

## CAPITAL ALLOWANCES IN PROPERTY TRANSACTIONS

**Factsheet: sales and purchases.** One important element of those transactions is the treatment of Capital Allowances.

It is often the case that property sale and purchase documentation does not adequately deal with the treatment of Capital Allowances and where it does then it is often discovered that there is insufficient utilisation of these allowances. I thought it might be useful to remind the reader of some of the issues on Capital Allowances that arise on a property transaction. I will focus on plant and machinery allowances which are by far the most important.

As you will be aware, Capital Allowances govern the way that capital expenditure on plant and machinery can be offset against tax. In order to claim allowances the taxpayer must carry on a qualifying activity and incur qualifying expenditure. In the property world the main qualifying activity is property investment. Qualifying expenditure is more complex. The requirements are:

- the expenditure must be capital. In essence it is expenditure on assets for the enduring benefit of your trade. In practice, HMRC appear to accept a useful life of 2 years as sufficient
- the expenditure must be on the provision of that plant and machinery (and would include transport and installation).
- the tax payer must own the plant and machinery as a result of incurring the expenditure

It is plant which is most commonly encountered in property transactions. There is no comprehensive definition of plant in the legislation. Certain assets are designated as plant e.g. the building's thermal insulation and integral features. Otherwise the definition arises from case law. In essence plant is any asset which is kept for permanent employment in the business but not if that asset forms part of the building or structure in which the business is located. Thus it is clear that walls, floors and ceilings, windows, stairs, drainage systems are not plant, whereas lifts, heating and air conditioning systems are plant.

Establishing the ownership of plant where land and buildings are concerned has an added dimension. Under English property law assets are divided between real property and personal property. Real property includes freehold land and "fixtures" (that is anything attached to the land so that it becomes in law part of land and belongs to the owner of the freehold). Personal Property is everything else. In a 1984 case a leaseholder (99 year term) incurred expenditure installing lifts and central heating (i.e. fixtures). As a result of the intervention of English property law neither the freeholder nor the leaseholder were able to claim Capital Allowances.

This was because once installed those fixtures were owned by the freeholder. Thus the leaseholder could not claim because it did not own the fixtures. The freeholder could not claim because he had not incurred the expenditure on the fixtures. This was clearly inequitable and was revoked by statute. The rule now is that the allowances are available to the owner of the interest in the relevant land who incurred the expenditure. Thus on the facts of the above case the leaseholder would be the tax payer who would be entitled to the allowances.

So you are the leaseholder or the freeholder of a building and have claimed Capital Allowances. You sell your interest in the building. What happens? If nothing is done HMRC will apportion the purchase price between the value of the land and buildings and the value of the plant. This will be done on a just and reasonable basis. The methodology for doing this is well known but beyond the scope of this fact file. Alternatively if the seller and buyer are well advised they will avoid surprises and make a joint election as to the Seller's disposal value and matching buyer's claim value. This cannot exceed the original cost or the actual sale price of the fixtures.

Once apportioned the value of the plant will be set off against the seller's Capital Allowance pool. This limits future Capital Allowance Claims by the seller or if the pool is exhausted may require the seller to pay a balancing charge. The apportionment also sets the ceiling for the claim which the buyer can make for the plant the subject of the apportionment. This does create a tension between the seller and the buyer where Capital Allowances are properly considered as an element of the property transaction. The seller will be looking to set the disposal value as low as possible (eg. £1) to effectively retain the value of the allowances. The buyer will want the highest possible valuation so that he can make his own claim for Capital Allowances at the maximum value. This tension is always resolved.

This article can only hope to touch on the main issues but it is important that these issues are addressed preferably when establishing the heads of terms but otherwise before contracts are exchanged.

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