

Capital allowances for fixtures

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 rules for fixtures 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

Main Proposal: Mandatory pooling

General

The stated policy intention of both the original fixtures legislation and this consultation is to ensure that a business can only claim capital allowances on a fixture on the lower of the original cost of the asset, the expenditure incurred by the business and the disposal value (if any) required to be brought into account by the seller. The aim is also to ensure that an asset is depreciated only once over its lifetime (see paragraphs 2.6 to 2.10 of the Consultation Document).

In general, we are not convinced that the existing legislation does not already ensure that the position described above is satisfied, especially when one takes into account the burden of proof that must fall on a taxpayer seeking to claim capital allowances. As these rules appear to be aimed at a particular brand of suspected avoidance, it may be more appropriate to target the rules properly at the mischief that is the subject of concern if, in fact, this is still deemed necessary following the decision of the First Tier Tribunal in *Tapsell, Tapsell & Lester t/a "The Granleys"* TC01231.

We are also concerned that the administrative burdens on both taxpayers and HMRC alike will be more significant than anticipated. In particular, whilst the present regime does not generally place stress on the question of whether a particular asset is a fixture, new rules of this type are likely to create pressure on taxpayers to try and classify particular assets as moveable. We suspect this is likely to cause an additional administrative burden as HMRC police which claims genuinely relate to moveables and which relate to fixtures.

However, if it is decided that a general time limit needs to be introduced to facilitate administration of the existing rules, we do not consider that it would be appropriate for this to be an exclusive means of claiming capital allowances on fixtures. It would not seem to be in keeping with the policy aim if a taxpayer who was able to prove that his expenditure met all the policy requirements was unable to claim capital allowances on expenditure simply because he had not met a formal requirement. It would therefore seem preferable that both the “mandatory pooling” and “record of agreement” proposals ought to be subject to an override where a taxpayer had evidence to show that an item of expenditure matched the existing requirements as to original cost and disposal value. In particular, in cases where a taxpayer acquires a new asset that becomes a fixture, the particular avoidance mentioned in the consultation document would not appear to be in point and it might be appropriate to consider an exemption from the rules for expenditure on new equipment.

It should be noted that this override would be there to avoid the position where a taxpayer was unable to obtain relief for (often significant) expenditure simply because of an administrative oversight. This is different to the position on capital allowances generally, where a failure to claim an allowance within the time limit generally means that the relevant relief is only deferred until another opportunity to claim it.

Specific questions

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

Based on the discussion itself and subject to our general comments above, two years would be a more appropriate time period. If it is decided that there will not be any opportunity to pool capital allowances on fixtures after this date, contrary to our suggestions above, then we would comment that this period seems unduly restrictive given that claims for capital allowances do not have to be finalised until effectively two years after the end of the relevant accounting period.

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

Where expenditure is incurred on an asset that may become a fixture over a long period of time (for example, in relation to the construction of a manufacturing plant), the final amount of expenditure may not be known until some years after the first amount of expenditure is made. Any rules will need to allow for the two-year period to start only once the final price is known. Even then, adjustments to the final price may be made for some years after the asset has been subject to practical completion (for example, through liquidated damages claims). There should therefore be the facility to adjust the claim outside the time limit where the taxpayer can show that there has been a corresponding change in the price.

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?

The key impact is the risk that a taxpayer will lose out on tax relief that is economically necessary to provide a fair tax result for his business because of an administrative oversight and particularly on smaller taxpayers where they may be less likely to obtain appropriate advice as to the necessity of making the appropriate claims. Capital expenditure, by its nature, tends to be significant in the context of any business and so loss of relief on that expenditure can also be significant.

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?

No.

Second proposal: the record of agreement requirement

General

Our general comments on the mandatory pooling suggestion apply equally to the record of agreement requirement in that, where a taxpayer has sufficient evidence to show that his capital allowances claim meets the existing requirements of the Capital Allowances Act, it does not seem appropriate to require a formal record of agreement.

Specific questions

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?

Whilst the avoidance described in the consultation document would be negated by the proposal, we are concerned that this could again prove an overly stringent administrative burden given the potential consequence of failing to comply with it. Again, if the taxpayer can show that the conditions of CAA 2001 are met, allowances should be available regardless of the presence or not of a "record of agreement".

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

No comment.

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?

It is not clear why the record needs to follow a specific form provided it contains the information required by HMRC and is signed on behalf of both buyer and seller.

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

General comments

It is difficult to generalise about the impact of the proposals on fixtures as the position will vary depending on the nature of the fixture, its importance in the context of the land to which it is affixed and its expected life. As a general comment, it would therefore be unsatisfactory to impose fixed disposal values on parties where that may be vastly different from the economic reality. For example, one would expect the relative proportion of the expenditure on a manufacturing plant to relate to the fixed equipment, whereas on the acquisition of an office block, rather less of the purchase price would tend to relate to fixed equipment.

In relation to either or both of the suggestions in relation to (a) section 198 CAA 2001 or (b) section 197 2001, outlined at Chapter 3.17 –

Q8 What issues would these suggestions [either or both of (a) or (b)] raise for business, and what impacts would either/both have?

For the reasons given above, it may often be the case that the value of a fixture to the parties to a transaction is negligible and hence they agree on attributing £1 to the sale of the fixture. This has the benefit of certainty and familiarity. Where there is genuine value in the fixtures to a purchaser, it will generally be the case that the purchaser will seek to attribute part of the consideration to the fixtures as the allowances will be of benefit to the purchaser and so we do not consider this, in practice, to be a significant issue. The fact that the property is then used by the purchaser in his business does not necessarily mean he attributes significant value to fixtures put in place by the seller (the purchaser may, as a first step, gut the building and remove the fixtures for example). We are therefore not convinced of the need to change the existing system.

In particular, if a moveable asset is scrapped or sold for a negligible value, the seller continues to depreciate the asset through the capital allowances pool even though he no longer owns the asset. There does not seem to be any reason why this position should not apply to fixtures in a similar position (there is no explanation given in the consultation as to why the policy should differ for fixtures).

As a practical matter, it may not always be possible to identify the tax written down value in relation to a particular fixture as it may have been pooled with other assets and so, if the proposal to limit disposal value to a set amount were to be pursued, it would seem more appropriate to use the notional written down value concept that is already present in section 197 CAA 2001.

In relation to section 197 CAA 2001, there does not seem to be any reason to depart from the existing notional written down concept. The fact that a balancing allowance may arise on a disposal does not necessarily mean that there is tax avoidance. The balancing allowance may arise where an asset is sold at notional written down value simply because the seller has not had sufficient profits to merit claiming the allowances in previous years. A sale at notional written down value in those circumstances might generate a balancing allowance but this would simply be the depreciation catching up with what the position would have been had the seller claimed all allowances to which it was entitled.

Q9 Do you have any suggestions for alternative proposals that would be more effective in delivering the underlying policy purposes?

It is difficult to ascertain from the Consultation Document what the underlying policy purposes of this particular piece of legislation are and so it is difficult to comment.

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).