Picture: Boosting liquidity - property owners of mixed-use and residential schemes, such as Lend Lease's Green Quarter in Manchester, can claim Capital Allowances against communal areas. The 7.8 acre, £240mn Green Quarter site benefits from green, landscaped communal areas occupying more than 50% of the site.

Capital Allowances

Owners Lose Billions in Unclaimed Property Tax

Capital Allowances are a complex, cumbersome and overlooked part of commercial property transaction but with up to a staggering £1bn in income annually going unclaimed by UK commercial property owners, it's an area of taxation that the industry can't afford to ignore.

What's more, a recent obscure 2014 policy change by the Government is again significantly inflating this already ballooning unclaimed tax relief figure. Billions of pounds could be saved by the sector, if owners and their advisers took the time to understand capital allowances. Importantly, correctly claiming the tax relief has the potential to significantly boost property owners' liquidity, as such, capital allowances experts, Mark Davey and Paul Munday of the UK property consultancy, GVA, outline the issue and offers advice on what can be done to secure capital allowance tax relief.

What are Capital Allowances?

Capital Allowances are a UK governed system of tax depreciation that provides significant tax relief for businesses and individuals. The tax relief regime is comprised of many facets with General Plant (GP) and Integral Features assets (IFAs) being the most common reliefs, along with Enhanced Capital Allowances (ECAs). The deductions from profits before taxation are applied in differing proportions per annum but energy efficient assets, classified as qualifying for ECAs can be offset 100% in the year of expenditure.

What commercial properties are eligible? Are mixed-use developments eligible?

All commercial properties are eligible for Capital Allowances, as are the commercial elements of mixed use developments. It's a common occurrence that few clients recognise that the communal areas of residential projects also qualify, including assets such as lifts, lighting, power, fire detection, etc which can be very valuable.

> **"It's a common occurrence that few clients recognise that the communal areas of residential projects also qualify.**

How and when are they claimed?

The qualifying tax relief can be claimed though a client's annual tax computation but it is essential this is supported by a detailed claim report which provides a fully disclosed analysis. The report must also be clearly auditable and reconciled to the relevant property accounts.

The tax relief is given through a reduction in tax payments when a tax liability is calculated. For businesses, this is nine months after the relevant accounting year end. Nevertheless the effect of the tax relief is given in real time for many businesses that pay through the on account tax payment system.

In 2013, Deloitte stated that UK business is missing out on up to £80bn on unclaimed CA, is this correct?

Well, it would be very interesting to see the theory behind that assessment but what all tax practitioners agree on is that the amount of Capital Allowances unused by clients is a very significant figure!

It would not be wrong to say however, that £100s of millions of property expenditure is not claimed each year by the unknowing, inexperienced and uninformed client (and their consultants), and many experienced advisers put this at somewhere between £ 0.5 - 1 billion per annum.

What has happened now? It seems there have been many government policy changes when it comes to Capital Allowances. Why do you think this is so?

This is a fair observation…of course there are many reasons for change and the first and foremost the Treasury will trumpet is the incentive to invest in property and

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infrastructure, resulting in an increase in the UK’s prosperity. This goes back to the original intention of the legislation’s introduction post the Second World War.

For example, at various points in time we have had new legislation for Enterprise Zone Allowances to help building in run down geographic locations; the introduction of ‘green allowances’ for energy efficient assets to help the Carbon emissions agenda; Business Premises Renovation Allowances to encourage businesses to bring empty properties back into use and Land Remediation Tax Relief (whilst not strictly an allowance) for the remediation of brownfield land and property.

The Treasury has also regularly incentivised small and medium sized business through the use of First Year Allowances via claims of 40%, 50% and even 100%, which could be claimed in set 12 month periods. More recently this has been replaced with Annual Investment Allowances, which have also bounced around somewhat over the years. Several years back the initial annual rate for claim was £50,000; this rose to £100,000, decreased to £25,000 before rising a year later to £250,000 and very recently this has increased again to £500,000 per annum!

One of the other big areas of constant update and change has to be anti-avoidance, targeting a reduction in the loss of income for the Exchequer through tax avoidance/evasion. Over recent years we have the General Anti-Abuse Rules (GAAR), which apply but also many amendments to close unintended gaps in the legislation; many for leasing, transactional provisions and of course clarifying any new rules.

The Treasury also recognise that our legislation, like much of the wider tax legislation, is complex and cumbersome and they have sought to simplify the rules on many occasions. One of the more challenging areas of consideration, which has remained without change is the link between tax relief and accounting deprecation but this has always fallen flat with no real workable solution ever coming to fruition. Some may recall that a few years back the Office for Tax Simplification did, however, make many changes to Capital Allowances’ reliefs, discontinuing several old unused allowances and amending others.

And the notion of ‘simplification’ leads us onto the final area of change to be discussed, which often disguises an underlying agenda to reduce the quantum of tax relief offered to businesses in the provisions. Several years ago Industrial Buildings Allowances were abolished and this made way, and no doubt indirectly paid for, the start of the sweeping general corporation tax cuts we have seen over the past five years or so.

This had a significant effect on long term projects with planned investment strategies and we had many unhappy and disgruntled industrial clients complaining about this for a long time, not to mention transport and airport providers. The long transitional period of four years gave only little consolation to the abolition.

Following on from this we also had one of the most significant consultations of the last decade to reconsider the main qualifying asset classifications. In the interests of ‘clearer’ legislation IFAs were introduced in 2008, a new category of ‘prescriptive’ Capital Allowances, departing from all that had gone before where clients had to demonstrate their right to claim. This applies to the larger and higher value mechanical and electrical building assets such as heating, air conditioning, lighting, power, lifts, etc.

At the same time the Treasury significantly reduced the general claim rate from 25% per annum reducing basis for this IFAs special rate pool to initially 10% and then 8%. The claim rate for the remaining secondary category of Capital Allowances, now containing General Plant, was reduced initially to 20% and then 18% per annum, reducing basis. This has had a huge effect on the timing for the tax relief, impacting cash flow enormously and saving HM Revenue Customs a great deal of current day value.

For the majority of qualifying Capital Allowances assets the claim profile and timeline extended from a relatively modest period of 8-9 years for 90-95% write off to up to 25 years; a much slower timeline over which to make claims!

One silver lining, which emanated from the changes at the same time was the introduction of new qualifying categories of tax relief, including, inter alia lighting, power and cold water installations. This slight appeasement at the time has led to brand new claims on all properties for a new owner when the property is acquired for the first time after this event, i.e. April 2008, and importantly, this remains so today.

We’ve heard that from April 2014, a change in legislation has left many real estate owners missing out on even more in unclaimed CA?

Yes, this is quite correct. The change concerns fixtures legislation and is one implemented by the Treasury to reinforce existing legislation that has been in operation for many years. We would note, however that purchasers have two years from date of the transaction from which to agree the Capital Allowances with a vendor, so all is not instantly lost. (And this remains so even if the vendor has not yet pooled the qualifying expenditure so long as they have an open relevant tax period).

What has changed?

The new changes were first enshrined in legislation in 2012 but with a transitional phase of two years. There were two main new rules. The first concerned agreement on second hand property between the transacting parties on Capital Allowances quantum. If a vendor had made a prior claim then there must be agreement between both parties for the purchaser to make a claim in the future. The traditional approach in these situations is to agree a CAA 2001 S198 Election. This was effective from April 2012.

Now, the deferred change concerns situations where a vendor has or could make a claim for Capital Allowances. As of April 2014, if a vendor could make a claim for Capital Allowances, i.e. all the entitling conditions are satisfied, then the qualifying expenditure must be ‘pooled’ for it to be passed on to a purchaser through a S198 agreement.

“ This is a significant step change, which will catch many more clients out…

Pooling does not mean a claim has to be made, but it must be placed in the relevant ‘tax pool’ in the tax computation and thus be put through the standard HM Revenue & Customs agreement process.
This is a significant step change, which will catch many more clients out, and will negate many claims going forward due to malaise at the transactional stage.

We should point out that neither the ‘agreement’ nor ‘pooling’ requirement need to be satisfied if the vendor could not make a claim for Capital Allowances, e.g. they are trading property, they are a charity, or they are a pension fund, etc. But, such business entities may wish to preserve the right to claim allowances through agreements with vendors when they purchase property themselves – this could be extremely valuable to an appreciative future purchaser!

It could be said that HM Revenue & Customs are seeking almost absolute certainty on all future claims with quantum synergy between transacting parties…and no doubt a sizeable decrease in the tax relief provided to those dealing in property!

How much income do you believe has been lost in unclaimed CA since the April change?
Once again with estimates of potential Capital Allowances in the market place, it is incredibly difficult to put accurate figures on this issue due to the private nature of tax affairs. But of course, we know this will be significant. For every one claim made we know there will be several not made but with the result this time that the tax relief will be lost for good; £10 million, £100 million, £200 million, whatever the figure, isn’t it about time that retained and transactional client advisers take measures to protect clients from this loss?

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What should property owners do as a result of this change?
Property owners need to be much more aware of Capital Allowances and the implications it can have whenever they incur capital expenditure buying or selling property and indeed building, refurbishing, fitting-out and extending. Both parties to a transaction really need pro-active specialist advice, through referral or otherwise to ensure the appropriate and value saving measures are put in place to protect the respective positons. For vendors it is vital that relevant Capital Allowances are pooled and if a claim is made to make sure an agreed S198 Election is put in place. For buyers, questions must be asked of the vendor at the pre-contract stage either as part of the CPSE enquiries or stand-alone but the historic Capital Allowances positon must be identified and then a negotiated agreement put in place in order to make a future claim.

Are normal accountants aware of property and capital allowances or should real estate owners seek specialist help?
It is fair to say accountants are aware of property and capital allowances and can identify and make claims for the more obvious plant and machinery expenditure incurred. For most accountants however, extracting plant and machinery from building costs can be a very difficult and protracted exercise. When this is extended to acquisitions, getting access to the transaction at the relevant stage is extremely rare and even then advising on the property asset aspect of the equation can be very uncomfortable, if not impossible for accountants. In our experience the cost to value ratio of employing a specialist far outweighs almost any other consideration, hundreds or thousands of times over.

That said, we continue to see a passive and hands off approach amongst lawyers, property agents and accountants, which is not just deferring the lost value of Capital Allowances anymore but losing the full value without any future recourse whatsoever.

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