

# Tax Representation



## TAXREP 18/08

### **‘Business tax reform: capital allowances changes: technical note’ and ‘Payable enhanced capital allowances: technical note’**

**Representations submitted on 19 February 2008 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to two technical notes issued jointly by HMRC and HM Treasury on 6 December 2007**

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# **'BUSINESS TAX REFORM: CAPITAL ALLOWANCES CHANGES: TECHNICAL NOTE' AND 'PAYABLE ENHANCED CAPITAL ALLOWANCES: TECHNICAL NOTE'**

## **INTRODUCTION**

1. We welcome the opportunity to respond to the Technical Notes:
  - 'Payable Enhanced Capital Allowances: Technical Note' and
  - Business tax reform: capital allowances changes Technical Note published by HM Treasury and HM Revenue & Customs (HMRC) on 17 December 2007. These can be found at [http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageLibrary\\_ConsultationDocuments&propertyType=document&columns=1&id=HMCE\\_PROD1\\_028211](http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_028211) and [http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/business\\_tax\\_reform/consult\\_business\\_tax\\_reform.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/business_tax_reform/consult_business_tax_reform.cfm) respectively.
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex 1. Our Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system are summarised at Annex 2.

## **KEY POINT SUMMARY**

3. We continue to disagree strongly with the decision to withdraw, without any consultation, Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs) for past expenditure and urge the Government to reconsider allowing some form of transitional relief in the coming Finance Bill.
4. We do not think that the reduction in the rate of writing down allowance from 25% to 20% more accurately reflects the economic life of those assets. Instead it would appear to have been an arithmetic exercise to balance the Chancellor's Budget following the reduction in the main rate of corporation tax to 28%.
5. We support the light touch approach which has been adopted for the anti-fragmentation rules for the new Annual Investment Allowance (AIA)
6. We support the simplification proposals in relation to groups claiming the AIA.
7. Partnerships which have a Limited Company or trust as a partner should be eligible for the AIA.
8. We are pleased that our previous suggestion to assist the Government's policy to simplify tax and reduce costs for small businesses in relation to small plant and machinery pool balances is still being considered (para 3.30).
9. We reiterate our suggestion that allowing pooling by building for the Integral Fixtures Allowance IFA would help to alleviate the problem of determining the value of fixtures on the sale of a building.

10. We reiterate that restricting the payable enhanced capital allowance to companies would appear counter to the stated objective to 'maintain fairness of the tax system by ensuring that people engaged in similar economic activities pay broadly the same overall level of tax regardless of the legal form they choose for their business'.

## **GENERAL COMMENTS**

### *Withdrawal of Industrial Buildings Allowances and Agricultural Buildings Allowances*

11. We continue to disagree strongly with the decision to withdraw, without any consultation, Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs) for past expenditure. The Tax Faculty has made Pre Budget Report (PBR) representations that the small business review needs to consider the impact of the changes to the capital allowances regime announced in the 2007 Budget and partially enacted in Finance Act 2007. Government states that IBAs and ABAs are being abolished because large business benefited from the cut in the main rate of corporation tax, yet small business saw an increase in the rate of corporation tax.
12. 95% of the value of IBAs and ABAs is with large business, which leaves only 5% with small business. We do not agree that such businesses find the compliance costs of making these claims excessive. Furthermore, to deny such reliefs to these businesses, which had made their investment under the old system, and who will not be able to benefit from the new proposals which allow capital allowances for fixtures in buildings creates an unfair distortion.
13. We remain concerned about the impact of these changes on small businesses. It is clear that the Government does not wish to consult on this matter, but we do not think that a consultation on a system change should cherry pick merely those aspects on which it seeks comment. We continue to believe that there should be a grandfathering provision for Industrial and Agricultural Buildings Allowances for expenditure incurred prior to 22 March 2007.
14. We support the introduction of a new definition for the embedded fixtures contained within most freehold properties, 'Integral Features'. The previous use of the term Fixtures as distinct from Fixtures & Fittings caused great confusion both within the Profession and HMRC.

## **DETAILED COMMENTS**

### *Sale of properties*

15. Under the Transitional Provisions 2.24 the concerns relating to the sale of properties is noted, but do not seem to be addressed other than a passing reference to elections under current s 198, CAA 2001.
16. Under the existing rules, HMRC has taken a pragmatic view and has been quite relaxed about retrospective capital allowance claims being made for "embedded fixtures", by a purchaser. These would be based on the trade values ascertained at the date of acquisition of the business (in the absence of any specific information on original cost from the vendor), assuming the vendor had not

previously claimed for those items and that they formed a “just and reasonable apportionment” of the acquisition cost.

17. This “relaxed approach” appears to have changed dramatically in the last three months with HMRC potentially now refusing to recognise that a purchaser can claim for previously unclaimed capital allowances in respect of such “embedded fixtures”.
18. Schedule 1, para 104E (2) – Disposal Value of Special Rate Assets – states ‘the Disposal Value that the taxpayer must bring into account is the notional written-down value of the item’. Notional written down value is expressed as “QE – A” where QE is the qualifying expenditure and A is the total of all allowances which could have been made.
19. This seems to suggest that on sale of a property containing Integral Features the vendor has to identify any such items and apply a notional written down value (WDV), even where no allowances have actually been claimed by the vendor. We wonder if this is the intended interpretation?
  - a) If the vendor does have to prepare notional WDV’s for items never claimed, this could give identification / valuation problems, particularly on Design & Build or fixed price contracts – and will certainly add to the administrative burden (contrary to the stated Government intent).
  - b) If the vendor does not have to prepare notional WDV’s for items never claimed what provision, if any, is there for a purchaser to make a claim?
20. More explanation needs to be given to the term “Active Facades” and possibly “Brise Soleil”.
21. Consideration should be given to transitional relief for those who have already committed to capital expenditure, to be incurred post the April 2008 starting date. Even small building projects take several months to design; pass through planning stages; and to arrange finance. Within the building’s budgeted cost it is quite likely that provision will already have been made to utilise the tax advantage from expenditure on current heating, ventilation and electrical power plant and machinery of 20%, rather than the reduced 10%.
22. The affect of forcing such projects to predominately only qualify for the proposed 10% new integral fixtures rate could have a serious affect on those project cash flows / viability.

#### *Mixed partnerships*

23. Section 48 Capital Allowances Act 2001, precludes partnerships which have a Limited Company or trust as a partner from claiming First Year Allowances. We are not aware that the historical tax avoidance reasons for this anti avoidance measure are still needed. However, it is clear that modern partnerships are now much more likely to have mixed partners. We suggest that this measure is not carried forward to the new regime.
24. Concerns about abuse would be better dealt with through anti avoidance provisions. In a growing and dynamic economy, business structures need to be flexible. Paragraph 3.12 states that the AIA will be available to individuals,

partnerships of individuals and companies (including unincorporated associations), but it will clearly not be available to partnerships which include a company or a trust as a partner.

25. There is an increasing number of joint ventures in today's business world and a partnership that has one or more companies as a partner is a typical business structure for a joint venture which should not be discriminated against in this way. Whilst it is recognised that the proposed eligible bodies are consistent with the existing legislation on first year allowances, the proposed changes in the legislation offer an ideal time to review existing clauses such as s48(2)(b), CAA 2001 and see if they promote or hinder the economy as a whole.

### **Administrative cost burden**

#### *Simplification for small businesses*

26. We are pleased that our previous comment has been retained for further consideration (para 3.30). Many small businesses have existing balances of tax written down value on pools being carried forward effectively for ever.
27. Under the new system, small businesses (micro business) will get a £50,000 allowance and no pool. We agree that this is much simpler and will save compliance costs.
28. We suggest that to assist the Government's policy to simplify tax and reduce costs for small businesses that any pool balances of less than say £1,000 could also be included within the £50,000 idea as a transitional relief to get rid of very small capital allowance pools.
29. An unrepresented businessman claiming small amounts may only be completing two boxes on his tax return, but could easily spend half an hour each year recalling what it was and how to calculate it.

#### *Pooling*

30. To alleviate the problem of determining value of fixtures on the sale of a building, we suggest that a pooling by building basis be permitted. HMRC assumes that this is too complex, but it is currently normal commercial practice for a s198, CAA 2001 election to be made on sale. This election sits well with the pooling concept, which could anyway be by election.

#### *Intra-group transfers*

31. The Government recognises that it would be unfair to require companies to reallocate expenditure on integral fixtures to a 10% pool where a property is transferred after 1 April 2008. There are other circumstances where a reallocation may be unfair such as the transfer of property on the incorporation of a sole trader which also need to be included.

### **Payable Enhanced Capital Allowances (ECAs)**

32. We are not convinced that the proposals will provide an additional incentive for purchasing assets qualifying for ECA's. Do capital allowances really incentivise

acquisition when so much remains uncertain in practice? For example, how can the purchaser be sure at point of purchase that the asset will definitely qualify? Sometimes only one component within an item of plant will qualify, for example a motor within a lift.

33. The time lag between spending the money and getting the credit make it almost unconnected (see also research carried out for the ICAEW last year on research and development (R&D) tax credits, [The Role of Tax Incentives in SMEs](#) Capital and R&D Expenditure Decisions, Mohsen Derregia, Nottingham University Business School and Francis Chittenden, Manchester Business School).
34. In practice the persons charged with making the purchase decision will often have no tax knowledge and so not take the tax advantages into account when making the choice. The tax accountant will often be unaware of the purchase of qualifying plant until after it has been acquired so that the tax breaks become a windfall rather than an incentive that promotes environmental benefits.
35. We suggest that tax breaks for environmentally beneficial investment would be more effective if targeted at those that sell the qualifying technologies rather than those buying them, for example a deduction of say 10% of the selling price of such items from the taxable profits of the vendors (this would work similarly to the extra deduction currently available for qualifying R & D expenditure). Then the tax benefit could be factored into the selling price of the qualifying items and so be more likely to encourage their purchase.

#### *Restriction to companies*

36. This would appear counter to the stated objective to 'maintain fairness of the tax system by ensuring that people engaged in similar economic activities pay broadly the same overall level of tax regardless of the legal form they choose for their business'. The restriction of the R & D tax credit (on which the payable enhanced capital allowances appear to be based) to companies already disadvantages unincorporated businesses, including LLPs.

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19/02/08

## ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [taxfac@icaew.com](mailto:taxfac@icaew.com) or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

## THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.