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Maximising the claim for Capital Allowances in the tax year to 5 April 2012

With the AIA allowance being phased out after 5 April 2012 there is great incentive for farmers to maximise Capital Allowances (CAs) for the forthcoming tax year. With greater farm profits expected due to increased corn prices and a general world shortage of food, there is great tax planning potential.

Case 1: The Wetherspoon Case

Currently, taxpayers may benefit from £100,000 of Annual Investment Allowances (AIAs) at the rate of 100%, so that clients could potentially accelerate the relief from Integral Features Allowances (IFAs) to AIAs up to this capped level, which should be sufficient for most envisaged projects. The cap is also due to reduce to £25,000 at the rate of 100% from 6 April 2012.

Guidance says that your clients can claim capital allowances on the cost of building work that's needed to install plant and machinery on their premises. This can include anything from toilet cubicles, concrete ramps, tiling or other splash backs to sinks, toilets etc, and the claim can be for work performed during the four previous tax years.

Tax law doesn't give a definition of plant, so it's been left up to the courts over the years to decide on a case-by-case basis. The decisions in these cases have produced a new point, that says plant is any asset that plays a functional role in your business but isn't machinery or part of the building. For example, a hand rail on a stairway or sink.

There is now greater chance of identifying items of plant and machinery, but what about the cost of altering the building to accommodate the plant and machinery; can capital allowances also be claimed on this?

As a general rule, the cost of installing plant and machinery can be added to the cost of the asset itself and capital allowances can be claimed on the lot. This includes alterations to a building that are needed for plant and machinery to function. This point has led to some titanic battles with HMRC over the years. It is positive that the tax tribunal's final decision in the five-year battle between J D Wetherspoon (JDW) (the pub group) and HMRC should mean making a claim will be easier in future.

In order for a building alteration to qualify as part of the installation costs of plant and machinery, it must remain identifiable as a separate structure from the building. So in the case of JDW, the company could claim capital allowances on the cost of bricks, mortar and tiles, and the labour in putting these together to form a toilet cubicle. The cubicle could easily be identified separately from the rest of the building.

This principle opened up more possibilities meaning JDW was entitled to capital allowances on raised flooring leading up to some machinery, as well as splash-back tiles surrounding sinks etc.

For tax planning it is worth considering the cost of the associated professional fees. Not only does the building work qualify for capital allowances but also a corresponding amount of professional fees and costs, e.g. architects and planning fees etc.

If the building work linked with installing the plant and machinery is only part of a larger building project, the tribunal said it was correct to estimate the proportion of the total costs. As well as applying this new guidance in future, think back to any building work in the four financial years prior to the current one.

Case 2: Gazebo is plant

What are the facts of the case?

The taxpayer runs a country pub in West Sussex. In August 2008 she bought a wooden gazebo which was placed in the pub's garden. The idea was to provide cover for customers who smoked.

The taxpayer claimed first-year capital allowances on the cost of the gazebo. HMRC said that the gazebo was not apparatus with which the publican's business was carried out, but formed part of the premises in which it was conducted: it was not therefore plant on which capital allowances were available. The taxpayer appealed. The First-tier Tribunal said that the publican had to provide facilities for its customers to eat and drink.

There was no doubt that had the gazebo been a polygonal bench surrounding a table then it would be plant. It would then be a permanent asset provided for the comfort of customers while in the pub. As such it would be part of the way the publican carried out his trade, rather than be part of the premises in which it was conducted.

The gazebo has been added to the pub's garden. The garden formed part of the premises of the pub, even though it was not a building. However, the gazebo did not look like part of the garden; rather it was attached by its own weight and was not fixed permanently. The garden would be complete without it. Overall the gazebo embellished the garden and provided facilities for customers of the pub to sit, eat and drink. This can give guidance on claiming further capital allowances.

Case 3: Alterations to an existing building

In *B & E Security Systems* TC452, alterations to an existing building – which would not normally qualify as plant – were allowed as they were 'incidental to the installation of plant and machinery'.

This case refers to HMRC's Capital Allowances Manual CA21190 where the guidance is to: 'treat capital expenditure on alterations to an existing building incidental to the installation of plant or machinery as if it were expenditure on that plant or machinery and as if the alterations were part of the plant or machinery'.

While CA21190 is referring to building alterations, it continues: 'the legislation is intended to cover the direct costs of installation, that is those works which are brought about by the installation of the plant and which are associated with it in such a way that their cost can properly be considered to be part of the cost of providing the plant.'

This appears strong guidance on the subject.

Case 4: Function and the wind turbine

In *Schofield v Hall* (1975) STC353, a grain silo, together with its attendant machinery, was found to be plant as it performed a function. It can be considered that both this case and the guidance at CA21190 would indicate that not only the wind turbine, but also any apparatus that was required to enable the turbine to function would qualify because together the apparatus perform a function, provided you could argue that the additional costs incurred were incidental to the operation of the plant.

The Inland Revenue Press Release of 15 March 1984 also stated that 'the cost of provision and installation of ducting in connection with construction of cable television networks is plant and machinery' – probably due to its incidental nature.

Wind turbine - is it plant?

Professional fees relating directly to the acquisition, installation and transportation of plant and machinery qualify as expenditure on plant and machinery.

The planning fees are therefore also likely to qualify, provided that they are specifically related to the turbines. Fees for the road widening and other similar activities are unlikely to be claimable.

CA21160 indicates that each part of a system should be looked at separately and allowances claimed only on those parts that are plant.

CA22010 disallows mains services and systems for water, electricity and gas. These seem to have been set up to disallow the cost of mains services and their associated components, especially when

the expenditure relates to buildings. *Bradley v London Electricity Plc* (1996) STC231 disallowed as plant the housing for an electricity substation, but this related to the building.

However, it is difficult to regard a turbine in the same way as a building, and it is more likely that the ancillary parts will qualify under CA21180 where: 'the main switchboard, transformer and associated switch gear provided that a substantial part of the electrical installation – both the equipment and the ancillary wiring – qualifies as plant'.

This, combined with the recent *B & E Security Systems* case above, arguably strengthens the argument that the incidental expenditure associated with turbines will qualify.

In summary therefore, with a well presented case that the majority of the expenditure is either plant or incidental to the installation or acquisition of the plant, a large proportion of the costs should qualify.

Expenditure on non-domestic wind turbines or other alternative energy generators will attract capital allowances relief, including a proportion of the associated costs such as professional fees and site preliminaries.

Typically for small discreet projects, these 'on costs' are included with the design and build price from the builder/ installer.

On larger projects these costs are usually part of a more significant capital project and so would be subject to a pro-rata apportionment against the full contract expenditure.

Integral Features Allowances (IFAs)

Under current rules, small scale turbines would fall into IFAs under CAA2001, s 33A(5)(a) as expenditure on 'an electrical system' and thus attract relief at 10% writing down allowances (WDAs) per annum, on a reducing balance basis. This is due to be reduced to 8% from 6 April 2012.

Not all such expenditure fits within the criteria of 'environmentally beneficial plant and machinery' and so cannot automatically benefit from 100% WDAs as 'enhanced capital allowances' (ECAs) as set out within the energy technology criteria list or water technology criteria list. These lists are monitored by the carbon trust and available at www.eca.gov.uk.

While the full wind turbine may not attract ECAs, certain component parts, e.g. motors or drives, may themselves be eligible, subject to a robust analysis of the project expenditure by a capital allowances specialist.

Summary

- There is the timing advantage of the year to 5 April 2012.
- Tax planners should carry out a detailed capital allowance analysis to ensure that all the relevant expenditure achieves maximum relief.
- Buildings should not be ignored for tax planning opportunities and features, installation of plant and machinery should be reviewed.
- Farmers must consider what expenditure lies ahead and what expenditure has already been made – has tax relief been claimed?

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