60 years ago as an incentive for post-war reconstruction and agricultural recovery. They are available under Ss271 – 393 CAA 2001. In general, the rate of WDA given to a person who constructs an industrial or agricultural building or who buys it unused was 4% per annum of the qualifying expenditure (construction cost or purchase price), written off on a straight-line basis over a 25-year period.

(b) In the 2007 Budget, the Government decided to withdraw these allowances (which also include hotel allowances) on the basis that they had become what the Treasury have called 'a poorly focused subsidy, selectively available on a disparate range of assets'. However, in order to give businesses time to adapt to the change, it was announced that the allowances would be gradually phased out over a four-year period.

(c) Specifically, the relevant WDAs will cease to be available for expenditure incurred on or after:

(i) 1 April 2011 (for corporation tax purposes); and

(ii) 6 April 2011 (for income tax purposes).

(d) The legislation dealing with the abolition of these allowances is set out in S84 and Sch 27 FA 2008.

(e) The progressive withdrawal of WDAs started on 1 April 2008 for companies and on 6 April 2008 for unincorporated businesses (S85(9) FA 2008). The position is that allowances will be ratcheted down by one-quarter for each year through until 2011 (S85(10) FA 2008). In the case of a company, this will give rise to reduced WDAs from the following dates:

	Rate of WDA
1 April 2008 – 31 March 2009	75% x 4% = 3%
1 April 2009 – 31 March 2010	50% x 4% = 2%
1 April 2010 – 31 March 2011	25% x 4% = 1%
1 April 2011 onwards	0% x 4% = 0%

There is a similar calculation for unincorporated businesses, except that the starting date each year is 6 April (see S85(3) FA 2008).

(f) Illustration 5

Holland Industries plc is a UK-resident manufacturing company which has a 31 March year end.

Since April 1999, the company has owned a warehouse which is a qualifying industrial building. As at 31 March 2008, the unrelieved residue

of expenditure was £640,000. Hitherto, the annual WDA has been £40,000 (4% x £1,000,000).

The capital allowances position is:

	£
b/f	640,000
1.4.08 – 31.3.09	
WDA (3% x 1,000,000)	30,000
	610,000
1.4.09 – 31.3.10	
WDA (2% x 1,000,000)	20,000
	590,000
1.4.10 – 31.3.11	
WDA (1% x 1,000,000)	10,000
RESIDUE NOT WRITTEN OFF	£580,000

(g) If the company in Illustration 5 did not have a 31 March accounting date, the legislation adopts a similar time-apportionment system to that used for the reduction in the WDA rate from 25% to 20% for plant or machinery where the chargeable period straddles 1 (or 6) April 2008 (S85(4) – (7) FA 2008).

(h) Illustration 6

Briscoe Ltd has a 30 September year end. The company owns a factory which it bought new 15 years ago and on which the annual WDA is £76,000 (4% x £1,900,000).

For the year ended 30 September 2008, the company's WDA is calculated as follows:

No. of days up to 31 March 2008	183
No. of days from 1 April 2008	183
No. of days in accounting period	366

The WDA rate is (183/366 x 4%) + (183/366 x 3%) = 3.5%.

Thus the company's WDA for the year ended 30 September 2008 is 3.5% x £1,900,000 = £66,500.

12. **FA 2007 provision and its effect**

(a) In order to pave the way for the final abolition of industrial buildings allowances, the Government announced last year that balancing adjustments and the recalculation of WDAs on the sale of an industrial

building were being withdrawn with effect from 21 March 2007 (S36 FA 2007). In other words, if a second-hand industrial building is acquired on or after 21 March 2007, the tax consequences are:

(i) there is no balancing adjustment;

(ii) there is no recalculation of WDAs; and

(iii) the new owner simply takes over the allowances to which the previous owner would have been entitled.

(b) The phasing out of industrial buildings allowances – in particular, the enactment of S36 FA 2007 referred to in (a) above – has inevitably led to the creation of schemes to accelerate allowances before they are lost. The basis of these schemes relied on the fact that, as long as a company owned a qualifying industrial building on the last day of its 12-month accounting period, it would be entitled to a full WDA, irrespective of the length of ownership. Therefore, by passing an industrial property round a group at frequent intervals, it was possible to accelerate the industrial buildings allowances, given that the group companies would typically all have different year end dates. In order to counteract these arrangements, a provision has been included in FA 2008 which requires a time-apportionment of the WDA where a transfer between connected parties takes place as part of a tax avoidance exercise (S313A CAA 2001 as inserted by S87(1) FA 2008). HMRC explain this provision as follows:

‘Put simply, this is a time-apportionment rule that limits the amount of the WDA to the fraction of WDA that relates to the period from the date of acquisition to the end of the chargeable period. For example, if a buyer bought a building on 15 April 2009 and had a chargeable period that started on 1 May 2008 and ended on 30 April 2009, the amount of WDA . . . would have reflected the whole of the buyer’s chargeable period. This (anti-avoidance measure) limits the buyer’s entitlement to 16/365ths of the WDA.’

13. Capital allowances buying and acceleration: anti-avoidance

(a) As a general rule, where a company ceases to trade and where the market value of its plant or machinery is less than the tax written down value, the company is entitled to a balancing allowance equal to the difference between the plant or machinery’s market value and its tax written down value. However, S343 ICTA 1988 provides that this rule does not apply where:

(i) a company (known as ‘the predecessor’) ceases to carry on a trade and the same trade then begins to be carried on by another company (known as ‘the successor’); and

(ii) both companies are under common control.

Instead, the relevant fixed assets are automatically transferred from the predecessor to the successor at their tax written down value (S343(2) ICTA 1988).

(b) A tax planning arrangement which has been widely used by companies involves the following scenario: a trading company is acquired by a profitable group and it then sells its trade to an unconnected buyer a short time later. When the trading company was acquired by this profitable group, its capital allowances were of course unaffected, but, when the trade was sold to the unconnected buyer, a substantial balancing allowance becomes available to the profitable group if, as would invariably be the case, the selling price of the company's plant or machinery was significantly less than its tax written down value.

(c) This had the effect of accelerating the rate at which capital expenditure was written off for tax purposes. As well as ensuring that the company's allowances could be used by a profitable group which had no long-term interest in the trade, they were available sooner than would otherwise have been the case if the trading company had simply been sold to the ultimate buyer.

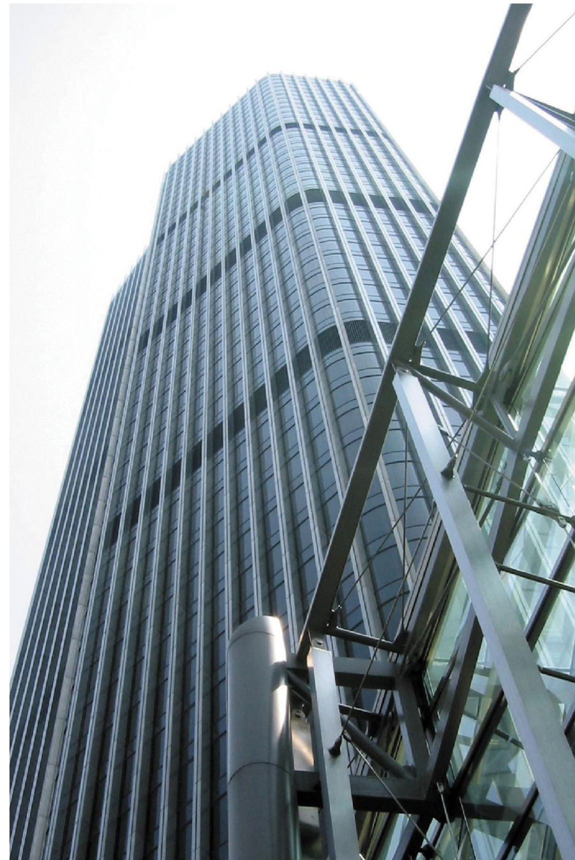
(d) Accordingly, S89 FA 2008, which introduces a new S343ZA ICTA 1988, makes it clear that such transactions on or after 12 March 2008 will now be treated as falling within S343(2) ICTA 1988. As a result, no balancing allowance will be available and capital allowances will continue to be claimed in the normal manner.

THE

Sense newsletter Sept 2008

Welcome to the latest edition of The Adviser, our update on developments in the world of financial services.

Markets in turmoil



Investors are becoming increasingly concerned with market progress through 2008. We have now seen the collapse of the US sub-prime mortgage market, a prolonged credit crunch, the nationalisation of a UK bank, support to shore up two of the US's largest lenders and now the take over of Merrill Lynch and bunkruptcy filing by investment bank Lehman Brothers. Speculation over the potential fallout continues to dominate and fears about the high oil and food prices have only helped to make matters worse.

Across the board, the credit crunch has led to an increase in the cost of borrowing, which has stalled mergers and acquisitions. Although many companies are in decent financial shape, some – particularly smaller companies – have found tighter credit conditions hard. This, coupled with the oil price, has led to the collapse of XL and also put Alitalia in the spotlight. Meanwhile, the end of the housing boom, and predictions that prices could fall significantly, has hit consumer confidence and retailers are feeling the pinch.

As a result, sentiment among equity investors has taken a huge knock. Bad news dominates so, although there will still be some winners, selectivity and realistic expectations will be important. Markets remain volatile, but it is worth remembering that stockmarkets tend to be driven by irrational fear (and greed), not logic. The key is to stay calm, think long term, and be selective. In the words of Franklin D Roosevelt, "the only thing we have to fear is fear itself".

Will rates move?

A hike in interest rates by the end of last year had been widely expected - until the credit crunch hit. House prices are now falling, the mortgage market is shrinking and high street retailers have reported much tougher conditions. The Bank of England has since cut rates to 5.00% in an attempt to stave off some of the impact of this squeeze. However, inflation reports indicate that, thanks to rising food and energy prices, the CPI figure is now 4.7% - well above the Bank of England's target 2%. On balance, despite market concerns, a further cut in rates may not materialise in the short term, as the Bank of England may want to see how much further inflation will run first.

Contact Us:

Miss Rebecca Bouch , Sense Financial Solutions , Unit 101a , Beeston Business Centre , Beeston , Nottingham , Notts , NG9 2ND

Pension Audit Service

Four local accountancy practices have engaged Sense Financial Solutions to offer a pension audit service to their clients.

Does the following apply to your clients?

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• Is your present provider closed to new business and therefore limiting your opportunities for growth of your pension plan?
• Is your pension invested in an under performing with profit fund – some are paying little or no bonuses at all?
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• Do the benefits provided by your projected fund meet your expectations of income levels when you come to take your benefits?

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Call Rebecca on 0115 9227107 or email her at rebecca@itmakessense.net

A new option

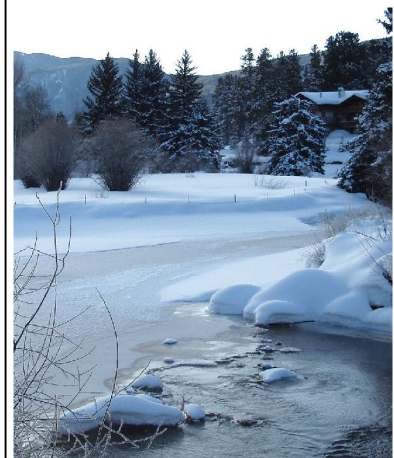
From October this year, the Government will correct a quirk in pensions planning and allow the inclusion of protected rights in SIPPs. This allows those with protected rights to consolidate their pension into one place and take advantage of new investment opportunities available within SIPP plans.

Protected rights are the result of contracting out of the second state pension scheme (now known as S2P). The idea was that people could divert these contributions into an investment which might outperform the Government scheme - and also save National Insurance contributions. It also offered more flexibility at retirement as the minimum retirement age is lower, a lump sum is available and the drawdown and deferral options can be used as they can with a normal pension plan. This latest move means you can now also get the investment flexibility benefits of SIPPs on this section of your pension.

So what should you do if you have protected rights? It is important to talk to an expert to see what the downsides might be. Transfers take time – and cost money – so it is worth considering your options fully. You will also have to make a decision on how to invest the funds if you do transfer. Perhaps they will follow the rest of your SIPP portfolio. On the other hand, equity and bond markets have been in turmoil and there are new products being included in SIPPs all the time. This could provide a good opportunity to have a wider conversation and maybe re-adjust the balance of your entire pension portfolio as a result.

Contracting out

The state pension system is made up of two tiers - a basic state pension and an earnings-related second state pension (or S2P). S2P is based on salary, so the higher the salary, the higher the S2P (up to a maximum limit). Many occupational schemes automatically contract out of S2P but with personal pension schemes, the choice is with you, the investor. Contracting out forfeits any entitlement from the S2P in return for a reduced NI contribution or NI rebate, which can go into a private plan. Whether this performs better than S2P however, depends on whether the investments are appropriate, how they perform and whether the charges are reasonable.



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EAST MIDLANDS CIOT & ATT – Events for 2008/2009

Date	Details	Timetable	Venue
Wednesday 22 October 2008 1.45pm – 5.15pm **Cost: £40.00** CPD Hours: 3	**Residence & Domicile – the changing landscape** Mike Truman LLB FCA CTA (Fellow) MSFA Editor of Taxation magazine **Branch AGM 1.30pm to 1.45pm**	**1.30pm – Branch AGM** 1.45pm - Registration & refreshments 2.00pm - Lecture starts 3.30pm - Break for refreshments 3.45pm - Lecture resumes 5.15pm – Close	The Quality Hotel Junction 23 M1 New Ashby Road Loughborough
Wednesday 26 November 2008 4.00pm – 8.00pm **Cost: £40.00** CPD Hours: 3	**Latest tax issues affecting owner-managed businesses** Chris Jones BA CTA (Fellow) ATT Lexis Nexus	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	The Novotel Nottingham/Derby Junction 25 M1 Bostock Lane Long Eaton Nottingham
Tuesday 9 December 2008 6.00pm – 8.00pm **Cost: £15.00** CPD Hours: 1.5	**The New Penalty Regime & Tax Investigations Update** Paul Lynam Lynam Tax – Positive Tax Solutions	6.00pm - Registration & refreshments 6.30pm - Lecture starts 7.45pm - Questions & informal discussion 8.00pm – Close	PricewaterhouseCoopers Offices Donington Court Pegasus Business Park Castle Donington, Derbyshire
Tuesday 10 February 2009 4.00pm – 8.00pm **Cost: £40.00** CPD Hours: 3	**Charity Update – accounts, law & tax** Rebecca Benneyworth BSc FCA Tax writer & lecturer Lexis Nexis Tax Lecturer of the year 2007	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	The Novotel Nottingham/Derby Junction 25 M1 Bostock Lane Long Eaton Nottingham
Tuesday 10 March 2009 4.00pm – 8.00pm **Cost: £40.00** CPD Hours: 3	**Property Tax Update** By Brian Ogilvie FCCA CTA Freelance Tax Lecturer & Consultant	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	Comfort Inn A46 Fosse Way Upper Broughton Leicestershire
Wednesday 22 April 2009 4.00pm – 8.00pm **Cost: £40.00** CPD Hours: 3	**The Interaction between Accounting Standards & Tax** By Andrew Guntert MSc FCA Lecturer for Mercia	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	Premier Inn, Braunstone Lane East Leicester
Wednesday 20 May 2009 4.00pm – 8.00pm **Cost: £40.00** CPD Hours: 3	**Finance Bill 2009** Mark Morton BA ATII ATT Senior Tax Lecturer for Mercia	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	Comfort Inn A46 Fosse Way Upper Broughton Leicestershire
Date to be advised 6.00pm – 8.00pm **Cost: £15.00,** CPD Hours: 1.5	Topical Tax Issues Andrew Hubbard BMus PhD ATT CTA (Fellow) Tax Director, Tenon Group PLC	6.00pm - Registration & refreshments 6.30pm - Lecture starts 8.00pm – Close	PricewaterhouseCoopers Offices Donington Court,Pegasus Business Park, Castle Donington, Derbyshire

The Branch Committee reserves the right to alter the above programme without prior notice.

For more details of any of the above events or to book a place please contact the Branch Secretary, Martin Tomes at Greenhalgh & Co.

2A Peveril Drive, Nottingham. NG7 1DE

Telephone: 0115 985 9517 or E-mail: martin.tomes@greenhalghco.net