

WITHIN THE RULES

The use of capital allowances to avoid tax is in government's sights, yet there are several areas where their use is appropriate, says **Julie Butler**

Capital allowances are, inherently, a complex area for the tax and accountancy professions. Given that no statutory definition of plant and machinery on which the majority of such allowances are claimed exists, there is constant debate and frequent tribunals as to what qualifies as plant, and what qualifies for this tax deduction. Similarly, while the maximum amount of allowance one entity can receive on purchasing an eligible asset never changes, the emphasis from a tax planning viewpoint is skewed to the timing of when such claims are recognised, to increase tax efficiency for the entity concerned.

REDUCTIONS

The government has, as of 1 April (for incorporated businesses) and 6 April 2012 (for unincorporated entities) reduced the amount of capital allowances available. Annual Investment Allowances (AIAs) have fallen from £100,000 to £25,000 per annum, and Writing Down Allowances (WDA) reduced from 20% or 10% to 18% or 8%, resulting in several entities attempting to exploit loopholes to accelerate potential claims. The government has looked to eliminate these avoidance strategies, endeavouring to ensure a standardised way of claiming is adopted, while adding circa £5m to the public purse per annum.

Previously capital allowances were restricted in the cases of connected persons, 'transactions to obtain allowances', or via sale and leaseback, except where purchased from a manufacturer or supplier in the normal course of said entity's

business. This provided some parties with a useful avoidance strategy. For example, by setting up a subsidiary to deal with procurement of large capital items over extended time periods, the parent could then purchase plant and machinery from this connected party in one transaction, so as to concentrate the entire capital allowance claim to one specific financial period. This concentration allowed the most tax-efficient use of the allowance to be employed, optimising the timing and generating enhanced taxation advantages.

In an effort to remove such avoidance, the government issued a number of changes to legislation effective as part of Finance Act 2012.

The first, and most important, is that the exemption for manufacturers and suppliers no longer exists, except in specific circumstances, where no avoidance purpose can clearly be demonstrated. Section 230 Capital Allowances Act (CAA) 2001 was actually repealed in advance of the Finance Act, with all such transactions disallowed from 12 August 2011. This means the use of separate procurement entities can no longer be utilised as a planning tool, and there is less scope for manipulation and control of allowances. The total amount of capital allowances available over the course of an asset's life remains unchanged, but tax advisers should be aware that pre-existing timing avoidance practises are now illegitimate. Therefore, extra care is needed when imparting advice as to when the most tax-efficient time to purchase a qualifying capital item might be.

A second change is HMRC's new 'purpose test' which allows it to check whether a

transaction is specifically made 'to obtain allowances' and thus its purpose is tax avoidance, rather than a continuation of normal business. This amendment to s215 CAA 2001 means that if HMRC deems a transaction to be wholly, or in part, an avoidance strategy, then it could restrict or reject a claim. Tax planners will therefore have to consider how computations are presented to exhibit that no tax avoidance scheme is being conducted, so as not to invoke this mechanism and thus maintain the level of allowance initially submitted.

The third change is the tightening of the definition of 'relevant transactions', and who is responsible for complex contracts such as hire purchase transactions, consequently clarifying to the tax planner what is available to claim and to which party. Using the example of the hire purchase contract as a 'relevant transaction', an allowance claim becomes obtainable as soon as the benefit passes between the seller and the buyer, regardless of the status of actual cashflows. While this further minimises the amount of manoeuvring available, there is no longer as much ambiguity, meaning advanced planning when using such contracts in future should be much clearer.

The final change noted is that when an avoidance case has been highlighted by HMRC, there is no longer a limit of a restriction to the deemed market value of the capital item concerned; instead the entire 'gain' of the tax avoidance strategy can be reversed, instantly reducing 'extra' tax efficiency to zero. The tax planner must consider the possibility of a claim being rejected or revised downwards before adopting an approach construed as tax avoidance. Previously, tax advisers could have pointed to market values as a failsafe valuation; the government, however, considers this to be too volatile a measure to employ as a benchmark. Therefore, the tax professional must provide robust evidence the claim is not excessive or obtained to create an additional allowance in order to protect their client's computations.

These revisions to capital allowance avoidance rules should not deter tax planners from fully utilising capital allowances where appropriate to do so. A list of examples of tax planning opportunities concerning capital allowances are as follows:-

- **Integral features:** A current focus for tax planners, even items such as office lighting could be claimed as capital allowances to maximise tax efficiency. With the increasingly extensive health and safety regulations adding costs to capital items, these can be argued as integral costs to the business operations, and any additional expenses could form the basis of a revised capital allowance computation.
- **Environmentally efficient assets:** Consider updated lists available from government



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websites as to what qualifies for an Enhanced Capital Allowance, allowing up to a 100% first year claim in some circumstances. Encourage clients to adopt these items over more 'traditional' alternatives, so an enhanced capital allowance claim could be available.

- **Items incidental to installation:** All incidental costs of facilitating the use of plant and machinery are potentially important to a capital claim. Expenses concerning health and safety and other regulations, should be included. Recent tribunals highlighted disagreements and areas of uncertainty over qualification. While clear definitions are established, it is worth liaising with HMRC over what counts in each unique case.
- **Short life assets:** With the changes to the length of the qualifying period now at eight years, by adopting the short life asset approach the tax planner can keep various assets separate rather than being absorbed by the main pool. HMRC must be informed of undertaking the strategy. This allows the full capital allowance to be claimed earlier, without excessive time delays.

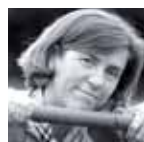
AGRICULTURAL BUILDINGS

An example of the review can be around an agricultural building. The loss of Agricultural Buildings Allowance (ABAs) from 5 April 2012 has focused the farming industry on looking at the maximisation of tax reliefs around new construction and repair. A starting point is the review of integral features involved in the construction of the building and the definition of plant and machinery used in the building together, eg the grain drying machinery in a grain store and the milking equipment in a milking parlour. Identification of the cost of installation is beneficial to improve the capital allowances claim.

Elements of the repair to buildings should be identified and help can be obtained from the recent case of *G Pratt and Sons v HMRC (TC 1269)*. Work to a concrete drive was deemed to be a repair as opposed to an improvement.

ACTION POINTS

All expenditure on plant and machinery, repairs and improvements to buildings should be reviewed to maximise capital allowances and accelerate valid tax reliefs where appropriate. But do be mindful that HMRC has always shown keen interest in 'over optimistic' claims through the enquiry system.



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