

Capital allowances anti-avoidance

Response of the Tax Law Committee of the Law Society of England and Wales

Introduction

The Law Society is the representative body for over 140,000 solicitors in England and Wales. It negotiates on behalf of the profession, and lobbies regulators, Government and others. We welcome the opportunity to comment on the proposed changes to the capital allowances anti-avoidance rules as set out in the May 2011 consultation document issued by HM Treasury and HM Revenue & Customs.

This response has been prepared on behalf of the Law Society by members of the Corporation Tax Sub-Committee. The Sub-Committee is made up of senior and specialist tax lawyers from across the country.

Responses to questions

General

The area of capital allowances is one that has been subject to constant change over recent years as a result of anti-avoidance legislation. It is therefore difficult to see what in particular the current amendments are aimed at that has not been covered by recent amendments. We are therefore not convinced of a need for these amendments at this stage. We are also not convinced it is appropriate to introduce a new generic anti-avoidance rule at a stage when it is not yet known whether a General Anti-Avoidance Rule will be introduced and, if so, what form it will take.

Specific Issues

Issue 1

Replacing the sole or main benefit test used to determine whether a transaction is a 'transaction to obtain allowances' with a purpose test consistent with those elsewhere in the tax code (as described in paragraph 3.13). The Government will consider suggestions for alternative structures or effect for the test to ensure that the test is as well crafted as possible.

Whilst the drafting suggested in the consultation is used in other parts of the tax legislation, it is generally limited in some additional way, particularly where it is part of a provision that seeks to restrict relief for expenditure that has actually been incurred. For example, section 441 CTA 2009 does not just require that obtaining an interest deduction is one of the main purposes of taking out a loan, it also requires that the borrowing concerned must have an unallowable purpose. We are therefore concerned that, without further qualification (such as it being one of the main purposes of

the taxpayer to obtain allowances on a higher amount than the market value of the asset), this proposal will produce a disincentive to investment in fixed assets.

As capital expenditure tends by its nature to be significant in the context of a business, it is vital to a taxpayer that it has some certainty about its ability to depreciate the cost for tax purposes, and this is the scheme in which capital allowances operate. It is therefore always likely to be the case that the ability to claim capital allowances on a particular asset will be one of the major considerations for a business investing in an asset and so a taxpayer will inevitably consider carefully the capital allowances position. The fact that capital allowances are available may even incentivise the business to invest (which we understand was the original point of capital allowances). We therefore recommend that some additional factor is introduced restricting the application of the proposed section. It is therefore likely to be difficult for taxpayers to show that capital allowances was not part of the decision-making process and hence will leave them susceptible to challenge on the basis that the allowances were one of several main purposes.

Issue 2

Extension of the scope of relevant transactions to include all transactions where the 'buyer' (B) becomes able to benefit from a contract providing that the 'seller' (S) shall or may become the owner of plant and machinery on the performance of a contract (as described in paragraph 3.16).

There are a number of circumstances where purchase contracts are novated (for example, between group companies), especially in the shipping and aviation sectors when the lead time for the building of assets can be significant. It is common in these circumstances for an asset to be novated before delivery, sometimes to a third party purchaser, sometimes to the group company that will actually use the asset. The asset would normally be novated at, effectively, original cost; however, at the time of novation this may no longer represent market value. In these circumstances, where an asset is bought direct from a manufacturer for the asset's list price, it would not seem appropriate to restrict capital allowances to the market value at delivery or novation. We are not therefore convinced of the need to bring novations into this section of the legislation.

Issue 3

Where the buyer's qualifying expenditure is restricted by reference to the market value of the asset, the market value will in future take into account any lease or other encumbrance that reduces the value of the asset from the buyer's perspective. Likewise, any arrangements which increase the apparent value of the asset from B's perspective would be disregarded (as described in paragraph 3.23).

There are practical difficulties where purchasers do buy assets with existing leases that may increase or decrease the value of the asset to a purchaser (and, indeed, a seller). The arrangement proposed would tend to restrict allowances to the lower of encumbered and unencumbered market value which could be vastly different amounts, and which are always likely to affect a commercial purchase price for an asset. If HMRC is concerned about structured tax avoidance transactions in this area, it is even more important to ensure that the "entry" test (the main purpose test referred to above) is more tightly drafted so that ordinary purchasers of encumbered assets are not concerned that their allowances claim might differ from their commercial expenditure.

Issue 4

Revoking the exception from the anti-avoidance rules for manufacturers and suppliers of plant and machinery. Particularly, the Government welcomes evidence of any potential adverse impacts of the proposed repeal (as described in paragraph 3.26).

A number of manufacturing companies also operate finance or leasing subsidiaries by which they offer a range of opportunities to their customers to acquire their products. Often, where a customer chooses a finance or leasing option, the manufacturer will transfer the asset to a group company who then leases the asset. We are aware of examples of this in the car, aviation and technology manufacturing sectors.

At present, section 230 enables the group company who now owns and operates the asset to claim capital allowances on its expenditure on the asset (which seems right as, for that company, the asset is a capital asset). However, if section 230 were to be repealed, no allowances would be available for that company because of the operation of section 214 (the seller and buyer are connected and the seller had no capital expenditure on the asset). As the company would be receiving taxable income with no allowances to offset this, its tax position would not match the economic position.

We therefore do not see why section 230 should be repealed in its entirety. If there has been avoidance in this area, then it would of course be appropriate for HMRC to counter this, but it would be inappropriate for this to be done in such a way that would prejudice companies which are assisting manufacturing companies to sell their products.

Contact details

If you have any questions on these representations, please contact the Chair of the Corporation Tax Sub-committee, Lydia Challen of Allen & Overy (tel: 020 3088 2753, e-mail: lydia.challen@allenoverly.com) or Matthew Hodkin (tel: 020 7444 3944, email: matthew.hodkin@nortonrose.com).