



CAPITAL ALLOWANCES FOR FIXTURES

Comments submitted in August 2011 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) to HMRC in response to the Consultation on changes to capital allowances for fixtures issued in May 2011

Contents	Paragraph
Introduction	1
Who we are	4
Major points	7
General points on mandatory pooling	18
Responses to specific questions on mandatory pooling	26
General comments on the record of agreement	45
Responses to specific questions on the record of agreement	48
Other possible suggestions for removing defects from the capital allowances rules for fixtures	54
 Ten Tenets for a Better Tax System	 Appendix 1

CAPITAL ALLOWANCES FOR FIXTURES

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper Capital allowances for fixtures published by HMRC on 31 May 2011 at http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PRO_D1_031314
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

MAJOR POINTS

7. There is currently no time limit by when expenditure on plant or machinery, including fixtures, needs to be pooled; qualifying expenditure may be pooled at any time after purchase, provided the asset is still owned and used in the business. This means that expenditure on fixtures can be pooled some years after the fixtures were acquired.
8. This facility to make 'late' claims, several years after a property acquisition, at a time when there is likely to be a dearth of relevant information about the previous owner can make it very difficult in practice for HMRC to substantiate claims.
9. The Government is currently considering two proposals in relation to claiming capital allowances on fixtures:
 - (i) A requirement that businesses must pool their expenditure on fixtures within a short period after acquisition, in order to qualify for capital allowances. This would be

- done through the capital allowances claim on the self assessment or corporation tax return.
- (ii) A related administrative requirement that, in order to qualify for capital allowances, the purchaser of a second hand building must agree with the seller the amount of the sale price attributable to the fixtures, and that both the purchaser and the seller should record and formally notify this to HMRC within a similar timescale.

Mandatory pooling

10. The perceived problem being addressed by the proposal for mandatory pooling of fixtures is that expenditure on qualifying plant fixtures is sometimes being written-off against taxable profits more than once over the economic life of the relevant fixtures. It appears that this could be happening because property vendors are continuing to claim capital allowances when they should not be doing so. These proposals place an added burden on purchasers rather than on the vendors who are largely responsible for the problem.
11. We believe that HMRC already has adequate resources and powers to deal with this through publicising best practice, raising discovery assessments (for example, where a vendor has failed to disclose appropriate information in the 'white space' box in the tax return as suggested by SP1/06) and charging penalties.
12. There is a considerable lack of awareness of capital allowances generally, particularly amongst smaller businesses, and of the requirements of the proposed legislation in particular. The timescale proposed for the changes to legislation is much too short to ensure that it is properly understood and applied.
13. Whilst we understand HMRC's concern to address its perceived problem as soon as possible, it would clearly be better to delay the implementation of any changes until April 2013.
14. There can be no justification for extending the proposals to expenditure on new fixtures. The perceived problem relates entirely to second-hand fixtures acquired as part of a property purchase
15. The time limit should be measured from the end of the chargeable period in which the fixture is acquired, not the date the expenditure is incurred. If the proposed legislation is enacted, the minimum requirement should be at least two years.

The record of agreement

16. Any clarity or improvement to the working of the fixtures rules resulting from the proposal that capital allowances should be conditional on a notice of agreement, would be at the cost of increased administration and unfairly denying allowances to taxpayers who have met all of the long-standing criteria for claiming them.
17. The proposal should not apply to any fixtures that have not previously been subject to a claim.

Part (i) Main Proposal: Mandatory Pooling

GENERAL POINTS ON MANDATORY POOLING

18. HMRC has put forward these proposals in order to address a perceived problem (which may not in fact be genuine or as widespread as feared) with expenditure on qualifying plant fixtures sometimes being written-off against taxable profits more than once over the economic life of the relevant fixtures.

19. It appears that this could be happening because property vendors are continuing to claim capital allowances when they should not be doing so. Capital allowances provide a tax deduction in lieu of depreciation. When plant is disposed of, statute requires the vendor to account for a disposal value which represents the value received for that plant. The tables in CAA 2001 s61(2) and s196(1) direct that for market value sales the disposal value should be the net proceeds of the sale (that is, a CAA 2001 s562 just and reasonable apportionment of the sale proceeds), limited by CAA 2001 s62 to a maximum of the qualifying expenditure incurred by the vendor (ie, typically the vendor's full original cost). In the majority of cases, where the property/ plant is sold for at least as much as it cost to buy, no depreciation has been suffered by the vendor, so this should result in a full clawback, with the purchaser being able to claim on that amount going forward (ie, by default the capital allowances should transfer to the purchaser). For plant fixtures upon which the vendor had claimed, the purchaser's claim is then limited by CAA 2001 s185 to the vendor's original cost.
20. There is a long-standing and well established methodology for preparing a just and reasonable apportionment, which is published in Section 3 of the Valuation Office Agency's 'Capital Gains Tax' manual. However, in practice it would appear that a number of vendors are erroneously and arbitrarily bringing into account inadequate, or sometimes no disposal values. Therefore the problem, if it exists, lies with vendors. We believe that HMRC already has adequate resources and powers to deal with this through publicising best practice, raising discovery assessments (for example, where a vendor has failed to disclose appropriate information in the 'white space' box in the tax return as suggested by SP1/06) and charging penalties.
21. However, instead HMRC proposes to deal with this problem by penalising purchasers, rather than requiring vendors to account for the correct disposal values required by legislation. By changing the rules in vendors' favour, the current proposals will prevent double-claiming, but they do nothing to require vendors to apply the law. In effect, they endorse one class of taxpayers (vendors) ignoring the longstanding requirements of statute to the detriment of another (purchasers).
22. In our view, there remains the problem that many smaller businesses and individuals frequently fail to claim capital allowances on fixtures. Clearly, when these businesses sell on their fixtures, there is no disposal value to account for and therefore even if the purchaser makes a claim, relief is not being given twice. In the limited cases where there is a risk of allowances being given twice, this is because the vendor has failed to properly account for a disposal value as discussed above. The impact of the proposals upon smaller businesses will be particularly severe as there is a low likelihood that they will receive specialist capital allowances advice.
23. Furthermore, even if HMRC was correct in its assessment of the problem, there can be no justification for extending the proposals to expenditure on new fixtures (that is for construction additions claimed under ss 11 and 176 CAA 2001). The perceived problem relates entirely to second-hand fixtures acquired as part of a property purchase (claimed under ss 11 and 181). HMRC's contention is in essence that there is a mismatch between vendor and purchaser. In the case of new fixtures, there is no vendor, and so the perceived problem simply cannot exist. In our view, the proposed legislation should apply only to claims under s181. To do otherwise, would be illogical or disingenuous.
24. There is, as HMRC is aware, a considerable lack of awareness of capital allowances generally, and of the requirements of the proposed legislation. The timescale proposed for the changes to legislation is much too short to ensure that it is properly understood and applied.
25. Whilst we understand HMRC's concern to address its perceived problem as soon as possible, it would clearly be better to delay the implementation of any changes until April 2013.

RESPONSES TO SPECIFIC QUESTIONS ON MANDATORY POOLING

Q1 Which time limit for mandatory pooling would be better: one year or two years after the property acquisition?

26. One year is plainly not a workable proposal. Indeed, the suggestion of a one-year time limit is impractical for a number of reasons detailed below.
27. It is also unfeasible that the time limit should be measured from the acquisition of a fixture, rather than from the end of the chargeable period in which the fixture is acquired. Whilst the former may be possible where fixtures are acquired as part of a property acquisition, it is wholly impractical where the fixtures are part of the construction of a property, or are newly installed in an existing building. As HMRC has conceded, in those circumstances, a business could be faced with 365 deadlines in a single year.
28. If a one-year time limit were adopted, the pooling deadline would pass only shortly after the end of the accounting period (ten months or more before the deadline for filing tax returns). It is possible, indeed almost certain, that the pooling deadline for expenditure incurred early in the accounting period would pass before the year-end audit had commenced.
29. For long construction projects, pooling would be required long before final costs were ascertained. This sits badly with the taxpayer's obligation to submit an accurate return.
30. A one-year time limit would be at odds with the normal deadlines for submitting tax returns. For expenditure incurred early in an accounting period, the pooling deadline would pass almost two years before the filing deadline (which is also the time limit for claiming capital allowances).
31. Tax filing deadlines based on accounting periods or tax years are the basis of computerised systems used by taxpayers and agents to monitor claims and elections required to be made. Deadlines based on when fixtures are acquired will be impractical to monitor. It is likely that a great many deadlines will be inadvertently missed, denying allowances to taxpayers who have otherwise met all the historical criteria for claiming allowances.
32. At least two years should be the minimum requirement, if the proposed legislation is enacted. Furthermore, at the very least for expenditure claimed under s176 but preferably all expenditure, the time limit should run from the year end, not the date the expenditure is incurred.
33. The requirement for mandatory pooling within even a two year period may force taxpayers to make a claim in advance of when they would normally do so. For example, a loss-making business may be forced to spend time and money on ascertaining capital allowances which it cannot use.
34. It is particularly concerning that HMRC intends the proposals should penalise future purchasers who acquire the property where the vendor has failed to make a proper claim for any reason set out above. Where there has been no previous claim, any time limit for mandatory pooling should begin afresh when the fixtures are acquired by a new owner.

Q2 What issues would arise from a requirement to pool historic expenditure on fixtures, and how might these affect what time could be set for pooling such expenditure?

35. This is an odd question, given that paragraph 3.8 of the consultation document confirms that there is no proposal to require the pooling of historic expenditure. Does the inclusion of this question indicate that HMRC has plans to extend the proposals to historic expenditure?

36. In our view, the proposal should not apply to historic expenditure, as defined in paragraph 3.7 of the consultation document. It would be unfair firstly to impose additional requirements on a taxpayer, long after the expenditure was incurred, and secondly to disadvantage any subsequent purchaser.
37. If the proposals were extended to cover historical expenditure, legislation should be changed to permit late capital allowances claims under the Repayment of Overpaid Tax provisions. Our understanding is that these rules prevent them being used to remedy capital allowances claims because the flexibility already existed for taxpayers to make late capital allowances claims. Attention was specifically drawn to this intended flexibility when CAA 2001 was written (CAA 2001 Rewrite Explanatory Notes, Annex 1, Change 8).

Q3 What impacts (if any) – perhaps particularly on smaller businesses or on the property sector – would you expect to arise from the proposed new pooling requirement?

38. Both smaller businesses and those in the property sector may have to incur fees to analyse expenditure for capital allowances at a time when the business cannot afford to do so and when the allowances are not required until a later date (in excess of 2 years).
39. For businesses (particularly perhaps, newly-started businesses) that are currently loss-making or low in profitability this will damage their cash flow and may jeopardise their existence for a future benefit that they may or may not ever be able to use. This is likely to lead to an increased level of business failure, and a consequent increase in unemployment.
40. Smaller businesses tend to be particularly poorly advised on capital allowances, and it is virtually certain that many valid capital allowances claims will be overlooked until it is too late. This will then have a knock-on effect on later purchasers. Our understanding is that these provisions are not primarily intended to raise extra revenue, but the unavoidable conclusion is that the chief beneficiary is likely to be the Exchequer.

Q4 Do you have any views on the assumptions or analysis in the initial Taxes Impact Assessment at Chapter 4, or any relevant data on potential impacts that would improve this assessment?

41. The statement ‘this is a business measure so would have no direct impact on individuals or households’ is nonsensical. Individuals own and operate businesses (particularly smaller businesses, which will be worst affected), and the denial of tax relief on qualifying expenditure will reduce the income available to be derived from those businesses. Similarly, large numbers of individuals own and rent out property and claim capital allowances. Again, the denial of allowances will reduce income from those properties.
42. The statement ‘the proposals should not have any adverse effects on businesses legitimate entitlements to capital allowances on fixtures’ is also grossly flawed. Any time limit imposed will automatically mean that businesses who would otherwise claim allowances in the fullness of time but chose not to do so immediately (for example, for loss making reasons) will be adversely affected, as will future purchasers of properties who would, through no fault of their own, be denied a full claim on the property simply because the qualifying expenditure has not previously been pooled within the required time limit.
43. The proposal that time limits are determined by reference to the date expenditure is incurred will mean that many taxpayers will need to keep track of numerous deadlines spread throughout the year. It is almost certain that many of these deadlines will be missed due to the difficulty of complying with the additional administrative burden.

44. It is incorrect to suggest that the overall result will be a 'modest net reduction in administrative burdens'. In reality, time and expenditure on applying the proposed rules will be considerably increased for all taxpayers.

Part (ii) Second proposal: the record of agreement required

GENERAL COMMENTS ON THE RECORD OF AGREEMENT

45. It is difficult to think of any capital allowances legislation that has been subject to more abuse than s198, which permits the vendor and purchaser of a property to agree the amount allocated to fixtures. In practice, s198 is often used by large and well-advised businesses to pressurise or even 'trick' small businesses into giving up the allowances to which they would be entitled under s562. The ROA is certain to be used in the same way, but more frequently.
46. The impression is that the proposed legislation is being rushed into being without giving taxpayers and their advisers time to promulgate awareness of the new rules.
47. In the government's interest of fairness, the legislation should be delayed until 2013.

RESPONSES TO SPECIFIC QUESTIONS ON THE RECORD OF AGREEMENT

Q5 Do you think that the proposal that capital allowances should be conditional on a notice of agreement would improve the clarity and working of the fixtures rules?

48. This is a leading question. Any clarity would be at the cost of increased administration and the unfair denial of allowances to taxpayers who have met all of the long-standing criteria for claiming allowances.
49. The proposal should not apply to any fixtures that have not previously been subject to a claim – it would be a simple matter for this to be confirmed by the vendor at the time of sale. Indeed for several years such information has been routinely sought during the conveyancing process via standard pre-contract enquiries, for example, enquiry 19 of the British Property Federation endorsed Commercial Property Standard Enquiries (CPSE.1), which is now in common use.

Q6 What comments do you have on the administrative implications and do you have any suggestions for improving the proposal?

50. There will inevitably be an administrative implication. Details of the items included in any claim identifying the asset and its cost with the date of expenditure and location within the property are vital. The record of agreement will not be a productive record without this. There will be a cost implication to businesses for providing this level of information.
51. The proposed new requirements are likely to be overlooked by the majority of conveyancing solicitors, who often have little direct tax expertise as HMRC has acknowledged. Consequently, more valid claims are likely to be missed, and there is likely to be an increased level of litigation between taxpayers and their professional advisers.
52. Particularly among smaller businesses, it is common practice to rely heavily on professional advisers and to sign whatever documents they propose. Very few smaller businesses have ever understood s198 elections, and they will not understand the implications of the ROA.

Q7 Do you think that such a record should follow a general format similar to that at section 201 CAA2001, or take some other form?

53. If this proposal is implemented, the format of the ROA would no doubt mirror the requirements of s201. However, many s198 elections currently fail to comply with s201 (in particular, they fail to adequately identify the fixtures to which they relate, using descriptions such as 'all fixtures') and yet are accepted by HMRC. If the requirement for a ROA is enacted, they must list in adequate detail the assets purported to be covered and it must be made clearer exactly (for example in HMRC's capital allowances manual) what level of information is acceptable to HMRC.

Other possible suggestions for removing defects from the capital allowances rules for fixtures

54. The legislation for s198 elections has never worked as envisaged. Such elections were claimed to be intended to remove the 'burden and expense of making an apportionment' (Tax Bulletin 35). Instead, s198 elections are most commonly used by large and well-advised taxpayers to pressurise smaller or less well-advised businesses into giving up allowances to which they would generally be entitled.
55. The underlying rationale for capital allowances is to give tax relief for a loss suffered (ie the gradual fall in value of a capital asset). The scope for s198 elections to substitute another amount for a just apportionment has allowed taxpayers to obtain tax relief for a loss which they have not in reality suffered.
56. In the interests of fairness, the legislation for s198 elections should be repealed.

Q8a What issues would be raised for business by changing the s198 apportionment so that the minimum amount that may be fixed as the price incurred on the provision of the fixture would become the tax written down value of the fixture in the hands of the Vendor?

57. Section 198 is used mainly by large or well-advised businesses to pressurise smaller and less well-advised businesses and taxpayers into giving up their legitimate entitlement to allowances by means of an election for £1. Whilst, therefore, this change would be welcome, there is no logical reason for allowing elections for tax written-down value. Where, as will be generally be the case, a property is sold for more than original cost, to permit an election at tax written-down value is to allow a vendor to retain the tax relief for a loss which he has not suffered.
58. The only justifiable solution is the complete abolition of the legislation relating to s198 elections.

Q8b What issues would be raised for business by amending s197 so as to make it clear that s197 would be triggered in all cases where a balancing allowance arose as a result of a scheme or arrangement where one of the main purposes was the obtaining of a tax advantage?

59. It is unclear what would be meant by a 'scheme or arrangement', and in particular whether the making of a s198 election would itself be regarded as falling within the definition, which it should not be.
60. It would be better to abolish s198 altogether and return to the basic and long-standing requirement for a just apportionment, limited to the vendor's original cost for plant fixtures upon which the vendor has claimed capital allowances.

E anita.monteith@icaew.com

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APPENDIX 1

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.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide_towards-a-better-tax-system.ashx)