



Green capital allowances

Capital Allowances are a form of direct tax relief (on business profits) that can be a very complex component of corporate tax returns. The biggest Capital Allowances tax relief relates to Plant and Machinery Allowances (PMAs) and this has traditionally covered all typical mechanical building services assets as well as some slightly more obscure 'plant' assets.

Various associated forms of Capital Allowances have co-existed over the years and one such form relates to the introduction of Enhanced Capital Allowances (ECAs) for Energy Efficient Assets in the Finance Act 2001. This is a well established tax relief and provides for a number of qualifying asset technologies (15 at the last count), including boilers, air conditioning and refrigeration. Environmentally Beneficial Assets were also added to ECAs in 2003 to provide tax relief for water efficient technologies.

PMAs provide tax relief on qualifying expenditure at a rate of between 20% and 10% per annum (although this will soon be reducing to 18% and 8%). However, ECAs are given at the far more generous rate of 100% in the first year. Unsurprisingly the vast majority of large building services assets (typically up to 70-80% by value) fall into the 10/8% category, meaning that 90% of the taxable benefit is relieved over 25 or so years.

There is a significant 'Green' ethos in ECAs, the intentions are excellent and it applies to the large and costly building service asset types. But the effective incorporation and use of this mechanism is extremely low. There are various reasons for this lack of success:

- too complex and unwieldy for asset certification and claim identification alike
- driven by non tax savvy suppliers and so inherently misunderstood
- difficult to know when assets are qualifying and when they are not
- hard to differentiate between actual claim costs and set claim values
- too reliant on disinterested project consultants who sign-off criteria led assets
- very difficult to obtain and review all relevant asset project specifications
- potentially more costly to purchase the ECAs qualifying energy efficient assets
- a disincentive to developers as they cannot make Capital Allowances claims
- unworkable for certain procurement routes, i.e. design and build as a client loses overall design control

The Office for Tax Simplification (OTS) Review of March 2011 was scathing and echoed many of the above points and noted this tax relief had very little impact on the decision to purchase. Furthermore, HM Revenue & Customs (HMRC) noted that only 7,000 such claims¹ had been received in the 6-7 years since inception up to 2007 which was described by HMRC as being 'low', or extremely low in our view.

¹ HMRC estimate, Review of Tax Reliefs, Office of Tax Simplification, March 2011

So what is the answer?

We think that EPCs are the most relevant assessment of asset installation and the closest of all the assessment tools to current ECAs ideology and governance.

Percentages of PMAs between 10% and 100% could be allocated to A-G level assessments of corresponding EPC assessments for the inclusion of certain technologies, e.g. heating, air conditioning, ventilation, lighting, etc. The actual cost of installation could then be written down at the relevant percentages.

Having relatively few percentage categories could keep the process simple but the targets would focus on the purchase of higher energy rated assets and overall building service levels. Alternatively, the overall energy rating could be used to govern the claim quantum using actual costs, at prescribed writing down percentages. This could bring in other building factors, such as passive thermal performance, which many believe should be a key consideration of sustainable tax relief.

The differing levels of percentages suggested above rising up to the current 100% given for ECAs could be used to keep the alternative scheme as revenue neutral as possible but, with the very low take up of ECA claims, it is hard to see this equating if a new scheme is halfway successful. A further pot of money akin to the disadvantaged area Enterprise Zone Plant & Machinery Allowances may be required, which would be difficult in the current climate, but must have surely have been considered when ECAs were first envisaged!

EPCs don't currently apply to upgrades of services, unless they coincide with the 10 years renewal policy. EPCs would need updating when large complete building services are renewed and some form of EPC like assessment should be added to any new scheme legislation. The assessment may be open to abuse, although EPC assessors are required to be qualified professionals, trained to the set government guidelines.

We acknowledge and applaud the ethos, the rationale and the effort that goes into the ECA scheme, but what is needed is something that is simple and practical to operate with appropriate levels of allowances to help the government achieve its carbon emissions.

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